

Registered Bank Disclosure Statement

Disclosure statement

For the year ended 30 June 2019

This Disclosure Statement has been issued by Kiwibank Limited (the “**Bank**” or “**Kiwibank**”) for the year ended 30 June 2019 in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the “**Order**”).

In this Disclosure Statement, unless the context requires otherwise:

- > “**Banking Group**” means Kiwibank’s financial reporting group, which consists of Kiwibank, all of its wholly owned entities and all other entities consolidated for financial reporting purposes; and
- > Words and phrases defined by the Order have the same meanings when used in this Disclosure Statement.

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General matters

Details of incorporation

Kiwibank (the “**Bank**”) is a company domiciled in New Zealand and was incorporated in New Zealand under the Companies Act 1993 on 4 May 2001. On 29 November 2001, the Bank was registered as a bank under the Reserve Bank of New Zealand Act 1989 and was required to comply with the conditions of registration as laid down by the Reserve Bank of New Zealand (“**RBNZ**”) from that date onwards.

Registered office

The registered office is: Kiwibank Limited, Level 9, 20 Customhouse Quay, Wellington 6011, New Zealand.

Address for service

The address for service is: Kiwibank Limited, Level 9, 20 Customhouse Quay, Wellington 6011, New Zealand.

Ultimate holding company

The ultimate holding company of Kiwibank is New Zealand Post Limited (“**NZP**”) whose address for service is: Ground Floor, New Zealand Post House, 7 Waterloo Quay, Wellington 6011, New Zealand.

Voting securities and power to appoint directors

There are 737 million voting shares in the Bank. Kiwi Group Holdings Limited (“**KGHL**”) is the registered and beneficial holder of all voting shares. KGHL, NZP, NZSF Tui Investments Limited (“**NZSF**”), Accident Compensation Corporation (“**ACC**”) and the New Zealand Crown (being those ministers who hold shares in NZP, NZSF and ACC on behalf of the New Zealand Crown) are the only holders of a direct or indirect qualifying interest in the voting shares of the Bank.

KGHL has the ability to directly appoint the Board of Directors of Kiwibank (the “**Board**”). NZP, as an immediate parent of KGHL and the ultimate holding company of the Bank, has the ability to indirectly appoint directors to the Board. NZSF and ACC, as immediate parents of KGHL, also have the ability to indirectly appoint to the Board. No appointment of any director, chief executive officer, or executive, who reports or is accountable directly to the chief executive officer, shall be made in respect of the Bank unless:

1. the RBNZ has been supplied with a copy of the curriculum vitae of the proposed appointee; and
2. the RBNZ has advised that it has no objection to that appointment.

Other material matters

The Board of Directors of Kiwibank (the “**Board**”) are of the opinion that there are no matters relating to the business or affairs of Kiwibank or the Banking Group, which would, if disclosed in this Disclosure Statement, materially affect the decision of a person to subscribe for debt securities of which Kiwibank or any member of the Banking Group is the issuer.

General matters

Continued...

Pending proceedings or arbitration

The Board is not aware of any pending legal proceedings or arbitration concerning Kiwibank or any member of the Banking Group, whether in New Zealand or elsewhere, that may have a material adverse effect on Kiwibank or the Banking Group.

Directorate

INDEPENDENT NON-EXECUTIVE DIRECTOR, CHAIR

Susan Carrel Macken

Qualifications: BSc (Maths), BCom, PhD in Economics

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosures Committee member: Yes

Risk, Credit and Compliance Committee member: Yes

External Directorships: Director of each of Panuku Development Auckland Limited, Blossom Bear Limited, Tamaki Regeneration Limited, THA GP Limited, Tamaki Redevelopment Company Limited, STG Limited, Spa Electrics Pty Limited (Aust), Station Mews Apartments Limited, Private Accounting Trustee Limited.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Michael Charles John O'Donnell

Qualifications: BA (Hons)

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosures Committee member: No

Risk, Credit and Compliance Committee member: Yes

External Directorships: Director of each of MOD Associates Limited, Serato Audio Research Limited, Timely Limited, Tourism New Zealand, Raygun Limited, Kiwi Investment Management Limited, Kiwi Wealth Limited, Kiwi Wealth Investments General Partner Limited, Portfolio Custodial Nominees Limited, Radio New Zealand Limited.

Kevin Mark Malloy

Qualifications: Dip Advertising & Marketing

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosures Committee member: Yes

Risk, Credit and Compliance Committee member: No

External Directorships: Director of each of Television New Zealand Limited, KM54 Limited, The Social Club Limited.

Alistair Bruce Ryan

Qualifications: MComm, FCA

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosures Committee member: Yes (Chair)

Risk, Credit and Compliance Committee member: No

External Directorships: Director of each of Barramundi Limited, Metlifecare Limited, Metlifecare LTIP Trustee Limited, Kingfish Limited, Marlin Global Limited

Ian Cameron Blair

Primary occupation: Managing Director

Country of residence: New Zealand

Finance, Audit and Disclosures Committee member: No

Risk, Credit and Compliance Committee member: Yes (Chair)

External Directorships: Director of each of Sapience Limited, Opus Fiji Limited, Opus International Consultants Limited, WSP New Zealand Limited.

General matters

Continued...

Directorate continued

NON-EXECUTIVE DIRECTOR

Carol Anne Campbell

Qualifications: BCom, CA

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosures Committee member: No

Risk, Credit and Compliance Committee member: No

External Directorships: Director of each of New Zealand Post Limited, Hick Bros Holdings Limited, AlphaXRT Limited, Kingfish Limited, Marlin Global Limited, Barramundi Limited, Key Assets NZ Limited, Fostering First New Zealand Limited, Michelle Alexander Trustees Limited, TBAG Trustees Me Limited, TBAG Trustees KA Limited, MH2 Trustees Limited, Farrimond Trustees Limited, Moore Nominees Limited, Hick Bros Earthmoving Limited, Hick Earthmoving Contractors Limited, Hick Bros Earthmoving Contractors Limited, Hick Bros Civil Construction Limited, Hick Bros Heavy Haulage Limited, Shortland Trustees (Mawhiti 2010) Limited, Alilou Trustees Limited, TBAG Trustees (Glanfield) Limited, Asset Plus Limited, Asset Plus Investments Limited, Earnslaw Lodge Limited, Sonoma Limited, Meridian Properties Limited, Hick Bros Infrastructure Limited, Cloudbreak Trustees Limited, Seahorse Trust Company Limited, NZME Limited, T&G Global Limited, Cordbank Limited, Nica Consulting Limited, Bankside Chambers Limited, T&G Insurance Limited, Chubb Insurance New Zealand Limited, Woodford Properties 2018 Limited, Merinous Management Company Limited.

Scott John Pickering

Qualifications: Associate Certified Insurance Professional, Certificate of Insurance (Non-Life)

Primary occupation: Chief Executive Officer, ACC

Country of residence: New Zealand

Finance, Audit and Disclosures Committee member: No

Risk, Credit and Compliance Committee member: Yes

External Directorships: Director of each of Chubb Insurance New Zealand Limited, Chubb Holdings Australia PTY Ltd, Chubb Insurance Australia Limited.

David James Walsh (appointed 31 August 2018)

Qualifications: BCA, CA

Primary occupation: Chief Executive Officer, NZ Post Limited

Country of residence: New Zealand

Finance, Audit and Disclosures Committee member: Yes

Risk, Credit and Compliance Committee member: No

External Directorships: Director of each of Kiwi Group Holdings Limited, New Zealand Post Holdings Limited, Datam Limited, New Zealand Post Group Finance Limited, New Zealand Post Australia Holdings Pty Limited, Kiwi Financial Services Retail Limited, International Post Corporation.

David James Walsh, previously an alternate director, was appointed as a director on 31 August 2018.

Carol Anne Campbell resigned as a director on 31 August 2018 and was subsequently reappointed as a director on 20 November 2018.

Deborah Jane Taylor resigned as a director on 31 October 2018.

General matters

Continued...

Directorate continued

FINANCE, AUDIT AND DISCLOSURES COMMITTEE

The charter of the Finance, Audit and Disclosures Committee provides that the membership of the Committee must include a majority of Independent Directors, a member of the Risk, Credit and Compliance Committee, and at least one member with material accounting experience.

EXECUTIVE DIRECTORS

There are no executive directors of the Bank.

COMMUNICATIONS WITH DIRECTORS

Communications addressed to the directors and responsible persons may be sent to the Bank's address for service.

POLICY FOR AVOIDING AND DEALING WITH CONFLICTS OF INTEREST

The policy and current practice of the Board is that conflicts of interest which may arise from the personal, professional or business interests of the directors, or any of them, must be disclosed to the Board. Directors are not entitled to vote on any matter in which they have an interest, unless Kiwibank's shareholders have agreed by ordinary resolution (or written notice signed by a majority of shareholder) to waive this requirement or unless the matter is one in respect of which the directors are required to provide a certificate under the Companies Act 1993. However, Directors can be counted in the quorum for any part of a Board meeting in respect of which they have a conflict.

The Companies Act 1993 requires each director to cause to be entered in the interests register and disclosed to the Board:

- a) the nature and monetary value of the director's interest in a transaction or proposed transaction if its monetary value is able to be quantified; or
- b) the nature and extent of the director's interest in a transaction or proposed transaction if its monetary value is not able to be quantified.

DIRECTORS' BENEFITS

There is no transaction which any director or immediate relative or close business associate of any director has with Kiwibank which either has been entered into on terms other than those which would, in the ordinary course of business of Kiwibank, be given to any other person of like circumstances or means, or could otherwise be reasonably likely to influence materially the exercise of that director's duties.

AUDITOR

The auditor whose report is referred to in this Disclosure Statement is Michele Embling assisted by PricewaterhouseCoopers, acting as agent on behalf of the Office of the Auditor-General. Her address for service is: PricewaterhouseCoopers, PwC Centre, 10 Waterloo Quay, Wellington 6011, New Zealand.

Credit ratings

The Bank has the following credit ratings applicable to its long term senior unsecured obligations payable in New Zealand dollars at the date the Directors signed this Disclosure Statement.

Rating agency	Current credit rating	Rating outlook
Standard & Poor's (Australia) Pty Limited (" S&P ")	A	Outlook Positive
Moody's Investors Service (" Moody's ")	A1	Outlook Stable
Fitch Ratings (" Fitch ")	AA	Outlook Stable

On 29 October 2018, S&P affirmed Kiwibank's credit rating of A and changed the outlook to positive from stable.

On 14 August 2018, Fitch affirmed Kiwibank's credit rating of AA with a stable outlook for senior unsecured debt obligations payable in New Zealand dollars and a credit rating of AA- with a stable outlook for senior unsecured debt obligations payable in other currencies.

On 7 January 2019, Moody's affirmed Kiwibank's credit rating of A1 with a stable outlook for long-term senior unsecured obligations payable in New Zealand in New Zealand dollars.

The following table describes the steps in the applicable rating scales for each rating agency:

	S&P	Moody's Investors Services	Fitch Ratings
Highest credit quality – ability to repay debt obligations is extremely strong	AAA	Aaa	AAA
High quality, low credit risk – ability to repay debt obligations is very strong	AA	Aa	AA
High quality – ability to repay is strong although may be susceptible to adverse changes in circumstances or in economic conditions	A	A	A
Low credit risk – satisfactory ability to repay debt obligations though changes in circumstances or in economic conditions are likely to impair this capacity	BBB	Baa	BBB
Ability to repay debt obligations is only adequate and likely to be affected by adverse economic change which might affect timeliness of repayment	BB	Ba	BB
Risk of default due to greater vulnerability	B	B	B
Significant risk of default. Repayment of debt obligations requires favourable financial conditions	CCC	Caa	CCC
Poor protection, highest risk of default	CC to C	Ca to C	CC to C
Obligations currently in default	D	–	RD to D

Credit ratings between AA and CCC by S&P and Fitch Ratings may be modified by the addition of a plus or minus sign (signalling higher and lower ends of the scale respectively). Moody's Investors Service applies numeric modifiers 1, 2 and 3 to each generic rating classification with a 1 indicating a higher rating and a 3 indicating a lower rating within that generic rating category.

Guarantees

As at the date the Board approved this Disclosure Statement, payment obligations of Kiwibank in relation to certain debt securities issued by Kiwibank have the benefit of a guarantee by Kiwi Covered Bond Trustee Limited (the “**Covered Bond Guarantee**”). Also, the payment obligations of Kiwibank owed as at 28 February 2017 and still outstanding have the benefit of a deed poll guarantee by NZP (the “**NZP Guarantee**”).

On 31 October 2016, NZP gave notice of the termination of the NZP Guarantee (with an effective date of withdrawal of 28 February 2017). This termination did not affect any payment obligations of Kiwibank that were already guaranteed at the time the guarantee was terminated. A summary of the details of each guarantee are set out below.

NZP GUARANTEE

NZP continues to support Kiwibank as a registered bank through the NZP Guarantee to the extent of guaranteed payment obligations that existed as at 28 February 2017.

The following is a summary of the main features of the NZP Guarantee effective for payment obligations that existed as at 28 February 2017:

- i. The address for service of NZP is: Ground Floor, New Zealand Post House, 7 Waterloo Quay, Wellington 6011, New Zealand.
- ii. NZP is not a member of the Banking Group (as that term is defined in the Order).
- iii. The NZP Guarantee is an unsecured guarantee of all the payment obligations (excluding any payment obligations, the terms of which expressly provide in writing that they do not have the benefit of the NZP Guarantee) of Kiwibank owing as at 28 February 2017 and still outstanding. The NZP Guarantee has no expiry date in relation to the payment obligations that continue to be guaranteed.
- iv. There are no material legislative or regulatory restrictions in New Zealand which would have the effect of subordinating the claims under the NZP Guarantee of any of the creditors of Kiwibank on the assets of NZP, to other claims on NZP, in a winding up of NZP. The net tangible assets of NZP were \$755m as calculated from NZP's most recent publicly available audited financial statements for the year ended 30 June 2018 and as disclosed in the Directors' Report in the NZ Post Group Finance Limited Annual Report for the year ended 30 June 2018. There were no modifications in the audit report accompanying the Annual Report.

NZP has a credit rating applicable to its long-term unsecured obligations payable in New Zealand, in New Zealand dollars, from S&P of A+ with a stable outlook.

See the previous page for an explanation of S&P's credit rating scale.

COVERED BOND GUARANTEE

Certain debt securities (“**Covered Bonds**”) issued by the Bank are guaranteed by Kiwi Covered Bond Trustee Limited (the “**Covered Bond Guarantor**”), solely in its capacity as Trustee of Kiwi Covered Bond Trust. The Covered Bond Guarantor has guaranteed the payment of interest and principal of Covered Bonds, pursuant to a guarantee which is secured over a pool of assets. The Covered Bond Guarantor's address for service is Level 9, 34 Shortland Street, Auckland 1010, New Zealand. The Covered Bond Guarantor is not a member of the Banking Group. The Covered Bonds have been assigned a long-term rating of Aaa and AAA by Moody's Investors Service and Fitch Ratings respectively.

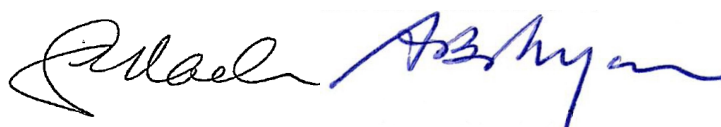
Directors' statement

The directors of Kiwibank state that each director believes, after due enquiry, that:

1. As at the date on which the Disclosure Statement is signed:
 - i. the Disclosure Statement contains all the information that is required by the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended); and
 - ii. the Disclosure Statement is not false or misleading.
2. During the year ended 30 June 2019:
 - i. Kiwibank has complied with the conditions of registration applicable during the period except as noted on page 119;
 - ii. credit exposures to connected persons were not contrary to the interests of the Banking Group; and
 - iii. Kiwibank had systems in place to monitor and control adequately the Banking Group's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks, and that those systems were being properly applied.

With agreement of the shareholder, the Bank has taken advantage of the concessions available to it under section 211 (3) of the Companies Act 1993.

Signed by Susan Carrel Macken and Alistair Bruce Ryan as directors and responsible persons on behalf of all the directors listed in the Directorate of this Disclosure Statement.



21 August 2019

Historical summary of financial statements

Audited	Year ended	Year ended	Year ended	Year ended	Year ended
Dollars in millions	30/06/19	30/06/18	30/06/17	30/06/16	30/06/15
Financial performance					
Interest income	933	879	831	898	957
Interest expense	(488)	(468)	(463)	(525)	(596)
Net gains on financial instruments at fair value	3	9	8	3	5
Net fee income	90	119	118	101	107
Operating expenses	(375)	(373)	(339)	(301)	(284)
Credit impairment (losses)/reversals	(12)	(1)	6	(11)	(13)
Other impairment losses	-	(11)	(90)	-	-
Profit before taxation	151	154	71	165	176
Income tax expense	(43)	(39)	(18)	(41)	(49)
Net profit after taxation	108	115	53	124	127
Net profit after taxation attributable to non-controlling interests	-	-	-	-	-
Dividends paid to non-controlling interest	-	-	(1)	-	-
Dividends paid on ordinary shares	(25)	-	(5)	(29)	(22)
Distributions to holders of perpetual capital	(11)	(11)	(12)	(11)	-
Dividends paid to holders of perpetual shares	-	-	-	-	(9)

Audited	As at	As at	As at	As at	As at
Dollars in millions	30/06/19	30/06/18	30/06/17	30/06/16	30/06/15
Balance sheet					
Total assets	22,734	20,715	20,616	19,357	18,344
Of which individually impaired assets	5	10	12	15	23
Total liabilities	21,185	19,228	19,236	18,228	17,311
Equity attributable to owners of parent	1,549	1,487	1,380	1,129	1,033
Non-controlling interest	-	-	-	-	-

Financial statements

Income statement

For the year ended 30 June 2019

Dollars in millions	Note	Year ended 30/06/19	Year ended 30/06/18
Interest income	3	933	879
Interest expense	3	(488)	(468)
Net interest income		445	411
Net gains on financial instruments at fair value	4	3	9
Gross fee and other income	5	185	211
Direct fee expenses	5	(95)	(92)
Net fee and other income	5	90	119
Total operating income		538	539
Operating expenses	6	(375)	(373)
Profit before impairment and taxation		163	166
Credit impairment losses	9	(12)	(1)
Other impairment losses	25	-	(11)
Profit before taxation		151	154
Income tax expense	7	(43)	(39)
Profit after taxation		108	115

Statement of comprehensive income

For the year ended 30 June 2019

Dollars in millions	Note	Year ended 30/06/19	Year ended 30/06/18
Profit after taxation		108	115
Other comprehensive income			
Net gains/(losses) from changes in reserves that may subsequently be reclassified to profit or loss:			
- Fair value reserve (net of tax)	28	6	-
- Cash flow hedge reserve (net of tax)	28	(12)	3
Other comprehensive income for the year		(6)	3
Total comprehensive income for the year		102	118

From 1 July 2018, the Banking Group has applied NZ IFRS 9 and NZ IFRS 15 in the preparation of the Income statement and Statement of comprehensive income. "Impairment (losses)/reversals on loans and advances" has been renamed "credit impairment (losses)/reversals". In relation to changes in reserves, "Available-for-sale reserve" has been renamed "Fair value reserve". See note 39 for more details of the related changes in accounting policies and impact of adoption.

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

Financial statements

Continued...

Statement of changes in equity

For the year ended 30 June 2019

Dollars in millions	Note	Fully paid ordinary shares	Retained earnings	Fair value reserve	Cash flow hedge reserve	Total shareholder's equity
Balance at 1 July 2017		737	651	5	(13)	1,380
Year ended 30 June 2018						
Profit for the year		-	115	-	-	115
Other comprehensive income						
Movement in fair value of investment securities (net of tax)		-	-	-	-	-
Cash flow hedges (net of tax)		-	-	-	3	3
Total other comprehensive income		-	-	-	3	3
Total comprehensive income		-	115	-	3	118
Transactions with owners						
Distributions to holder of perpetual capital	28	-	(11)	-	-	(11)
Balance at 30 June 2018		737	755	5	(10)	1,487
Balance adjusted for adoption of NZ IFRS 9 and NZ IFRS 15		-	(4)	-	-	(4)
Opening balance as at 1 July 2018		737	751	5	(10)	1,483
Year ended 30 June 2019						
Profit for the year		-	108	-	-	108
Other comprehensive income						
Movement in fair value of investment securities (net of tax)		-	-	6	-	6
Cash flow hedges (net of tax)		-	-	-	(12)	(12)
Total other comprehensive income		-	-	6	(12)	(6)
Total comprehensive income		-	108	6	(12)	102
Transactions with owners						
Dividends paid on ordinary shares	28	-	(25)	-	-	(25)
Distributions to holder of perpetual capital	28	-	(11)	-	-	(11)
Balance at 30 June 2019		737	823	11	(22)	1,549

From 1 July 2018, the Banking Group has applied NZ IFRS 9 and NZ IFRS 15 in the preparation of the Statement of changes in equity. "Available-for-sale reserve" has been renamed "Fair value reserve" and "Available-for-sale financial assets" have been renamed "Investment securities". See note 39 for more details of the related changes in accounting policies and impact of adoption.

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

Financial statements

Continued...

Balance sheet

As at 30 June 2019

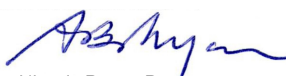
Dollars in millions	Note	30/06/19	30/06/18
Assets			
Cash and cash equivalents	12	421	447
Due from related parties	29	85	87
Due from other financial institutions	13	71	132
Investment securities	14	1,176	1,220
Derivative financial instruments	15	358	344
Loans and advances	8	20,443	18,304
Property, plant and equipment		51	45
Current tax asset		-	12
Deferred taxation	7	21	11
Intangible assets	25	74	78
Other assets	26	34	35
Total assets		22,734	20,715
<i>Total interest earning and discount bearing assets</i>		22,081	20,074
Liabilities			
Due to other financial institutions	16	126	128
Due to related parties	29	9	8
Deposits and other borrowings	17	18,240	16,173
Derivative financial instruments	15	343	293
Debt securities issued	18	2,078	2,265
Current tax liability		7	-
Contract liabilities	5	27	-
Other liabilities	27	102	107
Subordinated debt	19	253	254
Total liabilities		21,185	19,228
<i>Total interest and discount bearing liabilities</i>		18,325	16,752
Shareholder's equity			
Share capital	28	737	737
Reserves	28	812	750
Total shareholder's equity		1,549	1,487
Total liabilities and shareholder's equity		22,734	20,715

From 1 July 2018, the Banking Group has applied NZ IFRS 9 and NZ IFRS 15 in the preparation of the Balance Sheet. "Available-for-sale assets" has been renamed "Investment securities". See note 39 for more details of the related changes in accounting policies and impact of adoption.

The Board of Directors of Kiwibank Limited authorised these financial statements for issue on 21 August 2019.



Susan Carrel Macken



Alistair Bruce Ryan

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

Financial statements

Continued...

Cash flow statement

For the year ended 30 June 2019

Dollars in millions	Note	Year ended 30/06/19	Year ended 30/06/18
Cash flows from operating activities			
Interest received		967	915
Interest paid		(470)	(465)
Fees and other income received		185	202
Direct fee expenses paid		(95)	(92)
Operating expenses paid		(340)	(333)
Taxes paid		(29)	(38)
Net cash flows from operating activities before changes in operating assets and liabilities		218	189
Net changes in operating assets and liabilities			
Decrease in investment securities		53	255
Increase in loans and advances		(2,185)	(536)
Decrease/(increase) in amounts due from related parties		3	(5)
Decrease in balances due from other financial institutions		61	96
Increase in deposits and other borrowings		2,047	185
(Decrease)/increase in balances due to other financial institutions		(2)	69
Increase in contract liabilities		21	-
Net cash flows from operating activities		216	253
Cash flows from investing activities			
Purchase of property, plant and equipment		(18)	(27)
Purchase of intangible assets		(21)	(19)
Net cash flows from investing activities		(39)	(46)
Cash flows from financing activities			
Decrease in debt securities issued		(167)	(65)
Repayment of subordinated debt		-	(150)
Dividends paid on ordinary shares		(25)	-
Distributions to holders of perpetual capital		(11)	(11)
Net cash flows from financing activities		(203)	(226)
Increase in cash and cash equivalents		(26)	(19)
Cash and cash equivalents at beginning of the year		447	464
Effect of exchange translation adjustments		-	2
Cash and cash equivalents at end of the year	12	421	447

From 1 July 2018, the Banking Group has applied NZ IFRS 9 and NZ IFRS 15 in the preparation of the Cash Flow Statement. "Available-for-sale assets" has been renamed "Investment securities". See note 39 for more details of the related changes in accounting policies and impact of adoption.

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

Financial statements

Continued...

Cash flow statement continued

For the year ended 30 June 2019

Dollars in millions	Year ended 30/06/19	Year ended 30/06/18
Reconciliation of profit after taxation to net cash flows from operating activities		
Profit after taxation	108	115
Non cash movements and non-operating activities		
Unrealised fair value adjustments	(5)	(6)
Depreciation	12	9
Amortisation of intangibles	25	25
Net decrease in deferred expenditure and accrued income	36	34
Increase/(decrease) in provision for credit impairment	4	(4)
Lending losses written off	8	5
Intangible work in progress written off	-	2
Other impairment losses	-	11
(Increase)/decrease in deferred taxation asset	(5)	23
Movements in operating assets and liabilities		
Decrease in investment securities	54	250
Increase in loans and advances	(2,185)	(536)
Decrease in balances due from other financial institutions	61	96
Increase in deposits and other borrowing	2,047	185
Decrease/(Increase) in balances with related parties	3	(11)
(Decrease)/increase in balances due to other financial institutions	(2)	69
Increase in accrued operating expenses	(1)	9
Increase in interest payable	19	4
(Increase)/decrease in interest receivable	(2)	2
Increase/(decrease) in current taxation	17	(21)
Increase in contract liabilities	21	-
Increase in other assets	1	(8)
Net cash flows from operating activities	216	253

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

Financial statements

Continued...

Cash flow statement continued

For the year ended 30 June 2019

Reconciliation of movement in liabilities arising from financing activities

Dollars in millions	Debt securities issued	Subordinated debt
Balance as at 30 June 2017	2,258	405
Issuances	2,442	-
Redemptions	(2,502)	(150)
Foreign exchange	59	-
Fair value and other movements	8	(1)
Balance as at 30 June 2018	2,265	254
Issuances	1,102	-
Redemptions	(1,325)	-
Foreign exchange	9	-
Fair value and other movements	27	(1)
Balance as at 30 June 2019	2,078	253

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

Notes to the financial statements

1. Corporate information

These consolidated financial statements are presented for the “**Banking Group**”, which consists of Kiwibank Limited (“**Kiwibank**” or the “**Bank**”) and its subsidiaries. Kiwibank is a for-profit entity incorporated and domiciled in New Zealand under the Companies Act 1993 and is registered as a bank under the Reserve Bank of New Zealand Act 1989. The principal activity of the Banking Group is the provision of retail and banking products and services to individuals and small to medium-sized businesses.

Kiwibank's immediate parent company is Kiwi Group Holdings Limited (“**KGHL**”). KGHL is owned by New Zealand Post Limited (“**NZP**”) (53%), NZSF Tui Investments Limited (“**NZSF**”) (25%) and Accident Compensation Corporation (“**ACC**”) (22%). The ultimate holding company of Kiwibank is NZP whose address for service is: Ground Floor, New Zealand Post House, 7 Waterloo Quay, Wellington 6011, New Zealand. The ultimate shareholder of Kiwibank is the New Zealand Crown (the “**Crown**”).

These financial statements for the year ended 30 June 2019 have been approved for issue by the Board of Directors on 21 August 2019.

2. Basis of preparation and general accounting policies

2.1 Basis of accounting

These financial statements are general purpose financial statements prepared in accordance with Generally Accepted Accounting Practice in New Zealand. They comply with New Zealand Equivalents to International Financial Reporting Standards (“**NZ IFRS**”) and other applicable Financial Reporting Standards, as appropriate for for-profit entities, the Financial Markets Conduct Act 2013 and the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the “**Order**”). These financial statements also comply with International Financial Reporting Standards (“**IFRS**”) as issued by the International Accounting Standards Board.

The principal accounting policies adopted in the preparation of these financial statements are set out below and in the relevant notes to the financial statements. These policies have been consistently applied to all financial years presented unless otherwise noted for policies adopted in the current period.

Measurement base

These financial statements are based on the general principles of historic cost accounting, modified by the application of fair value measurements for financial instruments held at fair value through other comprehensive income, financial instruments held at fair value through profit or loss and derivatives used for hedging. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and otherwise carried at amortised cost, are adjusted to record changes in fair value attributable to the risks that are being hedged.

Accounting period and comparative amounts

These audited financial statements are for the year ended 30 June 2019. Comparative amounts are from the audited financial statements for the year ended 30 June 2018. Certain amounts in the comparative information have been reclassified or amended to ensure consistency with the current period's presentation. This included reclassification of comparative amounts as disclosed in the following notes: note 3 Interest income and interest expense, note 7 taxation, note 9 credit impairment losses, note 10 asset quality, note 29 related entities, and note 37 contingent liabilities and credit commitments.

From 1 July 2018, the Banking Group has applied NZ IFRS 9 and NZ IFRS 15. In the income statement “impairment (losses)/reversals on loans and advances” has been renamed “credit impairment (losses)/reversals”. In relation to changes in reserves, “available-for-sale reserve” has been renamed “fair value reserve”. In the balance sheet “available-for-sale assets” has been renamed “investment securities”. See note 39 for more details of the related changes in accounting policies and impact of adoption.

2.2 Critical accounting judgements, estimates and assumptions

The preparation of these financial statements in accordance with NZ IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amount of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. Although Kiwibank has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. It is not anticipated that such differences would be material.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised and any future years affected. Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in the following notes:

- Note 5 Contract liabilities and the timing of recognition of revenue
- Note 9 Credit impairment provisions and measurement of expected credit losses
- Note 20 Fair value estimation
- Note 25 Intangible assets and impairment testing
- Note 29 Securitisation and the consolidation of special purpose vehicles (“**SPV**”)

Notes to the financial statements

Continued...

2. Basis of preparation and general accounting policies continued

2.3 Basis of consolidation

The consolidated financial statements comprise the financial statements of Kiwibank and its subsidiaries for the year ended 30 June 2019. Subsidiaries are entities that are controlled by the Banking Group. Control is achieved when the Banking Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically the Banking Group controls an investee if, and only if, the Banking Group has:

- Power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- Exposure, or rights, to variable returns from its involvement with the investee; and
- The ability to use its power over the investee to affect its returns.

When the Banking Group has less than a majority of the voting or similar rights of an investee, the Banking Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- The contractual arrangements with other vote holders of the investee;
- Rights arising from other contractual arrangements; and
- The Banking Group's voting rights and potential voting rights.

Structured entities are entities that are designed so that their activities are not governed by way of voting rights. In assessing whether the Banking Group has power over such entities in which it has an interest, the Banking Group also considers factors such as:

- The purpose and design of the entity;
- Its practical ability to direct the relevant activities of the entity;
- The nature of the relationship with the entity; and
- The size of its exposure to the variability of returns of the entity.

The Banking Group reassesses whether it controls an investee if facts and circumstances indicate that there have been changes to one or more of the three elements of control.

Consolidation of a subsidiary begins when the Banking Group obtains control over the subsidiary and ceases when the Banking Group loses control of the subsidiary. On the date of acquisition of a subsidiary, identifiable assets and liabilities acquired are initially measured at fair value. The excess of the cost of acquisition over the fair value of the Banking Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the Banking Group's share of the net assets acquired, the difference is recognised directly in the income statement.

Subsequent to initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired is, from the date of acquisition, allocated to each of the Banking Group's cash-generating units that are expected to benefit from the acquisition, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed in these circumstances is measured based on the relative values of the disposed operation and the portion of the cash-generating unit retained.

The interest of non-controlling shareholders is stated at their proportion of the net profit and net assets of a subsidiary attributable to equity interests that are not owned directly or indirectly by the Banking Group. Losses are attributed to the non-controlling interest, even if that results in a deficit balance.

All intra-group balances, transactions, income or expenses are fully eliminated on consolidation. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Banking Group's accounting policies.

Notes to the financial statements

Continued...

2. Basis of preparation and general accounting policies continued

2.4 Associates and joint arrangements

An associate is an entity over which the Banking Group has a significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over these policies.

A joint arrangement, where the Banking Group and one or more other parties have joint control, is either a joint operation or a joint venture. In a joint operation, the Banking Group and other party or parties with joint control have rights to the assets and obligations for the liabilities of the arrangement resulting in each party recognising its relative share of the joint operation's assets, liabilities, revenues and expenses. In a joint venture, the Banking Group and other party or parties with joint control have rights to the net assets of the arrangement and each party uses the equity method.

2.5 New Accounting Standards and Interpretations

The Banking Group has applied, for the first time, the following new standards and amendments in the current period:

- NZ IFRS 9: *Financial Instruments*; and
- NZ IFRS 15: *Revenue from Contracts with Customers*

Changes in accounting policies are described in note 39 including a description of the nature and effect of the changes made in the Banking Group's accounting policies due to the adoption of the above standards and the financial impact of adoption.

No new standards, amendments or interpretations to existing standards that are not yet effective, have been early adopted by the Banking Group in these financial statements. The Directors expect to adopt the following standards in the period within which they become mandatory.

At the date of authorisation, the following new standards, amendments or interpretations to existing standards had been issued:

Standard	Effective for annual reporting periods beginning on or after:
NZ IFRS 16: <i>Leases</i>	1 January 2019
NZ IFRS 17: <i>Insurance Contracts</i>	1 January 2021

NZ IFRS 16: *Leases*

The final version of NZ IFRS 16: *Leases* was issued in February 2016 and is effective for the Banking Group from 1 July 2019. NZ IFRS 16 replaces NZ IAS 17: *Leases* and introduces a single, on-balance sheet accounting model for lessees and requires a lessee to recognise its right to use underlying leased assets as a right-of-use asset, and an obligation to make lease payments as a lease liability for all leases. There are recognition exemptions for short-term leases and leases of low-value items. The asset and liability will initially be measured at the present value of non-cancellable lease payments and payments to be made in optional periods where it is reasonably certain that the option will be exercised.

NZ IFRS 16 will involve a greater use of judgement than the existing approach to accounting for leases under NZ IAS 17. The key judgements for the Banking Group will be assessing options to extend or terminate a lease and the method applied to calculating Incremental Borrowing Rates that will be used to discount future lease payments to present value in calculating the lease liability.

NZ IFRS 16 will have an impact on the accounting treatment of leases within operating expenses disclosed in the Banking Group's income statement. Lease payments that were previously recognised as expenses on a straight-line basis over the term of a lease will be replaced by a depreciation expense on the right-of-use asset and financing costs calculated on the outstanding balance of the lease liability. Depreciation expenses and financing costs are expected to be higher in the near term than the equivalent lease expenses under NZ IAS 17. This may result in changes in certain expense and profit measures. The Banking Group's cash flow statement will also be impacted by the lease payments being reported as part of cash flows from financing activities rather than cash flows from operating activities.

Transition and impact

The Banking Group has substantially completed a project to implement a reporting solution for NZ IFRS 16 and complete an assessment of the estimated impact that the initial application of NZ IFRS 16 will have on its financial statements as described below.

The actual impact of adopting the standard on 1 July 2019 may change because the Banking Group has not yet finalised the testing and assessment of controls over new systems and processes and the accounting policies are subject to change until the Banking Group presents its first financial statements following the date of initial application. As permitted by the standard, the Banking Group intends to adopt NZ IFRS 16 using a modified retrospective approach where comparatives are not restated and a practical expedient is applied in recognising the right-of-use asset at 1 July 2019 at an amount equal to the lease liability adjusted by the amount of any prepaid or accrued lease payments. Therefore, no impact on opening retained earnings is expected on transition to NZ IFRS 16.

Details of the Banking Group's lease commitments are disclosed in note 35 Operating lease commitments. As at 30 June 2019, the Banking Group's future minimum lease payments under non-cancellable operating leases on an undiscounted basis is \$93.5m. The Banking Group has estimated that as at 1 July 2019 the right-of-use asset and corresponding lease liability is approximately \$85.5m.

Notes to the financial statements

Continued...

2. Basis of preparation and general accounting policies continued

2.5 New Accounting Standards and Interpretations continued

NZ IFRS 17: Insurance Contracts

The final version of NZ IFRS 17 *Insurance Contracts* was issued in August 2017 and is not effective for the Banking Group until 1 July 2021. NZ IFRS 17 establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts.

The Banking Group does not currently issue insurance or reinsurance contracts nor does it hold reinsurance contracts or issue investment contracts with discretionary participation features. Therefore, NZ IFRS 17 is not expected to have a material impact on the Banking Group.

2.6 Financial instruments

Recognition

The Banking Group initially recognises loans and advances, deposits and other borrowings, certain debt securities issued and subordinated debt on the date on which they were originated. All other financial instruments are recognised on trade-date – the date on which the Banking Group becomes a party to the contractual provisions of the instrument.

Financial instruments are measured initially at fair value, plus, for an item not at fair value through profit or loss, transaction costs directly attributable to its acquisition or issue.

Derecognition

A financial asset (or where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- The rights to receive cash flows from the asset have expired; or
- The Banking Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full, without material delay, to a third party under a 'pass-through' arrangement and cannot sell or re-pledge the asset other than to the transferee; or
- Either the Banking Group has transferred substantially all the risks and rewards of the asset, or the Banking Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A situation may arise where the Banking Group transfers its right to receive cash flows from an asset or has entered into a pass-through arrangement. In some cases the Banking Group would have neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of these assets. Should this occur to the extent that the Banking Group has continuing involvement in the asset, the asset continues to be recognised on the balance sheet.

The Banking Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

Classification

Financial assets – Policy applicable after 1 July 2018

On initial recognition, a financial asset is classified as measured at: amortised cost, fair value through other comprehensive income ("FVOCI") or fair value through profit or loss ("FVTPL").

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI").

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

On initial recognition of an equity investment that is not held for trading, the Banking Group may irrevocably elect to present subsequent changes in fair value in other comprehensive income. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Banking Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Notes to the financial statements

Continued...

2. Basis of preparation and general accounting policies continued

2.6 Financial instruments continued

Business model assessment

The Banking Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Banking Group's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and its strategy for how those risks are managed;
- how managers of the business are compensated (e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected); and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Banking Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment of whether contractual cash flows are SPPI

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are SPPI, the Banking Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Banking Group considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Banking Group's claim to cash flows from specified assets (e.g. non-recourse loans); and
- features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

The Banking Group holds a portfolio of long-term fixed-rate loans for which it has the option to propose to revise the interest rate at periodic reset dates. These reset rights are limited to the market rate at the time of revision. The borrowers have an option to either accept the revised rate or redeem the loan at par without penalty. The Banking Group has determined that the contractual cash flows of these loans are SPPI because the option varies the interest rate in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Banking Group changes its business model for managing financial assets.

Financial assets – Policy applicable before 1 July 2018

The Banking Group classified its financial assets into one of the following categories:

- loans and receivables;
- held-to-maturity;
- available-for-sale; and
- at FVTPL, and within this category as:
 - held-for-trading; or
 - designated as at FVTPL.

Financial liabilities

The Banking Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or FVTPL.

Designation at fair value through profit or loss

Financial assets

At initial recognition, the Banking Group may elect to designate financial assets as at FVTPL because this designation eliminates or significantly reduces an accounting mismatch, that would otherwise arise. As at 30 June 2019, the Banking Group has not elected to designate any financial assets as at FVTPL at initial recognition (30 June 2018: nil).

Notes to the financial statements

Continued...

2. Basis of preparation and general accounting policies continued

2.6 Financial instruments continued

Financial liabilities

The Banking Group has designated certain financial liabilities as at FVTPL in either of the following circumstances:

- the liabilities are managed, evaluated and reported internally on a fair value basis; or
- the designation eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Note 20 sets out the amount of each class of financial asset or financial liability that has been designated as at FVTPL. A description of the basis for each designation is set out in the note for the relevant asset or liability class.

2.7 Currency

Functional and presentation currency

The Banking Group's financial statements are presented in New Zealand dollars which is the Bank's functional and presentation currency. All amounts are expressed in millions of New Zealand dollars, unless otherwise stated.

Foreign currency translation

Transactions in foreign currencies are translated into the functional currency at the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions are recognised in the income statement. At the reporting date, foreign denominated monetary assets and liabilities are translated at the closing exchange rate, with exchange variations arising from these translations being recognised in the income statement.

2.8 Provisions

A provision is recognised in the balance sheet when the Banking Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

2.9 Cash flow statement

The following are definitions of the terms used in the cash flow statement:

- I. Cash and cash equivalents is considered to be cash on hand, current accounts in banks, ATM's, overnight bank deposits, net of bank overdrafts and inter-bank balances arising from the daily RBNZ settlement process.
- II. Investing activities are those relating to the acquisition, holding and disposal of property, plant and equipment, intangibles, equity or debt instruments of other entities and other long-term assets.
- III. Financing activities are those activities that result in changes in the size and composition of the capital structure of the Banking Group. This includes both equity and debt not falling within the definition of cash.
- IV. Operating activities include all transactions and other events that are not investing or financing activities.
- V. Certain cash flows have been netted to provide more meaningful disclosure, including changes in loans and advances to customers, deposits held by customers, balances with other banks, debt securities issued, and investment securities, and financial assets held for trading. Many of the cash flows are received and disbursed on behalf of customers and reflect the activities of the customers rather than those of the Banking Group.

2.10 Other accounting policies

Significant and other accounting policies which describe the measurement basis used and that are relevant to an understanding of the financial statements are provided throughout the notes to the financial statements.

Notes to the financial statements

Continued...

3. Interest income and expense



Accounting policy

Recognition of interest income and expense

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

When calculating the effective interest rate for financial instruments, the Banking Group estimates future cash flows considering all contractual terms of the financial instrument, but not credit impairment losses. The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Recognition of loan-related fees and costs

Commitment fees are deferred and, if it is probable that the commitment is exercised, recognised in income over the life of the loan as an adjustment of yield or, if unexercised, recognised in income on expiration of the commitment. Where the likelihood of exercise of the commitment is remote, commitment fees are recognised in income over the commitment period.

Direct loan origination costs are recognised over the life of the loan as an adjustment of yield. All other loan related costs are expensed as incurred.

Dollars in millions	Year ended 30/06/19	Year ended 30/06/18 ¹
Interest income		
Loans and advances at amortised cost	903	864
Government and local authority securities	9	11
Other securities ²	15	(3)
Cash and liquid assets	6	7
Total interest income	933	879
Interest expense		
Deposits and other borrowings	407	387
Other issues	81	81
Total interest expense	488	468

¹ The comparative prior period amounts have been reclassified to align with the simpler categories used in the current period's presentation.

² Interest income from other securities includes the net impact of the treasury business unit's interest rate management activities that may result in a debit balance.

Interest income earned from related parties is included within loans and advances at amortised cost. Interest expense paid or due to related parties is included within deposits and other borrowings and other issues. See note 29 for more detail on related party transactions.

The total interest income and expense that relates to financial assets or liabilities that are measured at amortised cost is \$910.2m and \$475.0m respectively. The total interest income that relates to financial assets that are measured at FVOCI is \$34.5m.

In the year ended 30 June 2018, the total interest income and expense that related to financial assets or liabilities that were not carried at fair value through profit or loss was \$879.2m and \$457.3m respectively.

Notes to the financial statements

Continued...

4. Net gains on financial instruments at fair value



Accounting policy

Accounting policies relating to gains on financial instruments at fair value are set out in notes 14, 15 and 18.

Dollars in millions	Year ended 30/06/19	Year ended 30/06/18
Derivative financial instruments held for trading	(1)	1
Financial instruments held for trading	(1)	-
Net ineffectiveness on qualifying fair value hedges	-	1
Cumulative gain transferred from fair value reserve	-	4
Cumulative loss transferred from cash flow hedge reserve	-	(1)
Net foreign exchange gains	5	4
Total net gains on financial instruments at fair value	3	9

Net ineffectiveness on qualifying cash flow hedges is \$nil (2018: \$nil). Net ineffectiveness on qualifying fair value hedges is (\$0.4m) (2018: \$0.7m).

5. Net fee and other income and contracts with customers



Accounting policy

Policy applicable after 1 July 2018

A contract with a customer that results in a recognised financial instrument in the Banking Group's financial statements may be partially in the scope of NZ IFRS 9 and partially in the scope of NZ IFRS 15. If this is the case, then the Banking Group first applies NZ IFRS 9 to separate and measure the part of the contract that is in the scope of NZ IFRS 9 and then applies NZ IFRS 15 to the residual.

Gross fee and other income is recognised as services are performed and the related performance obligations are fulfilled.

Performance obligations and timing of revenue recognition

The transaction price for contracts with customers, including any estimated variable consideration, is allocated to each distinct performance obligation within each contract and revenue is recognised as those performance obligations are fulfilled.

Direct fee expenses relate mainly to transaction and service fees and commissions paid, that are directly attributable to the generation of revenue, and which are recognised on an accrual basis.

Costs incurred to obtain or fulfil a contract with a customer are recognised as an asset when the costs relate directly to a specific contract, the costs improve or create resources to use in satisfying future performance obligations of the contract, and the costs are expected to be recovered in the future. The asset is amortised within operating expenses on a systematic basis consistent with the transfer to the customer of the services to which the asset relates.

Policy applicable before 1 July 2018

Fee and other income was recognised to the extent that it was probable that economic benefits will flow to the Banking Group and that revenue could be reliably measured. Fee income was generally recognised on an accruals basis when the service had been provided.

Direct fee expenses consisted of those expenses directly attributable to the generation of revenue, such as transaction fees and commissions paid, and were recognised on an accrual basis.

Notes to the financial statements

Continued...

5. Net fee and other income and contracts with customers continued



Critical accounting estimates and judgements

The timing of the recognition of revenue earned from contracts with customers is based on judgements made as to how the transaction price of a contract should be allocated to the performance obligations and when those performance obligations are considered fulfilled. Where possible, this allocation is made based on the exact terms of the contracts. In the absence of exact terms allocating the transaction price to a performance obligation, an appropriate method is used to estimate the price such as an adjusted market assessment approach, expected cost plus a margin approach, the residual approach, or a combination of these methods.

The disclosure of the estimated timing of recognition of revenue related to contract liabilities is based on contract terms and relies on estimates on when certain contractual and performance obligations will be fulfilled.

The nature and timing of the satisfaction of performance obligations in contracts with customers for each type of service is outlined further below.

Dollars in millions	Year ended	Year ended
	30/06/19	30/06/18
Lending and credit fee income	70	69
Transaction and other income	99	111
Agency services fee income	16	31
Gross fee and other income	185	211
Direct fee expenses	(95)	(92)
Total net fee and other income	90	119

Transaction and other income includes revenue of \$3.0m (2018: \$14.6m) in relation to insurance claims for damages suffered and losses incurred as a result of the 14 November 2016 Kaikoura earthquake. The Banking Group held insurance policies at the date of the Kaikoura earthquake that provided for cover for Material Damage and Business Interruption.

DISAGGREGATION OF REVENUE FROM CONTRACTS WITH CUSTOMERS

The nature and timing of the satisfaction of performance obligations in contracts with customers for each type of service is outlined below:

- *Transactional account and other services* – this includes services provided to personal and business customers and covers transactional accounts and other related services. Fees are generally charged monthly or are transaction-based fees charged at the point of the transaction. Revenue is recognised at the point in time when the transaction takes place or at the time it is charged for monthly fees.
- *Card services* – this includes credit card, debit card and prepaid card services offered to personal and business customers along with related long-term contracts with card schemes. Account or set-up fees are generally charged up front at the point the card is issued with a regular renewal period. The period covered by the fee is generally six to twelve months. These types of revenue are recognised on a straight-line basis over the period covered by the fee. Certain transaction-based fees are charged and recognised as income at the point in time when the transaction takes place. For longer-term contracts, revenue is recognised over time, consistent with when the Banking Group satisfies each performance obligation based on output methods measuring the value of the services transferred to date.
- *Lending services* - this includes fees related to lending and ancillary services to personal and business customers where the revenue is not caught by NZ IFRS 9 and treated as part of the effective interest rate. Fees are generally transaction-based fees charged at the point of the transaction. Revenue is recognised at the point in time when the transaction takes place.
- *Agency services* - this includes fees related to agency services including collection and verification services. Fees are generally transaction-based fees charged at the point of the transaction. Revenue is recognised at the point in time when the transaction takes place.

Notes to the financial statements

Continued...

5. Net fee and other income and contracts with customers continued

In the following table, gross fee and other income from contracts with customers in the scope of NZ IFRS 15 is further disaggregated by the type of service provided to Customers.

Dollars in millions	30/06/19		
	Personal	Business	Total
Major service categories			
Lending services	7	3	10
Card services	107	1	108
Transactional account and other services	41	7	48
Agency services	4	12	16
Total revenue from contracts with customers	159	23	182
Other income	2	1	3
Gross fee and other income	161	24	185

Reconciliation to segment analysis

Dollars in millions	30/06/19		
	Personal	Business	Total
Gross fee and other income	161	24	185
Direct fee expenses	(89)	(6)	(95)
Net gains on financial instruments at fair value (note 4)	(1)	4	3
Other external operating income as reported in note 31 - segment analysis	71	22	93

CONTRACT BALANCES

Contract liabilities

Dollars in millions	As at	As at	As at
	30/06/19	1/07/2018 ¹	30/06/18
Contract liabilities	27	6	-
Total contract liabilities	27	6	-
Current	23	6	-
Non-current	4	-	-

¹NZ IFRS 15 was adopted from 1 July 2018. The impact of adoption and transition to NZ IFRS 15 is disclosed within note 39.

The contract liabilities relate to non-refundable up-front fees received for card products with primarily short-term contracts from six to twelve months and up-front revenue received for long-term contracts that may be partially refundable where the terms of the contract are not met. Income is recognised and spread consistently over time with the fulfilment of the relevant performance obligations.

During the year ended 30 June 2019, \$5.6m of the \$6.3m contract liability recognised at 1 July 2018 has been recognised as revenue as the relevant performance obligations have been satisfied during the period.

Notes to the financial statements

Continued...

5. Net fee and other income and contracts with customers continued

Estimated timing of income recognition

The following table provides information about the estimated timing of income recognition related to the contract liabilities of the Banking Group.

Dollars in millions	30/06/19				Total
	Up to 12 months	Between 1 and 2 years	Between 2 and 3 years	More than 3 years	
Short-term contracts	5	-	-	-	5
Long-term contracts	18	1	1	2	22
Total contract liabilities	23	1	1	2	27

Costs to fulfil assets

The following table provides the closing balances of assets recognised from the costs incurred to fulfil contracts with customers.

Dollars in millions	As at 30/06/19	As at 30/06/18
Costs to fulfil assets	4	-
Total costs to fulfil assets	4	-

During the year ended 30 June 2019, no amortisation or impairment losses was recognised in relation to costs to fulfil assets.

6. Operating expenses



Accounting policy

Operating expense recognition

Operating expenses are recognised on an accrual basis.

Employee benefits

Employee entitlements to salaries and wages, bonuses, annual leave, long-service leave, retiring leave and other similar benefits are recognised in the income statement when they accrue to employees.

Obligations for contributions to defined contribution retirement plans are recognised as an expense in the income statement as they fall due.

Operating leases

Payments made under operating leases, where the lessor substantially retains the risks and rewards of ownership, are recognised in the income statement on a straight-line basis over the term of the lease. Leasehold improvements are capitalised and the cost is amortised over the unexpired period of the lease or the estimated useful life of the improvements, whichever is shorter. Lease incentives received are recognised evenly over the term of the lease as a reduction in rental expense.

Notes to the financial statements

Continued...

6. Operating expenses continued

Dollars in millions	Year ended 30/06/19	Year ended 30/06/18
Salaries and wages	161	153
Other personnel related costs	14	18
Leasing and premises costs	20	16
Information technology and system costs	47	37
Office supplies, postage and telephone	10	13
Consultancy and professional fees	22	19
Marketing and customer communications	17	17
Amortisation of intangibles	25	25
Depreciation	12	9
Other expenses	47	66
Total operating expenses	375	373

Dollars in thousands	Year ended 30/06/19	Year ended 30/06/18
Directors' fees	995	918

7. Taxation



Accounting policy

The income tax expense charged to the income statement includes both current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the current year, using tax rates enacted or substantively enacted at the reporting date, after taking advantage of all allowable deductions under current taxation legislation and any adjustment to tax payable in previous years.

Deferred tax is provided in full, using the balance sheet liability method, providing for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date. A deferred taxation benefit is recognised only to the extent that it is probable that a future taxable profit will be available against which the temporary differences can be utilised.

Current or deferred tax related to fair value measurement of investment securities and cash flow hedges, which is charged or credited to other comprehensive income, is subsequently recognised in the income statement if and when the deferred gain or loss on the related asset or liability affects profit or loss.

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

Notes to the financial statements

Continued...

7. Taxation continued

Income tax expense

Dollars in millions	Year ended 30/06/19	Year ended 30/06/18 ¹
Profit before taxation	151	154
Tax calculated at a rate of 28%	(42)	(43)
Tax effect of:		
Income not subject to tax and non-deductible expenses	(8)	(9)
Transfer of tax losses from other KGHL subsidiaries	7	13
Tax charge as per the income statement	(43)	(39)
Represented by:		
Current income tax	(47)	(17)
Deferred income tax	4	(22)
Tax charge as per the income statement	(43)	(39)
The deferred tax charge in the income statement comprises the following temporary differences:		
Accelerated tax depreciation	2	1
Other provisions and accruals	1	3
Allowances for credit and other impairment losses	1	(26)
Total movement in temporary differences	4	(22)

¹Comparative amounts have been reclassified to show the gross non-deductible expenses and tax losses transferred from other KGHL subsidiaries consistent with the presentation in the current year.

Notes to the financial statements

Continued...

7. Taxation continued

Deferred taxation

Dollars in millions	30/06/19	30/06/18
Deferred tax		
Balance at beginning of the year	11	34
Prior period adjustment	(1)	-
Transitional adjustments resulting from the adoption of NZ IFRS 9 and NZ IFRS 15	1	-
Movement in temporary differences	5	(22)
Tax on profits taken to reserves	5	(1)
Balance at end of the year	21	11
Deferred income tax assets		
Cash flow hedges	9	4
Other provisions and accruals	8	5
Allowance for loan impairment	11	10
Total deferred income tax assets	28	19
Accelerated tax depreciation	(7)	(8)
Total deferred income tax liabilities	(7)	(8)
Net deferred taxation	21	11
Deferred tax assets and liabilities expected to be realised within 12 months	27	18
Deferred tax assets and liabilities expected to be realised after 12 months	(6)	(7)

8. Loans and advances



Accounting policy

Policy applicable after 1 July 2018

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently at amortised cost using the effective interest method. Interest income, expected credit losses ("ECL") and reversals are recognised in the income statement.

Policy applicable before 1 July 2018

Loans and advances were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. Loans and advances were measured at amortised cost using the effective interest method. Loans and advances issued with an initial duration of less than 12 months were recognised at cost less impairment. Allowances for estimated irrecoverable amounts were recognised when there was objective evidence that the asset was impaired. Interest income and impairment losses were recognised in the income statement.

The following table presents gross loans and advances by type of product. Total gross residential mortgage loans at 30 June 2019 were \$18,894m (2018: \$17,068m). This includes *term loans – housing* and residentially secured lending within *other term lending* (see note 10).

Notes to the financial statements

Continued...

8. Loans and advances continued

Dollars in millions	30/06/19	30/06/18
Overdrafts	94	74
Credit card outstandings	398	385
Term loans - housing	17,977	16,186
Other term lending	1,837	1,550
Other lending	177	145
Gross loans and advances	20,483	18,340
Provision for credit impairment	(40)	(36)
Fair value hedge adjustments	-	-
Net loans and advances	20,443	18,304
Current	1,507	1,268
Non-current	18,936	17,036

9. Credit impairment losses



Accounting policy

Policy applicable after 1 July 2018

The Banking Group recognises credit impairment provisions for expected credit losses ("ECL") on the following financial instruments:

- financial assets measured at amortised cost;
- debt instruments measured at fair value through other comprehensive income ("FVOCI");
- lease receivables; and
- certain loan commitments and financial guarantees.

Measurement of ECL

A three-stage approach is applied to measuring ECL based on credit migration between the stages as follows:

- Stage 1: At initial recognition, a provision equivalent to 12 months of ECL is recognised.
- Stage 2: Where there has been a significant increase in credit risk since initial recognition, a provision equivalent to full lifetime ECL is recognised.
- Stage 3: This stage comprises all accounts that are impaired or in default. Lifetime ECL is recognised for loans where there is objective evidence of impairment.

ECL are probability weighted and determined by evaluating a range of possible outcomes, taking into account the time value of money, past events, current conditions and forecasts of future economic conditions. The new ECL models therefore involve a greater use of judgement than the previous impairment model.

The ECL models use three main components to determine expected credit loss (as well as the time value of money), including:

- Probability of default ("PD"): the probability that a counterparty will default;
- Loss given default ("LGD"): the loss that is expected to arise in the event of default; and
- Exposure at default ("EAD"): the estimated outstanding amount of credit exposure at the time of default.

These models incorporate past experience, current conditions and multiple probability-weighted macroeconomic scenarios to generate credit loss estimates under reasonably supportable future economic conditions.

Notes to the financial statements

Continued...

9. Credit impairment losses continued



Accounting policy continued

Changes to ECL are assessed through four economic scenarios:

- a central scenario reflecting the expected track for the economy based around low but steady economic, employment and house price growth, supported by a lower interest rate forecast,
- a mild upside scenario with a higher track for house prices and interest rates,
- a mild downside scenario with a short-term impact on Gross Domestic Product (“GDP”) with lower employment growth, house prices and interest rates, and
- a severe downside scenario incorporating a sharp reduction in GDP, a material increase in unemployment, the Official Cash Rate (“OCR”) falling and a sustained fall in house prices.

The probability weightings attached to each scenario are reviewed by executive management half-yearly, although more frequent reviews may be undertaken should macroeconomic conditions change materially.

The determination of a significant deterioration of credit risk (i.e. the movement from stage 1 to stage 2) is based on changes in internally assessed customer risk characteristics since origination of the facility. Those changes include arrears on loan facilities (at or less than the 30-day backstop), material movements in risk grades or behavioural scores, or other information the Banking Group becomes aware of which indicates that repayment on the original terms and conditions may now be uncertain. The movement between stages 2 and 3 is based on whether financial assets are credit impaired at the reporting date.

Credit-impaired financial assets

At each reporting date, the Banking Group assesses whether financial assets carried at amortised cost and debt instruments measured at FVOCI are credit impaired (referred to as ‘Stage 3 financial assets’). A financial asset is ‘credit impaired’ when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset may be credit impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Banking Group on terms that it would not consider otherwise;
- the borrower entering bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower’s condition is usually considered to be credit impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. A retail loan that is overdue for 90 days or more is considered credit impaired.

Presentation of allowance for ECL in the statement of financial position

Credit impairment provisions for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- where a financial instrument includes both a drawn and an undrawn component, the Banking Group presents a combined credit impairment provision for both components; and
- debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the credit impairment provision is disclosed and recognised in the fair value reserve.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Banking Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in ‘credit impairment losses’ in the statement of profit or loss and other comprehensive income.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Banking Group’s procedures for recovery of amounts due.

Notes to the financial statements

Continued...

9. Credit impairment losses continued



Accounting policy continued

Policy applicable before 1 July 2018

At each reporting date an assessment was made as to whether there was objective evidence that a loan or advance (a "loan") or group of loans was impaired. A loan or a group of loans was impaired and impairment losses were recognised if, and only if, there was objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the loan (a "loss event") and that loss event (or events) had an impact on the estimated future cash flows of the loan or group of loans that could be reliably estimated.

Objective evidence that a loan or group of loans is impaired included observable data that came to the attention of the Banking Group about the following loss events:

- significant financial difficulty of the issuer or obligator;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the Banking Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the Banking Group would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there was a measurable decrease in the estimated future cash flows from a group of loans since the initial recognition of those loans, although the decrease cannot yet be identified with the individual loans in the Banking Group, including:
 - a) adverse changes in the payment status of borrowers in the Banking Group; or
 - b) national or local economic conditions that correlate with defaults on the assets in the Banking Group.

Management assessed whether objective evidence of impairment existed individually for loans that were individually significant, and individually or collectively for loans that were not individually significant. If no objective evidence of impairment existed for an individually assessed loan, whether significant or not, the loan was included in a group of loans with similar credit risk characteristics and collectively assessed for impairment.

Loans that were individually assessed for impairment and for which an impairment loss was, or continued to be, recognised were not included in a collective assessment of impairment. If there was objective evidence that an impairment loss on a loan carried at amortised cost had been incurred, the amount of the loss was measured as the difference between the loan's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the loan's original effective interest rate.

The carrying amount of the loan was reduced through the use of an impairment allowance account and the amount of the loss was recognised in the income statement. If a loan had a variable interest rate, the discount rate for measuring any impairment loss was the current effective interest rate determined under the contract.

For the purposes of a collective evaluation of impairment, loans were grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Banking Group's grading process that considered asset type, industry, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of loans by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the loan being evaluated. In some instances the Banking Group used loan mortgage insurance on origination of loans where the loan-to-valuation ratio was greater than 80%.

Future cash flows for a group of loans that were collectively evaluated for impairment were estimated on the basis of the contractual cash flows of the loans and historical loss experience for loans with similar credit risk characteristics. Historical loss experience was adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience was based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows were reviewed regularly to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss was reversed. The amount of the reversal, not exceeding what the amortised cost would have been had the impairment not been recognised, was recognised in the income statement.

When a loan was uncollectable, it was written off against the related allowance for loan impairment. Such loans were written off after all the necessary procedures had been completed and the amount of the loss had been determined. Subsequent recoveries of amounts previously written off were recognised through the income statement.

Notes to the financial statements

Continued...

9. Credit impairment losses continued



Critical accounting estimates and judgements

Loan portfolios are assessed for impairment on a monthly basis. In determining whether an impairment loss should be recorded in the income statement, judgements are made as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Applicable from 1 July 2018

The measurement of ECL and the assessment of a significant increase in credit risk requires consideration of information about past events and current conditions as well as reasonable and supportable projections of future events and economic conditions. The Banking Group considers four macroeconomic scenarios with a base case, upside and two downside scenarios. The macro economic variables used in these scenarios are based on current economic forecasts and include unemployment rates, interest rates, GDP growth rates and property price indices.

The macroeconomic scenarios are weighted based on the Banking Group's best estimate of the relative likelihood of each scenario. This estimate is based on historical frequency, past and current trends, and forecasts of future conditions.

Applicable prior to 1 July 2018

The total provision for credit impairment comprised an individual impairment and collective impairment provision. Individual provisions had been raised where objective evidence of impairment existed. If no objective evidence of impairment existed exposures were included in a group of loans (personal markets and business markets lending) and collectively assessed for impairment. Collective impairment calculations had been determined by a provisioning model, historical loss experience and management's experience of economic stress factors. Key macro-economic assumptions considered in the collective provisioning assessment were geographical concentration risk, personal savings levels, unemployment levels, property price discounts and insurance recoveries.

Dollars in millions	Year ended 30/06/19			
	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Credited/(charged) to the income statement for collectively assessed provisions	1	(2)	(6)	(7)
Credited/(charged) to the income statement for individually assessed provisions	1	-	1	2
Amounts written off directly to the income statement	(10)	(1)	-	(11)
Recovery of amounts previously written off	4	-	-	4
Total credit impairment losses per income statement	(4)	(3)	(5)	(12)

Notes to the financial statements

Continued...

9. Credit impairment losses continued

Dollars in millions	Year ended 30/06/18			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Credited/(charged) to the income statement for collectively assessed provisions	1	4	(2)	3
(Charged)/credited to the income statement for individually assessed provisions	(1)	1	1	1
Amounts written off directly to the income statement	(9)	-	-	(9)
Recovery of amounts previously written off	4	-	-	4
Total credit impairment (losses)/reversals per income statement	(5)	5	(1)	(1)

10. Asset Quality

Summary of lending

Dollars in millions	30/06/19			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Neither past due nor impaired	406	18,784	1,140	20,330
Past due but not impaired	25	107	16	148
Impaired	-	3	2	5
Gross loans and advances	431	18,894	1,158	20,483
Provision for credit impairment	(10)	(16)	(14)	(40)
Fair value hedge adjustments	-	-	-	-
Net loans and advances	421	18,878	1,144	20,443

Dollars in millions	30/06/18 ¹			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Neither past due nor impaired	393	16,963	831	18,187
Past due but not impaired	29	100	14	143
Impaired	1	5	4	10
Gross loans and advances	423	17,068	849	18,340
Provision for credit impairment	(9)	(17)	(10)	(36)
Fair value hedge adjustments	-	-	-	-
Net loans and advances	414	17,051	839	18,304

¹The comparative period amounts have been reclassified to align with the classifications used in the current period. This included a move for certain exposures from 'retail unsecured lending' to 'business exposures' (\$64m) and a move from loans classified as neither past due nor impaired to loans classified as past due but not impaired (\$5m).

Notes to the financial statements

Continued...

10. Asset quality continued

Loans and advances past due but not impaired

Dollars in millions	30/06/19			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Past due less than 30 days	21	82	12	115
Past due 30 - 59 days	3	6	2	11
Past due 60 - 89 days	1	7	1	9
Past due 90 days or greater	-	12	1	13
Total loans and advances past due but not impaired	25	107	16	148

Dollars in millions	30/06/18 ¹			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Past due less than 30 days	23	75	6	104
Past due 30 - 59 days	4	13	3	20
Past due 60 - 89 days	1	4	2	7
Past due 90 days or greater	1	8	3	12
Total loans and advances past due but not impaired	29	100	14	143

¹The comparative period amounts have been reclassified to align with the classifications used in the current period. This included a move from loans classified as neither past due nor impaired to loans classified as past due but not impaired (\$5m).

Impaired assets

Dollars in millions	Year ended 30/06/19			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Gross impaired assets				
Balance at beginning of the year	1	5	4	10
Transfers from performing	9	3	4	16
Transfers to performing	-	(2)	-	(2)
Asset realisations and loans repaid	-	(2)	(6)	(8)
Amounts written off	(10)	(1)	-	(11)
Balance at end of the year	-	3	2	5
Individually assessed provision for credit impairment	-	(2)	(1)	(3)
Total net impaired assets	-	1	1	2

Notes to the financial statements

Continued...

10. Asset quality continued

Dollars in millions	Year ended 30/06/18 ¹			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Gross impaired assets				
Balance at beginning of the year	1	7	4	12
Transfers from performing	9	1	2	12
Transfers to performing	-	-	(1)	(1)
Asset realisations and loans repaid	-	(3)	(1)	(4)
Amounts written off	(9)	-	-	(9)
Balance at end of the year	1	5	4	10
Individually assessed provision for credit impairment	(1)	(2)	(2)	(5)
Total net impaired assets	-	3	2	5

¹The comparative prior period amounts have been reclassified to align with the classifications used in the current period. This included grossing up the transfers to/from performing and recoveries against amounts written off.

Adjustment to provision for credit impairment upon adoption of NZ IFRS 9

Dollars in millions	NZ IAS 39	NZ IFRS 9	NZ IFRS 9	NZ IFRS 9
	30/06/2018	Measurement Impact on Transition	ECL classification	01/07/2018
Individually assessed	5	-	(5)	-
Stage 3 individually assessed	-	-	5	5
Collectively assessed	31	(1)	(30)	-
Stage 1 collectively assessed	-	-	16	16
Stage 2 collectively assessed	-	-	12	12
Stage 3 collectively assessed	-	-	2	2
Total provision for credit impairment	36	(1)	-	35

See note 39 for more details on the Banking Group's transition to NZ IFRS 9 on 1 July 2018.

Notes to the financial statements

Continued...

10. Asset quality continued

Movement in provision for credit impairment – retail unsecured lending

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Retail unsecured lending					
As at 1 July 2018	5	6	-	1	12
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	(1)	1	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	-	-	-	-	-
Charged/(credited) to income statement for collectively assessed provisions					
- Changes due to additions and deletions	-	1	-	-	1
- Changes due to amounts written off	-	(2)	-	-	(2)
- Other changes	-	-	-	-	-
Total (credited) to income statement for collectively assessed provisions	-	(1)	-	-	(1)
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	-	-
- Write-back of provisions no longer required	-	-	-	(1)	(1)
Total (credited) to income statement for individually assessed provisions	-	-	-	(1)	(1)
Amounts written off from individually assessed provisions	-	-	-	-	-
Balance at end of period - retail unsecured lending	5	5	-	-	10

Impact of changes in gross financial assets on loss allowances – retail unsecured lending

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount - retail unsecured lending					
Balance at the beginning of the period	300	121	1	1	423
Net transfers between stages	-	-	-	-	-
Additions	43	31	2	-	76
Deletions	(32)	(23)	(2)	(1)	(58)
Amounts written off	-	(10)	-	-	(10)
Balance at the end of the period - retail unsecured lending	311	119	1	-	431

Notes to the financial statements

Continued...

10. Asset quality continued

Overall, credit impairment provisions for retail unsecured lending exposures decreased a net \$2m after the adjustment to opening balances upon adoption of NZ IFRS 9.

- Stage 1 collectively assessed: collective provision on stage 1 unsecured assets was unchanged. New lending of \$43m was largely offset by \$32m of repayments generating an immaterial collective provision charge reflecting low expected losses on newly originated lending. There was a \$1m reduction of Stage 1 collective provision due to \$11m of exposures moving to stage 2 due to evidence of credit deterioration. This was matched by \$11m of stage 2 exposures demonstrating improved credit quality and moving back to stage 1 requiring an additional \$1m of stage 1 collective provision.
- Stage 2 collectively assessed: collective provision reduced \$1m following a net reduction of \$2m in stage 2 balances over the year. A \$1m increase of collective provision was driven by a \$31m increase in stage 2 balances along with the \$11m transferred from stage 1 but that was offset by \$23m of balances repaid with another \$10m written-off.
- Stage 3 collectively assessed: collective provision is minimal for this stage as the Bank has a policy of writing off balances once they are 90 days delinquent. There is a small balance of \$1m in this stage comprising customers >90 days delinquent and not yet written-off due to timing or due to the exposure being impaired for reasons other than 90 day delinquency.
- Stage 3 individually assessed: Specific provisions reduced by \$1m as these exposures were repaid. There were no individually assessed provisions for unsecured lending as at 30 June 2019.

Movement in provision for credit impairment – residential mortgage loans

Dollars in millions	30/06/19					Total
	Stage 1	Stage 2	Stage 3			
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed		
Residential mortgage loans						
As at 1 July 2018	7	4	1	2		14
Transfers between stages:						
- Transferred to Stage 1	1	(1)	-	-		-
- Transferred to Stage 2	(1)	1	-	-		-
- Transferred to Stage 3	-	-	-	-		-
- Transferred to Stage 3 individually assessed	-	-	-	-		-
Total transfers between stages	-	-	-	-		-
Charged/(credited) to income statement for collectively assessed provisions						
- Changes due to additions and deletions	1	(1)	2	-		2
- Changes due to amounts written off	-	-	-	-		-
- Other changes	-	-	-	-		-
Total (credited) to income statement for collectively assessed provisions	1	(1)	2	-		2
Charged/(credited) to income statement for individually assessed provisions						
- New and increased provisions	-	-	-	1		1
- Write-back of provisions no longer required	-	-	-	(1)		(1)
Total (credited) to income statement for individually assessed provisions	-	-	-	-		-
Amounts written off from individually assessed provisions	-	-	-	-		-
Balance at end of period – residential mortgage loans	8	3	3	2		16

Notes to the financial statements

Continued...

10. Asset quality continued

Impact of changes in gross financial assets on loss allowances – residential mortgage loans

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount - residential mortgage loans					
Balance at the beginning of the period	16,463	591	9	5	17,068
Net transfers between stages	10	(12)	1	1	-
Additions	4,689	159	16	-	4,864
Deletions	(2,899)	(128)	(8)	(2)	(3,037)
Amounts written off	-	-	-	(1)	(1)
Balance at the end of the period - residential mortgage loans	18,263	610	18	3	18,894

Overall, credit impairment provisions for residential mortgage lending increased by \$2m after the adjustment to opening balances upon adoption of NZ IFRS 9.

- Stage 1 collectively assessed: collective provisions increased \$1m due to a net increase of \$1,790m in gross balances. New lending of \$4,689m was partially offset by repayments of \$2,899m with the net lending attracting low levels of collective provisions due to very low loss rates expected in the 12 months following origination. \$10m of stage 1 balances moved to stage 2 as the exposures deteriorated which reduced stage 1 collective provisions by \$1m. However that was balanced by \$21m of stage 2 loans showing improved credit performance after a 6 month review period, allowing them to be returned to stage 1.
- Stage 2 collectively assessed: collective provisions reduced \$1m with transfers of mortgage balances into stage 2 (\$10m) being more than offset by \$21m of stage 2 mortgage lending transferring back to stage 1. Overall there was an increase of \$19m in the total balances within this stage with new stage 2 balances and additional lending provided to existing stage 2 customers only partially offset by repayments.
- Stage 3 collectively assessed: collective provisions increased \$2m during the year due to a net increase of \$9m in stage 3 lending balances. \$2m of mortgage lending was transferred into stage 3 from other stages with a net \$8m increase from additional lending to these customers or from customers more recently originated.
- Stage 3 individually assessed: Specific provisions were stable over the year at \$2m although total impaired balances reduced from \$5m to \$3m. \$1m of balances were transferred from stage 3 with \$2m of lending repaid and \$1m written-off.

Notes to the financial statements

Continued...

10. Asset quality continued

Movement in provision for credit impairment – business exposures

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Business exposures					
As at 1 July 2018	4	2	1	2	9
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	(2)	2	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	(1)	1	-	-	-
Charged/(credited) to income statement for collectively assessed provisions					
- Changes due to additions and deletions	3	3	-	-	6
- Changes due to amounts written off	-	-	-	-	-
- Other changes	-	-	-	-	-
Total (credited) to income statement for collectively assessed provisions	3	3	-	-	6
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	-	-
- Write-back of provisions no longer required	-	-	-	(1)	(1)
Total (credited) to income statement for individually assessed provisions	-	-	-	(1)	(1)
Amounts written off from individually assessed provisions	-	-	-	-	-
Balance at end of period - business exposures	6	6	1	1	14

Impact of changes in gross financial assets on loss allowances – business exposures

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount - business exposures					
Balance at the beginning of the period	804	34	7	4	849
Net transfers between stages	(1)	-	(3)	4	-
Additions	642	28	-	-	670
Deletions	(343)	(10)	(2)	(6)	(361)
Amounts written off	-	-	-	-	-
Balance at the end of the period - business exposures	1,102	52	2	2	1,158

Notes to the financial statements

Continued...

10. Asset quality continued

Credit impairment provisions for business exposures increased a net \$5m after the adjustment to opening balances upon adoption of NZ IFRS 9.

- Stage 1 collectively assessed - collective provisions increased \$2m driven by a net increase of \$299m in gross balances. New lending of \$642m was partially offset by repayments of \$343m generating a \$3m change. \$2m of stage 1 collective provision reduced from exposures moved to stage 2 or stage 3 with \$1m added to stage 1 collective provision as lending was transferred back to this stage.
- Stage 2 collectively assessed - collective provisions increased \$4m from a net increase in gross balances of \$18m. \$2m of the increase was due to exposures transferred from stage 1 with a \$1m reduction from exposures transferred back to stage 1. The remainder of the increase in collective provisions in that stage was due to newly originated and increases in stage 2 balances of \$28m offset by repayments of \$10m. Transfers to and from stage 3 were immaterial.
- Stage 3 collectively assessed - collective provisions was stable during the year with small transfers in and out from stage 1 and 2 largely offsetting each other. Gross balances reduced from \$7m to \$2m. \$4m transferred to stage 3 individually assessed provisions and \$2m was repaid with the balance comprising \$1m of net movements other stages and from increases in lending to these customers.
- Stage 3 individually assessed - Specific provisions reduced \$1m over the year. \$4m of new lending transitioned from stage 3 collectively assessed was offset by \$6m of repayments which allowed \$1m to be written back to profit. There were no business balances written-off in the year ended 30 June 2019. At 30 June 2019 total lending of \$2m was covered by \$1m of individually assessed provisions.

Movement in provision for credit impairment – total exposures

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Total exposures					
As at 1 July 2018	16	12	2	5	35
Transfers between stages:					
- Transferred to Stage 1	3	(3)	-	-	-
- Transferred to Stage 2	(4)	4	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	(1)	1	-	-	-
Charged/(credited) to income statement for collectively assessed provisions					
- Changes due to additions and deletions	4	3	2	-	9
- Changes due to amounts written off	-	(2)	-	-	(2)
- Other changes	-	-	-	-	-
Total (credited) to income statement for collectively assessed provisions	4	1	2	-	7
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	1	1
- Write-back of provisions no longer required	-	-	-	(3)	(3)
Total (credited) to income statement for individually assessed provisions	-	-	-	(2)	(2)
Amounts written off from individually assessed provisions	-	-	-	-	-
Balance at end of period - total	19	14	4	3	40

Notes to the financial statements

Continued...

10. Asset quality continued

Impact of changes in gross financial assets on loss allowances – total exposures

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount - total					
Balance at the beginning of the period	17,567	746	17	10	18,340
Net transfers between stages	9	(12)	(2)	5	-
Additions	5,374	218	18	-	5,610
Deletions	(3,274)	(161)	(12)	(9)	(3,456)
Amounts written off	-	(10)	-	(1)	(11)
Balance at the end of the period - total	19,676	781	21	5	20,483

Reconciliation of collective allowance for impairment by asset class for prior year

Dollars in millions	Year ended 30/06/18			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Collective allowance for impairment losses				
Balance at beginning of the year	9	19	6	34
Impairment (reversals)/losses on loans not at fair value through profit or loss	(1)	(4)	2	(3)
Amounts written off	-	-	-	-
Balance at end of the year	8	15	8	31

Reconciliation of the individual allowance for impairment for prior year

Dollars in millions	Year ended 30/06/18			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Individual allowance for impairment losses				
Balance at beginning of the year	-	3	3	6
Impairment losses on loans not at fair value through profit or loss	6	1	1	8
Amounts written off	(5)	-	-	(5)
Reversals of previously recognised impaired assets	-	(2)	(2)	(4)
Balance at end of the year	1	2	2	5

Asset quality of loans and advances

There were no real estate or other assets acquired through the enforcement of security/collateral held at 30 June 2019 (30 June 2018: nil). There were no assets under administration as at 30 June 2019 (30 June 2018: nil).

There were no unrecognised impaired assets as at 30 June 2019 (30 June 2018: nil). The aggregate amount of undrawn limits on lending commitments to counterparties for whom drawn balances were classified as individually impaired was \$0.4m at 30 June 2019 (30 June 2018: \$1.0m).

Notes to the financial statements

Continued...

10. Asset quality continued

Credit quality of financial assets neither past due nor impaired

A large portion of the credit exposures, such as residential mortgages, are secured. That is, the fair value of associated security is sufficient to ensure that the Banking Group will recover the entire amount owing over the life of the facility and there is reasonable assurance that collection efforts will result in payment of the amounts due in a timely manner.

The credit quality of loans and advances to customers that were neither past due nor impaired can be assessed by reference to the Bank's credit scoring systems. At the origination of loans and advances to customers, retail advances are assessed on a combination of debt servicing ability, demographic characteristics and loan-to-valuation ("LVR") ratios. Non-retail advances are individually risk-graded against similar characteristics. The behavioural credit characteristics are reviewed periodically for adverse changes during the loan's life. Interest continues to be accrued on all loans. No interest has been foregone.

Credit quality of other financial assets

In addition to assessing impairment for loans and advances, the Banking Group has assessed impairment for cash and cash equivalents, due from other financial institutions, due from related parties, investment securities and other financial assets. All of these financial assets are considered of high credit quality and are neither past due nor impaired. The identified impairment loss for all other financial assets, excluding loans and advances, was immaterial.

Definitions

"Impaired asset" means any credit exposures which have defaulted or against which an individually assessed provision has been recorded in accordance with NZ IFRS 9 – *Financial instruments*. (2018: "Impaired asset" means any credit exposures against which an individually assessed provision has been recorded in accordance with NZ IAS 39 – *Financial Instruments: Recognition and Measurement*).

A "90 day past due asset" is any loan which has not been operated by the borrower within its key terms for at least 90 days and which is not an impaired asset.

An "asset under administration" is any credit exposure which is not an impaired asset or a past due asset, but which is to a counterparty who is in receivership, liquidation, bankruptcy, statutory management or any form of administration. These are classified as "other assets under administration" and reported separately.

Notes to the financial statements

Continued...

11. Concentration of credit risk

Concentrations of credit risk arise where the Banking Group is exposed to risk in activities or industries of a similar nature. An analysis of financial assets by industry sector at reporting date is as follows:

Dollars in millions	30/06/19	30/06/18
New Zealand		
Government, local authorities and services	829	814
Finance, investment and insurance	523	659
Households	18,521	16,614
Transport and storage	43	195
Professional, scientific and technical services	55	52
Electricity, gas and water	5	4
Construction	254	201
Property and business services	1,070	855
Agriculture	28	18
Health and community services	90	83
Personal and other services	98	101
Retail and wholesale trade	151	154
Food and other manufacturing	127	120
Overseas		
Finance, investment and insurance	800	700
	22,594	20,570
Less provision for credit impairment	(40)	(36)
Other financial assets	25	27
Total financial assets	22,579	20,561

Australian and New Zealand Standard Industrial Classification ("ANZSIC") codes have been used as the basis for disclosing customer industry sectors in the above table.

Notes to the financial statements

Continued...

11. Concentration of credit risk continued

Maximum exposure to credit risk and collateral held

Dollars in millions	30/06/19			30/06/18		
	Maximum exposure	Collateral	Net exposure	Maximum exposure	Collateral	Net exposure
Credit risk relating to balance sheet assets						
Fixed rate lending	16,804	(16,802)	2	14,348	(14,344)	4
Variable rate lending	3,268	(3,267)	1	3,592	(3,591)	1
Unsecured lending	411	-	411	400	-	400
Due from other financial institutions	71	-	71	132	-	132
Balances with related parties	85	-	85	87	-	87
Derivative financial instruments	358	(69)	289	344	(91)	253
Investment securities	1,176	-	1,176	1,220	-	1,220
Cash and cash equivalents	421	-	421	447	-	447
Other financial assets	25	-	25	27	-	27
	22,619	(20,138)	2,481	20,597	(18,026)	2,571
Less provision for credit impairment	(40)	-	(40)	(36)	-	(36)
Total financial assets	22,579	(20,138)	2,441	20,561	(18,026)	2,535

The table above represents the maximum net credit risk exposure of the Banking Group at 30 June 2019. The exposures set out are based on net carrying amounts as reported in the balance sheet.

The exposure of the Banking Group derived from loans and advances to retail and corporate customers is 91% of the total maximum exposure at 30 June 2019 (2018: 89%).

The table above provides a quantification of the value of the financial charges the Banking Group holds over a borrower's specific asset (or assets) where the Banking Group is able to enforce the collateral in satisfying the debt in the event of the borrower failing to meet its contractual obligations. For the purposes of this disclosure, where collateral held is valued at more than the corresponding credit exposure, coverage is capped at the value of the credit exposure less amounts for which an individually assessed provision for credit impairment has been recognised. The most common type of collateral is over real estate including residential, commercial, industrial and rural property.

The Banking Group is potentially exposed to credit risk for undrawn loan commitments (note 37) for an amount equal to the undrawn balance.

Notes to the financial statements

Continued...

12. Cash and cash equivalents



Accounting policy

Cash and cash equivalents is considered to include notes and coins on hand, current accounts in banks, ATMs, overnight bank deposits, net of bank overdrafts and inter-bank balances arising from the daily RBNZ settlement process, with original maturities of three months or less from the date of acquisition that are subject to an insignificant risk of changes in their fair value, and are used by the Banking Group in the management of its short-term commitments.

Cash and cash equivalents are measured at amortised cost on the balance sheet.

Dollars in millions	30/06/19	30/06/18
Cash in hand	38	34
Cash with central bank	311	340
Call and overnight advances to financial institutions	72	73
Total cash and cash equivalents – current	421	447

13. Due from other financial institutions



Accounting policy

Policy applicable after 1 July 2018

Balances due from other financial institutions are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method. Interest, ECL and reversals and foreign exchange gains and losses are recognised in the income statement.

Policy applicable before 1 July 2018

Balances due from other financial institutions were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. They were subsequently measured at amortised cost using the effective interest method. If the initial duration was less than 12 months, they were recognised at cost less impairment. Allowances for estimated irrecoverable amounts were recognised when there was objective evidence that the asset was impaired. Interest, impairment losses and foreign exchange gains and losses were recognised in the income statement.

Reverse repurchase agreements

The Banking Group purchases (a reverse repurchase agreement) or borrows collateral in the form of securities and provides cash in exchange. The Banking Group may sell or re-pledge any collateral received, but has an obligation to return the collateral at the maturity of the contract and the counterparty retains substantially all the risks and rewards of ownership. Consequently the collateral is not recognised by the Banking Group, which instead records a receivable for the cash provided. The difference between the purchase and sale price of the collateral represents interest income and is recognised in the income statement over the term of the reverse repurchase agreement.

Dollars in millions	30/06/19	30/06/18
Short term advances due from other financial institutions	-	80
Collateralised loans	71	52
Total amounts due from other financial institutions – current	71	132

Included within the above balance, is \$70.6m of collateral pledged by Kiwibank in respect of its credit support annex obligations to derivative counterparties (2018: \$52.0m).

Notes to the financial statements

Continued...

14. Investment securities



Accounting policy

Policy applicable after 1 July 2018

Investment securities are debt securities measured at fair value through other comprehensive income (“FVOCI”). Gains and losses are recognised in other comprehensive income, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost: any interest calculated using the effective interest method; ECL and reversals; and foreign exchange gains and losses. On derecognition, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to the income statement; see net gains on financial instruments at fair value (note 4).

The accounting policy for the calculation of ECL is outlined in credit impairment losses (note 9).

Policy applicable before 1 July 2018

Available-for-sale financial assets were non-derivative financial assets that were either designated in this category or not classified in any of the other categories. Investment securities were designated as available-for-sale financial assets. Available-for-sale financial assets were held at fair value and gains and losses resulting from changes in their fair value were recognised directly in equity except for impairment losses, any interest calculated using the effective interest method and, in the case of monetary items (such as debt securities), foreign exchange gains and losses, which were all recognised in the income statement. For non-monetary available-for-sale financial assets (e.g. equity instruments), the fair value movements recognised in equity included any related foreign exchange component. On derecognition the cumulative fair value gain or loss previously recognised directly in equity was taken to the income statement in net gains/(losses) on financial instruments at fair value (note 4).

Impairment

The Banking Group assessed at each reporting date whether there was objective evidence that an available-for-sale asset was impaired. An available-for-sale asset was impaired and impairment losses were recognised if, and only if, there was objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a “loss event”) and that loss event (or events) had an impact on the estimated future cash flows of the available-for-sale asset that could be reliably estimated.

When a decline in fair value had been recognised directly in equity and there was objective evidence that the available-for-sale asset was impaired, the cumulative loss that had been recognised directly in equity was removed from equity and recognised in the income statement. If, in a subsequent period, the fair value increased and the increase could be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss was reversed through the income statement.

Dollars in millions	30/06/19	30/06/18
Government stock and multilateral development banks	869	679
Treasury bills	-	57
Local authority securities	-	7
Other debt securities	307	477
Total investment securities – current	1,176	1,220

Notes to the financial statements

Continued...

15. Derivative financial instruments and hedging activities



Accounting policy

The Banking Group uses derivatives as part of its asset and liability management activities to manage exposures to interest rate and foreign currency, including exposures arising from forecast transactions. These derivatives include swaps, futures, forwards, options and other contingent or exchange-traded contracts in the interest rate and foreign exchange markets.

Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are presented as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the resulting fair value gain or loss depends on the nature of the item being hedged. The Banking Group designates certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities or firm commitments (a “**fair value hedge**”); or, (2) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (a “**cash flow hedge**”). Hedge accounting is used for derivatives designated in this way, provided that certain criteria are met.

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

As permitted by NZ IFRS 9, the Banking Group has elected to continue to apply the hedge accounting requirements of NZ IAS 39. As permitted by NZ IFRS 7, comparative information prior to the date of initial application of NZ IFRS 9 has not been restated.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Derivatives held for trading

Certain derivative instruments do not qualify for hedge accounting. These include derivatives transacted as part of the trading activity of the Banking Group, as well as derivatives transacted as economic hedges but not qualifying for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement.

Notes to the financial statements

Continued...

15. Derivative financial instruments and hedging activities continued

The Banking Group uses the following derivative instruments for both hedging and non-hedging purposes:

- Currency forwards represent commitments to purchase domestic and foreign currency, including undelivered spot transactions.
- Foreign currency and interest rate futures are contractual obligations to receive or pay a net amount based on changes in currency rates or interest rates, or to buy or sell foreign currency or a financial instrument on a future date at a specified price, established in an organised financial market. The credit risk is negligible, as futures contracts are collateralised by cash or marketable securities, and changes in the futures' contract value are settled daily with the exchange.
- Forward rate agreements are individually negotiated interest rate futures that call for a cash settlement at a future date for the difference between a contracted rate of interest and the current market rate, based on a notional principal amount.
- Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates (e.g. fixed rate for floating rate) or a combination of all these (i.e. cross-currency interest rate swaps). No exchange of principal takes place, except for certain currency swaps. The Banking Group's credit risk represents the potential cost to replace the swap contracts if counterparties fail to fulfil their obligation. This risk is monitored on an ongoing basis with reference to the current fair value. To control the level of credit risk taken, the Banking Group assesses counterparties using the same techniques as for its lending activities.
- Foreign currency and interest rate options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of a foreign currency or a financial instrument at a predetermined price. The seller receives a premium from the purchaser in consideration for the assumption of foreign exchange or interest rate risk. Options may be either exchange-traded or negotiated between the Banking Group and a customer over the counter. The Banking Group is exposed to credit risk on purchased options only and only to the extent of their carrying amount, which is their fair value.
- The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Banking Group's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand and the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time. The fair value of derivative instruments is set out on the following page.

Notes to the financial statements

Continued...

15. Derivative financial instruments and hedging activities continued

Dollars in millions	30/06/19			30/06/18		
	Notional Principal Amount	Fair values		Notional Principal Amount	Fair values	
		Assets	Liabilities		Assets	Liabilities
Derivatives held for trading						
Foreign exchange derivatives	641	4	(5)	846	25	(6)
Interest rate derivatives	16,791	252	(257)	17,421	219	(229)
Total derivatives held for trading	17,432	256	(262)	18,267	244	(235)
Derivatives held for hedging						
Designated as cash flow hedges						
Interest rate derivatives	11,941	36	(75)	10,048	23	(42)
Exchange rate derivatives	815	63	(6)	1,086	71	(14)
Total derivatives designated as cash flow hedges	12,756	99	(81)	11,134	94	(56)
Designated as fair value hedges						
Interest rate derivatives	150	3	-	830	6	(2)
Total derivatives designated as fair value hedges	150	3	-	830	6	(2)
Total derivatives held for hedging	12,906	102	(81)	11,964	100	(58)
Total derivative financial instruments	30,338	358	(343)	30,231	344	(293)
Current		58	(73)		89	(59)
Non-current		300	(270)		255	(234)

Derivatives held for hedging

INTEREST RATE DERIVATIVES

The Banking Group's approach to managing market risk, including interest rate risk, is discussed in note 33. The Banking Group hedges benchmark interest rate risk. Hedge accounting is applied where economic hedge relationships meet the hedge accounting criteria.

Before hedge accounting is applied by the Banking Group, the Banking Group determines whether an economic relationship between the hedged item and the hedging instrument exists based on an evaluation of the qualitative characteristics of these items and the hedged risk that is supported by quantitative analysis. The Banking Group considers whether the critical terms of the hedged item and hedging instrument closely align when assessing the presence of an economic relationship. The Banking Group evaluates whether the fair value of the hedged item and the hedging instrument respond similarly to similar risks.

The Banking Group establishes a hedge ratio by aligning the par amount of the exposure to be hedged and the notional amount of the interest rate swap designated as a hedging instrument. The hedge relationship is reviewed on a monthly basis and the hedging instruments and hedged items are de-designated and re-designated, if necessary, based on the effectiveness test results and changes in the hedged exposure.

Hedge accounting strategies:

- Micro fair value hedge accounting is applied to receive fixed interest rate swaps designated as hedges of interest rate risk arising from fixed-rate subordinated debt issuances and medium-term notes.
- Micro fair value hedge accounting is applied to pay fixed interest rate swaps designated as hedges of interest rate risk arising from fixed-rate investment securities.
- In fair value hedging, the designated hedging relationships result in fair value gains and losses on the hedged item and derivative being recorded through the income statement as incurred. When a fair value hedging relationship is de-designated, the fair value adjustments to the balance sheet carrying value are amortised to the income statement over the remaining period to the maturity date of the de-designated hedge.

Notes to the financial statements

Continued...

15. Derivative financial instruments and hedging activities continued

- Portfolio (macro) cash flow hedge accounting is applied to interest rate swaps designated as hedges of the Banking Group's portfolios of floating-rate customer loans and deposits. The effective portion of the fair value gains and losses on the hedging instrument is initially recognised directly in other comprehensive income ("OCI") within equity (cash flow hedge reserve). The ineffective portion of the gain or loss on the hedging instrument is recognised immediately in 'net gains in financial instrument at fair value' in the income statement.
- When a cash flow hedging instrument expires, is sold, terminated, or when a hedge no longer meets the criteria for cash flow hedge accounting, any cumulative gain or loss that has been recognised in OCI at that time remains in OCI and is recognised when the hedged forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in OCI is immediately transferred to the income statement.

For all hedge strategies, ineffectiveness arises from the following sources:

- differences in timing of cash flows of hedged items and hedging instruments;
- different interest rate curves applied to discount the hedged items and hedging instruments; and
- the effect of changes in counterparties' credit risk on the fair values of hedging instruments.

INTEREST AND FOREIGN EXCHANGE DERIVATIVES

The Banking Group's approach to managing market risk, including interest rate and foreign exchange risk, is discussed in Note 33.

The interest and foreign currency risk arising from the Bank's foreign currency debt issues is hedged using cross-currency swaps. The foreign currency legs of the cross-currency swaps match the critical terms of the hedged debt issues, creating economic hedge relationships that meet hedge accounting criteria.

These are designated as either cash flow or both fair value and cash flow hedges (split designation) to manage the different components of foreign currency and interest rate risk:

- fair value hedge relationship where cross-currency swaps are used to manage the interest rate and foreign currency risk in relation to foreign-currency-denominated borrowing with fixed interest rates.
- cash flow hedge relationship where cross-currency swaps are used to manage the variability in cash flows arising from interest rate movements on floating interest rate payments and foreign exchange movements on payment of principal and interest.

Ineffectiveness arises from the following sources:

- differences in timing of cash flows of hedged items and hedging instruments;
- different interest rate curves applied to discount the hedged items and hedging instruments; and
- the effect of changes in counterparties' credit risk on the fair values of hedging instruments.

Similar to the hedge relationships under interest rate risk, the ineffective portion of the gain or loss on the hedging instrument is recognised immediately in 'net gains in financial instruments at fair value' in the income statement.

Notes to the financial statements

Continued...

15. Derivative financial instruments and hedging activities continued

The following table shows the maturity and interest rate risk profiles of the interest rate swaps as hedging instruments in continuing fair value and cash flow hedge relationships.

Dollars in millions	30/06/19				Total
	Up to 3 months	3 to 12 months	Between 1 and 5 years	More than 5 years	
Interest rate risk					
Cash flow hedge relationships					
<i>Pay fixed</i>					
Interest rate swaps					
Nominal amounts	1,376	3,098	4,833	-	9,307
Average interest rate	2.08%	2.29%	1.85%	-	
<i>Receive fixed</i>					
Interest rate swaps					
Nominal amounts	45	1,664	925	-	2,634
Average interest rate	2.32%	2.08%	2.28%	-	
Fair value hedge relationships					
<i>Pay fixed</i>					
Interest rate swaps					
Nominal amounts	-	50	-	-	50
Average interest rate	-	4.65%	-	-	
<i>Receive fixed</i>					
Interest rate swaps					
Nominal amounts	100	-	-	-	100
Average interest rate	4.50%	-	-	-	
Total interest rate risk nominal amounts	1,521	4,812	5,758	-	12,091
Interest rate and foreign exchange risk					
Cash flow hedge relationships					
Cross-currency swaps (HKD: NZD)					
Nominal amounts	-	-	104	-	104
Average HKD-NZD exchange rate	-	-	5.49	-	
Average interest rate	-	-	float	-	
Cross-currency swaps (USD: NZD)					
Nominal amounts	-	22	-	-	22
Average USD-NZD exchange rate	-	0.79	-	-	
Average interest rate	-	float	-	-	
Fair value and cash flow hedge relationships					
Cross-currency swaps (CHF: NZD)					
Nominal amounts	-	-	459	-	459
Average CHF-NZD exchange rate	-	-	0.74	-	
Average interest rate	-	-	0.64%	-	
Cross-currency swaps (AUD: NZD)					
Nominal amounts	-	-	73	157	230
Average AUD-NZD exchange rate	-	-	0.85	0.89	
Average interest rate	-	-	4.35%	4.25%	
Total interest rate and foreign exchange risk nominal amounts	-	22	636	157	815
Total nominal amounts	1,521	4,834	6,394	157	12,906

Notes to the financial statements

Continued...

15. Derivative financial instruments and hedging activities continued

The following table sets out the accumulated fair value adjustments arising from the corresponding continuing fair value hedge relationships and the outcome of the changes in fair value of the hedge item as well as the hedging instruments used as the basis for recognising ineffectiveness.

Dollars in millions	30/06/19		Year ended 30/06/19
	Carrying value	Accumulated amount of fair value hedge adjustments	Gains/(losses) on fair value attributable to hedged risk used for recognising hedge ineffectiveness
Interest rate risk			
Debt securities issued	(151)	(1)	2
Interest rate swaps	3	1	(2)
Interest rate risk and foreign currency risk			
Debt securities issued	(1,005)	(33)	(20)
Cross-currency swaps	57	32	20
Total ineffectiveness of financial instruments in fair value hedge relationship			-

The gain/(loss) on fair value hedges attributable to the hedged risk and ineffectiveness for the prior year are as follows:

Dollars in millions	Year ended 30/06/18
Gain/(loss) arising from fair value hedges:	
Hedged item	5
Hedging instrument	(4)
Net ineffectiveness on qualifying fair value hedges	1

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for any hedged items that have ceased to be adjusted for hedging gains and losses is nil.

Notes to the financial statements

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15. Derivative financial instruments and hedging activities continued

The table below sets out the notional and carrying amounts of the derivatives the Banking Group uses as hedging instruments in continuing cash flow hedge relationships and the changes in fair values used for measuring hedge ineffectiveness, showing separately the effective and ineffective portions:

Dollars in millions	Interest rate risk		Interest and foreign currency risk	Total
	Interest rate swaps		Cross-currency swaps	
As at 30/06/19				
Notional amount		11,941	815	12,756
Carrying amount:				
Assets		36	63	99
Liabilities		(75)	(6)	(81)
Changes in fair value of hedging instruments used for measuring hedge ineffectiveness:				
Hedged item		39	(26)	13
Hedging instrument		(39)	26	(13)
Year ended 30/06/19	Recognised in / reclassified to:			
Effective portion	OCI ¹	(16)	(1)	(17)
Hedge ineffectiveness	Net gains on FI at FV ²	-	-	-
Reclassified into income statement as:	Interest (expense)/income	(4)	14	10
	Net gains on FI at FV ²	-	(20)	(20)

¹Other comprehensive income

²Net gains on financial instruments at fair value

Notes to the financial statements

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16. Due to other financial institutions



Accounting policy

Amounts due to other financial institutions are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses are recognised in the income statement, as is any gain or loss when the liability is derecognised.

Repurchase agreements

Under repurchase agreements, collateral in the form of securities is advanced to a third party and the Banking Group receives cash in exchange. The counterparty is allowed to sell or re-pledge the collateral advanced under repurchase agreements in the absence of default by the Banking Group, but they have an obligation to return the collateral at the maturity of the contract. The Banking Group has determined that it retains substantially all the risks and rewards of the securities advanced and therefore they are not derecognised and are retained within the relevant security portfolio and accounted for accordingly. Liability accounts are used to record the obligation to repurchase. The difference between the sale and repurchase price represents interest expense and is recognised in the income statement over the term of the repurchase agreement.

Dollars in millions	30/06/19	30/06/18
Cash collateral received	69	91
Transaction balances with other financial institutions	57	37
Total amounts due to other financial institutions – current	126	128

17. Deposits and other borrowings



Accounting policy

Deposits and other borrowings are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses are recognised in the income statement, as is any gain or loss when the liability is derecognised.

Notes to the financial statements

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17. Deposits and other borrowings continued

Dollars in millions	30/06/19	30/06/18
Demand deposits non-interest bearing	2,314	2,031
Demand deposits bearing interest	3,498	3,285
Term deposits	12,428	10,857
Total deposits from customers	18,240	16,173
Current	17,625	15,537
Non-current	615	636

In the event of the liquidation of Kiwibank, deposit holders will rank equally with all other creditors but ahead of subordinated debt holders and the shareholder. In addition, all payment obligations of Kiwibank covered by the NZP Guarantee that existed at the time the NZP Guarantee was terminated on 28 February 2017 are guaranteed under the NZP Guarantee but only in relation to and to the extent of those obligations.

The Kiwibank PIE Unit Trust (the “**Trust**”), established in May 2008, operates three funds: the PIE Term Deposit Fund, the Notice Saver and PIE Online Call Fund. Kiwibank Investment Management Limited is the issuer and manager (the “**Manager**”), Trustees Executors Limited is the Supervisor and Kiwibank is the promoter of the Trust. Units in the Trust do not directly represent deposits or liabilities of Kiwibank; however, the Trust is invested exclusively in term and call deposits with Kiwibank. At 30 June 2019, \$4,438m of the Trust’s funds were invested in Kiwibank products or securities (30 June 2018: \$3,856m).

Kiwibank guarantees the payment obligations of the manager and any amounts owing to Unit holders under the Trust Deed in respect of their units. Kiwibank agrees to pay to Unitholders any shortfall between the amount they may receive on redeeming their units or in the winding up of the Trust and the balance of their unit accounts.

18. Debt securities issued



Accounting policy

Debt securities issued, with the exception of Commercial paper, are measured at amortised cost. Commercial paper is measured at fair value through profit or loss. Debt securities measured at amortised cost are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses are recognised in the income statement, as is any gain or loss when the liability is derecognised.

Commercial paper is designated as a financial liability as at fair value through profit or loss (“**FVTPL**”), and consists of European Commercial Paper (“**ECP**”). ECP is measured at fair value with any realised and unrealised gains or losses recognised in the income statement. ECP issued has been designated at fair value through profit or loss as the Banking Group holds related derivatives at fair value through profit or loss, and the designation therefore eliminates or significantly reduces an accounting mismatch that would otherwise arise.

The amount of change in the fair value of the liability that is attributable to changes in its credit risk would be presented in other comprehensive income (“**OCI**”) as a liability credit reserve. Amounts presented in the liability credit reserve are not subsequently transferred to profit or loss. When these instruments are derecognised, the related cumulative amount in the liability credit reserve is transferred to retained earnings.

Notes to the financial statements

Continued...

18. Debt securities issued continued

Dollars in millions	30/06/19	30/06/18
Short-term debt		
Commercial paper at fair value through profit or loss	-	298
Certificates of deposit	495	56
Long-term debt		
Medium-term notes	1,319	1,673
Covered bonds	230	223
Fair value hedge adjustment	34	15
Total debt securities issued	2,078	2,265
Current	878	898
Non-current	1,200	1,367

In the event of the liquidation of Kiwibank, holders of these debt securities, with the exception of covered bonds, will rank equally with all other creditors but ahead of subordinated debt holders and the shareholder. In addition, all payment obligations of Kiwibank that existed at the time the NZP Guarantee was terminated on 28 February 2017, excluding any payment obligations, the terms of which expressly provide that they do not have the benefit of the guarantee, are guaranteed under the NZP Guarantee but only in relation to and to the extent of those obligations.

The guarantee arrangements and other details relating to covered bonds are disclosed in note 24.

Kiwibank has not had any defaults of principal, interest or other breaches with respect to debt securities issued during the year (year ended 30 June 2018: nil).

Notes to the financial statements

Continued...

19. Subordinated debt



Accounting policy

Subordinated debt issues are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses are recognised in the income statement, as is any gain or loss when the liability is derecognised.

Dollars in millions	30/06/19	30/06/18
Kiwibank bonds	104	105
Perpetual capital bonds	149	149
Total subordinated debt	253	254
Current	104	3
Non-current	149	251

The Banking Group has not issued any subordinated debt during the year ended 30 June 2019 (year ended 30 June 2018: nil). The Banking Group has not repaid any subordinated debt during the year ended 30 June 2019 (year ended 30 June 2018: the Banking Group fully repaid \$150m of subordinated debt on 15 December 2017).

The Banking Group has not had any defaults of principal, interest or other breaches with respect to these liabilities during the year (year ended 30 June 2018: nil).

As at 30 June 2019, \$100m (30 June 2018: \$100m) of subordinated debt qualified as Tier 2 capital for Capital Adequacy calculation purposes. As at 30 June 2019, \$149m (30 June 2018: \$149m) of subordinated debt qualified as Additional Tier 1 capital for Capital Adequacy calculation purposes. The contractual terms of subordinated debt instruments on issue expressly provide that they do not have the benefit of a deed poll guarantee (the "NZIP Guarantee") provided by NZP. The NZP Guarantee was terminated with an effective date of 28 February 2017.

The subordinated debt instruments on issue are subordinate to all other general liabilities of the Banking Group and are denominated in New Zealand dollars.

The terms and conditions of the subordinated debt instruments on issue are as follows:

Instrument	Issue date	Amount (\$m)	Coupon rate	Call date	Maturity date
Kiwibank bonds	6 June 2014	100	6.61% p.a. ¹	15 July 2019	15 July 2024
Perpetual capital bonds	27 May 2015	150	7.25% p.a. ²	27 May 2020	None

On 15 July 2019, Kiwibank fully repaid \$100m of Kiwibank bonds at the first call date.

The perpetual capital bonds have no maturity date; however, Kiwibank may elect to make an early repayment on 27 May 2020 after obtaining the consent of the RBNZ. The classification of perpetual capital bonds as non-current is based on the contractual maturity date of the instruments because the Banking Group is not contractually obliged to make any early repayment and early repayment is subject to the RBNZ's consent being obtained prior to repayment.

¹ Fixed interest rate which will be reset on 15 July 2019

² Fixed interest rate which will be reset on 27 May 2020 and at five-yearly intervals thereafter

Notes to the financial statements

Continued...

20. Financial instruments



Accounting policy

The Banking Group measures certain financial instruments at fair value at each reporting date. In addition, the fair values of certain financial instruments which are measured at amortised cost are disclosed.

Fair value is the price that would be received to sell an asset or be paid to transfer a liability in an orderly transaction between market participants at the reporting date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability; or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

The Banking Group must have access to the principal or the most advantageous market.

The fair value of an asset or liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their own economic best interest.

The Banking Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy based on the lowest level input that is significant to the fair value measurement as a whole.

For assets and liabilities that are recognised in the financial statements at fair value on a recurring basis, the Banking Group determines whether any transfers between levels in the hierarchy have occurred by reassessing categorisation at the end of each reporting period.



Critical accounting estimates and judgements

The fair value of financial instruments that are not quoted in an active market is determined by using valuation techniques. Management use a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Where unobservable market data is used, more judgement is required to determine fair value. The valuation methodologies are described further below within this note.

The term “financial instruments” includes both financial assets and financial liabilities. The fair value of a financial instrument is the price that would be received to sell an asset or be paid to transfer a liability in an orderly transaction between market participants, at the reporting date, in the principal, or in its absence, the most advantageous market to which the Banking Group has access (at that date).

a. Measurement basis of financial assets and liabilities

The accounting policies describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following tables analyse the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

Notes to the financial statements

Continued...

20. Financial instruments continued

Dollars in millions	30/06/19					Total
	Amortised cost	FVOCI	Mandatorily at FVTPL	Designated at FVTPL	Derivatives used for hedging at FVTPL	
Cash and cash equivalents	421	-	-	-	-	421
Due from other financial institutions	71	-	-	-	-	71
Investment securities	-	1,176	-	-	-	1,176
Loans and advances	20,443	-	-	-	-	20,443
Derivative financial instruments	-	-	256	-	102	358
Due from related parties	85	-	-	-	-	85
Other financial assets	25	-	-	-	-	25
Total financial assets	21,045	1,176	256	-	102	22,579

Dollars in millions	30/06/19					Total
	Amortised cost	Mandatorily at FVTPL	Designated at FVTPL	Derivatives used for hedging at FVTPL		
Due to other financial institutions	126	-	-	-	126	
Deposits and other borrowings	18,240	-	-	-	18,240	
Derivative financial instruments	-	262	-	81	343	
Debt securities issued	2,078	-	-	-	2,078	
Subordinated debt	253	-	-	-	253	
Due to related parties	9	-	-	-	9	
Other financial liabilities	63	-	-	-	63	
Total financial liabilities	20,769	262	-	81	21,112	

Notes to the financial statements

Continued...

20. Financial instruments continued

Dollars in millions	30/06/18					Total
	Loans and receivables	Available-for-sale	Assets at fair value through profit or loss		Derivatives used for hedging	
			Held for trading	Designated at FVTPL		
Cash and cash equivalents	447	-	-	-	-	447
Due from other financial institutions	132	-	-	-	-	132
Investment securities	-	1,220	-	-	-	1,220
Loans and advances	18,304	-	-	-	-	18,304
Derivative financial instruments	-	-	244	-	100	344
Due from related parties	87	-	-	-	-	87
Other financial assets	27	-	-	-	-	27
Total financial assets	18,997	1,220	244	-	100	20,561

Dollars in millions	30/06/18				Total
	Amortised cost	Liabilities at fair value through profit or loss		Derivatives used for hedging	
		Held for trading	Designated at FVTPL		
Due to other financial institutions	128	-	-	-	128
Deposits and other borrowings	16,173	-	-	-	16,173
Derivative financial instruments	-	235	-	58	293
Debt securities issued	1,967	-	298	-	2,265
Subordinated debt	254	-	-	-	254
Due to related parties	8	-	-	-	8
Other financial liabilities	69	-	-	-	69
Total financial liabilities	18,599	235	298	58	19,190

Notes to the financial statements

Continued...

20. Financial instruments continued

b. Fair values of financial assets and liabilities

The following tables summarise the carrying values of financial assets and liabilities presented on the Banking Group's balance sheet. The fair values presented in the tables are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

Dollars in millions	30/06/19		30/06/18	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets				
Investment securities	1,176	1,176	1,220	1,220
Loans and advances	20,443	20,481	18,304	18,371
Derivative financial instruments	358	358	344	344
Due from related parties	85	85	87	87
Financial liabilities				
Deposits and other borrowings	18,240	18,264	16,173	16,185
Derivative financial instruments	343	343	293	293
Debt securities issued	2,078	2,090	2,265	2,278
Subordinated debt	253	260	254	265
Due to related parties	9	9	8	8

The carrying values of the following financial instruments are a reasonable approximation of fair value because, for example, they are short term in nature or reprice to current market rates frequently: cash and cash equivalents, due from other financial institutions, other financial assets, due to other financial institutions and other financial liabilities.

c. Fair value measurement

Assets and liabilities carried at fair value or for which fair values are disclosed have been classified into three levels according to the quality and reliability of information used to determine the fair values. The three levels of the fair value hierarchy are defined as follows:

Level 1 – Fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Fair value measurements are those where quoted market prices are not available, e.g. where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3 – Fair value measurements where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data

Unless otherwise noted, the following disclosures are provided separately for assets and liabilities at fair value and those carried at amortised cost.

There have been no transfers between levels 1 and 2 during the year (year ended 30 June 2018: no transfers). There were also no transfers into/out of level 3 during the year (year ended 30 June 2018: no transfers).

Notes to the financial statements

Continued...

20. Financial instruments continued

d. Financial assets and liabilities carried at fair value

Valuation methodology

The fair values of assets and liabilities carried at fair value were determined by application of the following methods and assumptions.

Investment securities

Estimates of fair value for investment securities are based on quoted market prices or determined using market-accepted valuation models as appropriate (including discounted cash flow models) with inputs including an interest rate yield curve developed from quoted rates and market-observable credit spreads.

Debt securities issued

Debt securities issued that are classified at fair value through profit or loss are short term in nature. For these liabilities, fair value has been determined using a discounted cash flow model with inputs including an interest rate yield curve developed from quoted rates and market-observable credit spreads.

Derivative financial instruments

Where the Banking Group's derivative financial assets and liabilities are not traded on an exchange, they are valued using valuation techniques, including discounted cash flow and option pricing models, as appropriate. The types of derivatives classified as level 2 and the valuation techniques used include:

- interest rate swaps which are valued using discounted cash flow models; the most significant inputs into those models are interest rate yield curves which are developed from quoted rates; and
- foreign exchange derivatives that do not contain options which are priced using rates available from publicly quoted sources.

Dollars in millions	30/06/19				30/06/18			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets at fair value								
Derivative financial assets	-	358	-	358	-	344	-	344
Investment securities	475	701	-	1,176	411	809	-	1,220
Financial liabilities at fair value								
Derivative financial liabilities	-	343	-	343	-	293	-	293
Debt securities issued	-	-	-	-	-	298	-	298

e. Financial assets and liabilities carried at amortised cost

Valuation methodology

The fair values of assets and liabilities carried at amortised cost were determined by application of the following methods and assumptions.

Loans and advances

The Banking Group provides loans and advances to corporate and retail customers at both fixed and variable rates. The carrying value of the variable rate loans and advances is assumed to be their fair value. For fixed-rate lending, several techniques are used to estimate fair value taking into account expected credit losses, prevailing market interest rates and expected future cash flows. For retail exposures, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Banking Group and other financial institutions.

Notes to the financial statements

Continued...

20. Financial instruments continued

Certain loans secured on residential properties are made at a fixed rate for a limited period, typically six months to five years, after which loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period.

The fair value of corporate and retail loans are estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk.

Impaired and past due loans and advances

For impaired loans as well as past due loans, fair value is estimated by discounting the expected future cash flows using current market interest rates incorporating an appropriate risk factor or, where such loans are collateralised and have been written down to the current market value of the collateral, the estimated fair value is based on the written-down carrying value.

Deposits by customers

For fixed-term deposits by customers, fair values have been estimated using a discounted cash flow model with reference to market interest rates. For other deposits by customers, the carrying amount is a reasonable estimate of fair value.

Debt securities issued and subordinated debt

The fair values of these instruments are calculated based on quoted market prices, where available. For those instruments where quoted market prices are not available, a discounted cash flow model is used based on inputs including an interest rate yield curve developed from quoted rates and market-observable credit spreads.

Dollars in millions	30/06/19				30/06/18			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets at amortised cost								
Loans and advances	-	-	20,481	20,481	-	-	18,371	18,371
Due from related parties	-	-	85	85	-	-	87	87
Financial liabilities at amortised cost								
Deposits and other borrowings	-	-	18,264	18,264	-	-	16,185	16,185
Debt securities issued	-	2,090	-	2,090	-	1,980	-	1,980
Subordinated debt	-	260	-	260	-	265	-	265
Due to related parties	-	-	9	9	-	-	8	8

21. Offsetting financial assets and liabilities



Accounting policy

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

The following tables set out the effect or potential effect of netting arrangements on the Banking Group's financial position. This includes the effect or potential effect of rights of set-off associated with the Banking Group's recognised financial assets and recognised financial liabilities that are subject to an enforceable master netting arrangement, irrespective of whether they are set off in accordance with the above accounting policy.

The following financial instruments are subject to offsetting, enforceable master netting arrangements.

Notes to the financial statements

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21. Offsetting financial assets and liabilities continued

		30/06/19					
Dollars in millions	Note	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the balance sheet	Net amounts of financial assets presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
					Financial instruments	Cash collateral received	
Derivative financial assets	15	358	-	358	(268)	(69)	21
Total		358	-	358	(268)	(69)	21

		30/06/19					
Dollars in millions	Note	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the balance sheet	Net amounts of financial liabilities presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
					Financial instruments	Cash collateral pledged	
Derivative financial liabilities	15	343	-	343	(268)	(71)	4
Total		343	-	343	(268)	(71)	4

		30/06/18					
Dollars in millions	Note	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the balance sheet	Net amounts of financial assets presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
					Financial instruments	Cash collateral received	
Derivative financial assets	15	344	-	344	(234)	(91)	19
Total		344	-	344	(234)	(91)	19

		30/06/18					
Dollars in millions	Note	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the balance sheet	Net amounts of financial liabilities presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
					Financial instruments	Cash collateral pledged	
Derivative financial liabilities	15	293	-	293	(234)	(52)	7
Total		293	-	293	(234)	(52)	7

The 'Financial instruments' column identifies financial assets and liabilities that are subject to set off under netting arrangements such as International Swaps and Derivatives Association ("ISDA") master agreements. The arrangement between the Banking Group and the counterparty allows for net settlement of the relevant financial assets or financial liabilities when both elect to settle on a net basis. In the absence of such an election, financial assets and financial liabilities will be settled on a gross basis. However, each party to the master agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

Notes to the financial statements

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22. Credit exposure concentration

CREDIT EXPOSURE TO INDIVIDUAL COUNTERPARTIES

Credit exposure concentrations are disclosed on the basis of actual exposures and gross of set-offs. Peak end-of-day aggregate credit exposures have been calculated using the Banking Group's Tier 1 capital at the end of the year.

There were no individual counterparties, excluding connected persons, bank counterparties and the central government of any country with a long-term credit rating of A- or A3 above, or its equivalent, where the year-end and peak end-of-day aggregate actual credit exposures, net of individual credit impairment allowances (which were nil), equalled or exceeded 10% of the Banking Group's shareholder's equity as at the reporting date.

As at 30 June 2019 and in the three months ended 30 June 2019, there have been no credit exposure concentrations with non-bank counterparties where actual credit exposures equalled or exceeded 10% of the Banking Group's shareholder's equity as at the reporting date (three months ended 30 June 2018: nil).

CREDIT EXPOSURES TO CONNECTED PERSONS

Credit exposure concentrations are disclosed on the basis of actual credit exposures and calculated on a gross basis (net of individual credit impairment allowance and excluding advances of a capital nature). The information on credit exposure to connected persons has been derived in accordance with the Banking Group's conditions of registration and the RBNZ's Connected Exposures Policy BS8.

The Banking Group does not have credit exposures to connected persons other than non-bank connected persons. Peak end-of-day credit exposures to non-bank connected persons have been calculated using the Banking Group's Tier 1 capital at the end of the year.

The rating-contingent limit, which is applicable to the Banking Group as at the reporting date, is 60%. There have been no rating-contingent limit changes during the last year. Within the rating-contingent limit there is a sub-limit of 15% of the Banking Group's Tier 1 capital, which applies to non-bank connected persons.

All limits on aggregate credit exposure to all connected persons and non-bank connected persons in the Banking Group's conditions of registration have been complied with at all times over the past year. The limit is 125% of the Banking Group's Tier 1 capital in respect of the gross amount of aggregate credit exposure to connected persons that can be netted off in determining the net exposure.

There are no individual impairment credit allowances against credit exposures to non-bank connected persons nor are there any contingent exposures arising from risk lay-off arrangements to connected persons as at 30 June 2019 (30 June 2018: nil).

	Year ended	Year ended
Dollars in millions	30/06/19	30/06/18
Credit exposures to non-bank connected persons at year-end	88	92
Credit exposures to non-bank connected persons at year-end as a percentage of Tier 1 capital	5.4%	5.9%
Peak credit exposures to non-bank connected persons during the year	88	92
Peak credit exposures to non-bank connected persons during the year as a percentage of Tier 1 capital	5.4%	5.9%

Notes to the financial statements

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23. Concentration of funding

Concentrations of funding arise where the Banking Group is funded by industries of a similar nature or in particular geographies. ANZSIC codes have been used as the basis for disclosing industry sectors. An analysis of financial liabilities by industry sector and geography at the reporting date is as follows:

Dollars in millions	30/06/19	30/06/18
New Zealand		
Transport and storage	149	108
Finance, investment and insurance	3,536	2,829
Electricity, gas and water	31	42
Food & other manufacturing	159	75
Construction	179	132
Communications	33	36
Government, local authorities and services	250	284
Agriculture	58	64
Health and community services	225	158
Personal and other services	321	291
Property and business services	453	369
Education	200	199
Retail and wholesale trade	98	68
Households	14,097	12,450
Overseas		
Finance, investment and insurance	949	1,729
Households	311	287
	21,049	19,121
Other financial liabilities	63	69
Total financial liabilities	21,112	19,190

Notes to the financial statements

Continued...

24. Transfer of financial assets

The following financial assets have been transferred but have not been derecognised.

Kiwibank RMBS Trust Series 2009-1 (the “RMBS Trust”)

In May 2008 the RBNZ expanded the range of acceptable collateral that the banks can pledge and borrow against as part of changes to its liquidity management programme, designed to ensure adequate liquidity for New Zealand financial institutions. The expanded collateral criteria includes the use of a pool of individual residentially secured mortgages (loans and advances) that are aggregated together to form a residential mortgage backed security (“RMBS”).

An RMBS can be transferred to a separate Trust allowing the Banking Group to enter into a repurchase agreement on these loans with the RBNZ. The Banking Group can borrow from the RBNZ using the RMBS as collateral until repurchased at a later date, in order to manage its liquidity requirements.

On 26 June 2009 the Banking Group established an in-house RMBS facility in order to issue securities that meet the RBNZ criteria. These assets and liabilities do not qualify for derecognition as the Banking Group retains a continuing involvement and retains substantially all the risks and rewards of ownership of the transferred assets (funding, liquidity and credit risk remains with the Banking Group).

The carrying value and fair value of the RMBS pool at 30 June 2019 is \$1,100m (30 June 2018: \$1,100m). These securities are ring fenced to ensure they are not used as collateral outside of agreements established with the RMBS Trust.

Kiwi Covered Bond Trust (the “Covered Bond Trust”)

On 23 January 2013, the Covered Bond Trust was established to hold Kiwibank housing loans and to provide guarantees to certain debt securities issued by the Banking Group. Guarantees provided by the Covered Bond Trust have a prior claim over the assets of the Covered Bond Trust. On 19 February 2013, selected Kiwibank housing loans were transferred to the Covered Bond Trust in order to establish and facilitate the Banking Group’s covered bond programme. These assets and liabilities do not qualify for derecognition as the Banking Group retains a continuing involvement and retains substantially all the risks and rewards of ownership of the transferred assets. The Covered Bond Trust is consolidated within the Banking Group.

Substantially all of the assets of the Covered Bond Trust comprise housing loans originated by Kiwibank and highly rated short-dated securities, together which are security for the guarantee of issuances of covered bonds by the Banking Group, provided by Kiwi Covered Bond Trustee Limited as Trustee of the Covered Bond Trust. The assets of the Covered Bond Trust are not available to creditors of Kiwibank, although the Banking Group (or its liquidator or statutory manager) may have a claim against the residual assets of the Covered Bond Trust (if any) after all prior ranking creditors of the Covered Bond Trust have been satisfied.

The carrying value and approximate fair value of the Covered Bond Trust pool at 30 June 2019 is \$316m (30 June 2018: \$316m). These securities are ring fenced to ensure they are not used as collateral outside of agreements established with the Covered Bond Trust.

The financial statements of the Banking Group do not change as a result of establishing the RMBS Trust and the Covered Bond Trust.

Repurchase agreements

The Banking Group enters into sale and repurchase agreements with the wider market in order to manage short term liquidity. Under the repurchase agreements, collateral in the form of securities is advanced to a third party and the Banking Group receives cash in exchange. The counterparty is allowed to sell or repledge the collateral advanced under repurchase agreements in the absence of default by the Banking Group, but has an obligation to return the collateral at the maturity of the contract. The Banking Group has determined that it retains substantially all the risks and rewards of these securities and therefore has not derecognised them (funding, liquidity and credit risk remains with the Banking Group). In addition, it recognises a financial liability for cash received which is included in due to other financial institutions.

As at 30 June 2019, the Banking Group has recognised liabilities for outstanding repurchase agreements of \$0.0m (30 June 2018: \$0.0m), which have settlement dates ranging up to seven days.

Transferred financial assets that are derecognised in their entirety but where the Banking Group has a continuing involvement

As at 30 June 2019, the Banking Group has not derecognised any financial assets where they have a continuing involvement (30 June 2018: nil).

Notes to the financial statements

Continued...

25. Intangible assets



Accounting policy

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring the assets to use. These costs are amortised on a straight line basis over the estimated useful lives of the licences (being 3 to 5 years). Developed software assets expected to generate net economic benefits beyond 12 months are recognised as intangible assets. The cost of developed software assets includes the cost of all materials used in construction, direct labour on the project, and an appropriate proportion of variable and fixed overheads.

Developed software intangible assets are amortised over their estimated useful lives (being 3 to 15 years).

Intangible assets that are not yet available for use are assessed for impairment on at least an annual basis and whenever events or changes in circumstances indicate that the carrying amount of intangible assets may exceed their recoverable amount. Any impairment loss is recognised in the income statement as an expense.



Critical accounting estimates and judgements

Software and other intangible assets, including intangible assets that are not yet available for use, are assessed for indicators of impairment on at least an annual basis and whenever events or changes in circumstances indicate that the carrying amount of intangible assets may exceed their recoverable amount. Where the asset's carrying amount is determined to be greater than the recoverable amount, the carrying amount is written down immediately and an impairment loss is recognised in the income statement as an expense. The expected useful life of intangible assets, including software assets, is reviewed on an annual basis.

The assessment of impairment and expected useful life requires judgement to be applied and consideration of a number of factors including but not limited to: changes in business strategy, technology, regulations, and customer preferences or requirements.

Dollars in millions	30/06/19			30/06/18		
	Internally developed			Internally developed		
	Computer software	Computer software work in progress	Total	Computer software	Computer software work in progress	Total
Cost at beginning of year	237	11	248	221	117	338
Accumulated amortisation at beginning of year	(170)	-	(170)	(151)	-	(151)
Accumulated impairment at beginning of year	-	-	-	-	(90)	(90)
Carrying value at beginning of year	67	11	78	70	27	97
Additions	5	16	21	-	19	19
Transfers from computer software work in progress	16	(16)	-	22	(22)	-
Amortisation	(25)	-	(25)	(25)	-	(25)
Other impairment	-	-	-	-	(11)	(11)
Impairment released on write off	-	-	-	-	101	101
Amortisation released on write off or disposal	2	-	2	6	-	6
Written off or disposed	(2)	-	(2)	(6)	(103)	(109)
Carrying value at end of year	63	11	74	67	11	78
Cost at end of year	256	11	267	237	11	248
Accumulated amortisation at end of year	(193)	-	(193)	(170)	-	(170)
Carrying value at end of year	63	11	74	67	11	78

Notes to the financial statements

Continued...

26. Other assets



Accounting policy

Trade and other receivables are initially measured at fair value and subsequently at amortised cost using the effective interest method (2018: designated as loans and receivables). Interest, ECL (2018: impairment losses) and reversals, and foreign exchange gains and losses are recognised in the income statement.

Prepayments include costs paid relating to subsequent financial years and are measured at cost.

Costs incurred to obtain or fulfil a contract with a customer are recognised as an asset when the costs relate directly to a specific contract, the costs improve or create resources to use in satisfying future performance obligations of the contract, and the costs are expected to be recovered in the future. The asset is amortised within operating expenses on a systematic basis consistent with the transfer to the customer of the services to which the asset relates. See note 5 for more detail on the accounting policies related to revenue earned from contracts with customers.

Dollars in millions	30/06/19	30/06/18
Prepayments	5	6
Trade and other receivables	25	29
Costs to fulfil	4	-
Total other assets - current	34	35

27. Other liabilities



Accounting policy

Other liabilities are initially measured at fair value and subsequently at amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses, are recognised in the income statement as is any gain or loss when the liability is derecognised.

Dollars in millions	30/06/19	30/06/18
Trade and other payables	31	40
Employee entitlements	22	24
Other liabilities	49	43
Total other liabilities - current	102	107

In the event of liquidation, the above creditors rank in priority to subordinated debt holders and the shareholder and will rank equally with deposit holders and other creditors.

Notes to the financial statements

Continued...

28. Equity



Accounting policy

Share capital

(i) Ordinary shares

Ordinary shares are recognised at the amount paid up per ordinary share, net of directly attributable issue costs.

(ii) Distributions

Dividends distributed in respect of shares are recognised as a liability in the financial statements in the reporting period in which the dividend distribution is approved.

Perpetual capital bonds

(i) Discretionary distributions

Discretionary distributions made in respect of perpetual capital bonds are recognised as deductions from equity when paid.

Other reserves

(i) Fair value reserve

The fair value reserve includes changes in the fair value of investment securities, net of tax. When the asset is derecognised these changes in fair value are transferred to the income statement. If an investment security asset held at FVOCI is impaired the associated impairment charge is recognised in the income statement.

(ii) Cash flow hedge reserve

The cash flow hedge reserve includes the fair value gains or losses associated with the effective portion of designated cash flow hedging instruments.

ORDINARY SHARES

The total authorised number of ordinary shares in Kiwibank at the reporting date was 737 million (30 June 2018: 737 million). All issued ordinary shares are fully paid. All ordinary shares have equal voting rights and share equally in dividends and surpluses on winding up. Ordinary shares do not have a par value. The whole of the issued ordinary share capital is owned by KGHL, which is incorporated in New Zealand.

Dollars in millions	30/06/19	30/06/18
Balance at beginning of the year (2019: 737m shares; 2018: 737m shares)	737	737
Issued in year (2019: nil shares; 2018: nil shares)	-	-
Balance at end of the year (2019: 737m shares; 2018: 737m shares)	737	737

Notes to the financial statements

Continued...

28. Equity continued

RESERVES

Dollars in millions	30/06/19	30/06/18
Balance at beginning of the year	750	643
Balance adjusted for adoption of NZ IFRS 9 and NZ IFRS 15	(4)	-
Net profit for the year	108	115
Dividends paid on ordinary shares	(25)	-
Distributions to holders of perpetual capital	(11)	(11)
Net movement in fair value reserve	6	-
Net movement in cash flow hedge reserve	(12)	3
Balance at end of the year	812	750

CASH FLOW HEDGING RESERVE

The cash flow hedging reserve comprises the effective portion of the cumulative change in the fair value of foreign exchange and interest rate derivative contracts related to hedged forecasted transactions that have not yet occurred.

Dollars in millions	30/06/19	30/06/18
Balance at beginning of the year	(10)	(13)
Gross changes in fair value	(17)	3
Tax on changes in fair value	5	(1)
Cumulative loss transferred to the income statement	-	1
Tax effect of items transferred to income statement	-	-
Balance at end of the year	(22)	(10)

Notes to the financial statements

Continued...

28. Equity continued

Fair value reserve

The fair value reserve includes the cumulative net change in the fair value of investment securities until the investment is derecognised or impaired.

Dollars in millions	30/06/19	30/06/18
Balance at beginning of the year	5	5
Gross changes in fair value	8	4
Tax on changes in fair value	(3)	(1)
Cumulative gain transferred to the income statement on disposal of financial assets	1	(4)
Tax effect of items transferred to income statement	-	1
Balance at end of the year	11	5

Capital

The Banking Group's regulatory capital is analysed in two tiers:

- Tier 1 capital, which includes ordinary shares, perpetual capital bonds ("PCB"), retained earnings including current year profit, and the fair value reserve.
- Tier 2 capital, which includes convertible subordinated bonds (2018: convertible subordinated bonds).

The Banking Group maintains an actively managed capital base to cover risks inherent in the business and meet the capital adequacy requirements of the RBNZ. The adequacy of the Banking Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision and adopted by the RBNZ in supervising the Banking Group. Further details can be found in the Capital Adequacy section of this Disclosure Statement.

During the year ended 30 June 2019, Kiwibank was in compliance with all of its externally imposed conditions of registration except as noted on page 119.

Capital management

The primary objectives of the Banking Group's capital management policy are to ensure that the Banking Group complies with externally imposed capital requirements and maintains strong credit ratings and healthy capital ratios in order to support its business.

The Banking Group manages its capital structure and makes adjustments to it according to changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Banking Group may adjust the amount of dividend payment to the shareholder, return capital to the shareholder or issue capital securities. No changes have been made to the objectives, policies and processes from the previous year. However, they are under constant review by the Board.

Dividends

Dollars in millions	30/06/19	30/06/18
Declared and paid during the year on ordinary shares:		
3.41 cents per share (2018: Nil cents per share)	(25)	-
Total dividends paid	(25)	-

Notes to the financial statements

Continued...

28. Equity continued

If for any reason an interest payment on the PCBs has not been paid in full on an Interest Payment Date, Kiwibank must not, without approval of an extraordinary resolution of the holders of the PCBs:

- a) resolve to pay or pay any dividend on its Ordinary Shares;
- b) undertake any capital reduction; or
- c) make any payments on other capital instruments that rank equally with or junior to the PCBs (unless the payment is made in respect of capital instruments that rank equally with the PCBs and a pro rata payment is made in respect of the PCBs at the same time).

These restrictions will apply until:

- a) Kiwibank pays the interest payments in full on two subsequent consecutive Interest Payment Dates; and
- b) either:
 - i) the interest payments on perpetual capital notes issued by Kiwi Capital Funding Limited ("PCN") are paid in full on those dates; or
 - ii) there are no PCNs outstanding.

29. Related entities



Critical accounting estimates and judgements

The Banking Group sponsors the formation of special purpose vehicles ("**SPV**") in the ordinary course of business, primarily to provide funding. SPVs are typically set up for a single, pre-defined purpose, have a limited life and generally are not operating entities nor do they have employees. The most common form of SPV structure involves the acquisition of financial assets by the SPV that are funded by the issuance of securities to external investors (securitisation). Repayment of the issued securities is determined by the performance of the financial assets acquired by the SPV.

A SPV is consolidated and reported as part of the Banking Group if it is controlled by the Bank. The definition of control is outlined in note 2.3. As it can sometimes be difficult to determine whether the Banking Group controls an SPV, management makes judgements about the Banking Group's power over an SPV, its exposure to variable returns and its ability to affect those returns by exercising its power.

The Banking Group consists of Kiwibank and all of its controlled entities. At the reporting date, Kiwibank had the following controlled entities:

Name of entity	Principal activity	Interest held by Kiwibank Limited	
		30/06/19	30/06/18
New Zealand Home Lending Limited	Agency services for mortgage lending through the New Zealand Home Loans Company Limited	100%	100%
AMP Home Loans Limited	Agency services for mortgage lending through the AMP Advisor network	100%	100%
Kiwibank Investment Management Limited	Provision of investment management services	100%	100%
KB Custodial Services Limited	Funds management	N/A ²	100%
Kiwi Asset Finance Limited	Asset finance company	100%	100%
Kiwibank PIE Unit Trust ¹ ("PIE Unit Trust")	Provision of investment management services	-	-
Kiwibank RMBS Trust Series 2009-1 ¹	Securitisation finance entity	-	-
Kiwi Covered Bond Trust ¹	Securitisation finance entity	-	-

¹The Banking Group consolidates the following SPVs: PIE Unit Trust, the Kiwibank RMBS Trust Series 2009-1, Kiwi Covered Bond Trust on the basis that Kiwibank is deemed to control these entities.

²KB Custodial Services Limited was amalgamated into Kiwibank Investment Management Limited effective 30 November 2018.

Notes to the financial statements

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29. Related entities continued

All Banking Group entities have a reporting date of 30 June and are incorporated and/or domiciled in New Zealand.

Transactions with NZP, the NZP Group, KGHL and other subsidiaries of KGHL

The “**NZP Group**” comprises NZP and its subsidiaries. “**Other subsidiaries of KGHL**” comprises KGHL subsidiaries excluding Kiwibank. The other subsidiaries of KGHL that have had transactions with the Banking Group are The New Zealand Home Loan Company Limited (“**NZHL**”), Kiwi Financial Services Retail Limited (“**KFSRL**”), Kiwi Insurance Limited (“**KI**”), Kiwi Capital Funding Limited (“**KCFL**”) and Kiwi Wealth Management and its subsidiaries. All transactions with the NZP Group, KGHL and other subsidiaries of KGHL were conducted on normal commercial terms and within the Banking Group’s approved policies. Refer to note 28 for details of dividends paid to shareholders.

All payment obligations of Kiwibank that existed at the time the NZP Guarantee was terminated on 28 February 2017, excluding any payment obligations, the terms of which expressly provide that they do not have the benefit of the guarantee, are guaranteed under the NZP Guarantee. No consideration is paid to NZP for the NZP Guarantee.

Transactions conducted with related entities including NZP, entities within the NZP Group, KGHL, and other subsidiaries of KGHL include:

- Certain shared service activities have been provided to the Banking Group in common with other NZP Group companies. The fee paid for this service is based upon activity and a mutually agreed fee.
- The Banking Group utilises a shared retail network with NZP in its provision of retail banking services to customers. The fee paid for this service is based upon activity and a mutually agreed fee. The Banking Group reimbursed KFSRL for personnel costs of \$16.2m for the year ended 30 June 2019 (2018: \$25.0m).
- During the year, NZP held a number of property leases on behalf of the Banking Group including shared sites. The Banking Group reimbursed NZP for the lease charges. At 30 June 2019, property leases held directly with NZP or shared sites where NZP recharge lease costs to the Banking Group are included within the lease commitments disclosed in note 35.
- Kiwibank is a member of, and purchases tax losses from members of, the Kiwi Group Holdings Limited Consolidated Tax Group (see note 7).
- Agency Services fee revenue and expenditure are included in the Banking Group under a management agreement whereby the Banking Group manages the Agency Services activity of NZP. Agency Services activity consists of agency collection and verification services.
- The Crown has entered into a \$300m uncalled capital facility with KGHL where KGHL can drawdown capital for contingent events around Kiwibank’s conditions of registration. The annualised cost of this facility on charged to the Banking Group by KGHL is \$3.0m (2018: \$3.0m).
- Kiwibank provides certain shared service activities to other subsidiaries of KGHL and, from the current year, charges for these services on an arm’s length basis. The total charged to other subsidiaries of KGHL for shared services was \$2.0m (2018: nil).
- On 25 March 2019, KGHL entered into a loan agreement with Kiwibank, allowing KGHL to drawdown \$75.5m provided that the Banking Group does not exceed credit exposure to connected persons of 15% of Tier 1 capital, as required in Kiwibank’s banking conditions of registration. When loans are drawn down under the loan agreement the transaction is undertaken at market interest rates. As at 30 June 2019 the balance of the loan owed by KGHL to the Banking Group was \$75.5m (30 June 2018: nil).
- NZP had a credit facility with the Banking Group that allowed NZP to drawdown to the extent that the Banking Group did not exceed credit exposure to connected persons of 15% of Tier 1 capital, as required in Kiwibank’s banking conditions of registration. When loans were drawn down the transaction was undertaken at market interest rates. On 29 March 2019, this credit facility was repaid in full as part of a refinancing agreement with KGHL noted above and the facility with NZP was closed. As at 30 June 2019 the balance of the facility owed by NZP to the Banking Group was nil (30 June 2018: \$75.8m).
- There is a revolving credit agreement between the Banking Group and NZHL, the balance of which was \$2.2m at 30 June 2019 (30 June 2018: \$3.6m).
- During the year NZHL received commissions from the Banking Group totalling \$18.2m (year ended 30 June 2018: \$15.2m).
- During the year the Banking Group received commissions from KI, a fellow subsidiary of KGHL, totalling \$2.4m (year ended 30 June 2018: \$2.2m).

Notes to the financial statements

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29. Related entities continued

The table below shows balances outstanding at the reporting date with NZP, KGHL and other subsidiaries within the KGHL Group. No individually assessed provision for credit impairment has been recognised for loans issued to or receivables due from related parties.

Dollars in millions	30/06/19	30/06/18
Outstanding balances		
NZP (due to related parties)	7	6
Other subsidiaries of KGHL (due to related parties)	2	2
Total due to related parties	9	8
NZP (Deposits)	-	-
NZP Superannuation Plan (Deposits)	2	8
KGHL (Deposits)	4	4
Other subsidiaries of KGHL (Deposits)	4	9
Total due to related parties included in deposits	10	21
NZP (derivative financial instruments - liabilities)	1	2
Total due to related parties included in derivative financial instruments - liabilities	1	2
Other subsidiaries of KGHL (subordinated debt)	253	254
Total due to related parties included in subordinated debt	253	254
Total outstanding balances due to related parties	273	285
Receivables		
NZP (due from related parties)	8	86
KGHL (due from related parties)	76	-
Other subsidiaries of KGHL (due from related parties)	1	1
Total due from related parties per balance sheet	85	87
Other subsidiaries of KGHL (Loans and advances)	2	4
Total due from related parties included in loans and advances	2	4
NZP (derivative financial instruments - assets)	1	1
Total due from related parties included in derivative financial instruments - assets	1	1
Total receivable from related parties	88	92
Balances due to/from related parties per balance sheet		
Payables - current	9	8
Payables - non-current	-	-
Receivables - current	9	87
Receivables - non-current	76	-

Notes to the financial statements

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29. Related entities continued

The table below shows revenue and expenditure during the year with NZP, KGHL, and other subsidiaries of KGHL. In addition, Kiwibank undertakes some transactions with State-Owned Enterprises and Government departments.

Dollars in millions	Year ended 30/06/19	Year ended 30/06/18 ¹
Interest income		
Interest received or due from NZP	4	5
Interest received or due from KGHL	1	-
Total interest income received or due from related parties	5	5
Interest expense		
Interest paid or due to NZP	(4)	(4)
Interest paid or due to other subsidiaries of KGHL	(7)	(7)
Total interest expense paid or due to related parties	(11)	(11)
Net gains on financial instruments at fair value		
Net gains on financial instruments at fair value received or due from NZP	1	1
Total net gains on financial instruments at fair value received or due from related parties	1	1
Net fees and other income		
Other income received or due from NZP	15	30
Other income received or due from other subsidiaries of KGHL	4	2
Direct expenses paid or due to other subsidiaries of KGHL	(18)	(15)
Total net fees and other income paid or due from related parties	1	17
Operating expenses		
Operating expenses paid or due to NZP	(50)	(56)
Operating expenses recovered or due from NZP	14	9
Operating expenses paid or due to other subsidiaries of NZP	(1)	-
Operating expenses paid or due to other subsidiaries of KGHL	(16)	(25)
Operating expenses recovered or due from other subsidiaries of KGHL	3	3
Total operating expenses paid or due from related parties	(50)	(69)
Other transactions		
Other reimbursements paid or due to NZP	(6)	(4)
Other reimbursements received or due from other subsidiaries of KGHL	3	3
Assets purchased from NZP	(1)	-
Insurance reimbursements received from NZP	2	8
Loan drawdown paid to KGHL	(76)	-
Loan repayments received from NZP	76	-
Other distributions paid to other subsidiaries of KGHL	(11)	(11)

¹The comparative prior period amounts have been reclassified to align with the more granular categories used in the current period's presentation.

Notes to the financial statements

Continued...

29. Related entities continued

Transactions with key management personnel

Loans made to and deposits held by key management personnel (including personally related parties) are made in the ordinary course of business on normal commercial terms and conditions, no more favourable than those given to other employees or customers. Loans are on terms of repayment that range between fixed and variable, all of which have been made in accordance with the Banking Group's lending policies. No individually assessed provision for credit impairment has been recognised for loans made to key management personnel (30 June 2018: \$nil).

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly. This includes the Board and members of the senior executive team.

The table below shows the amount of benefits paid to key management personnel within the Banking Group.

Dollars in millions	Year ended 30/06/19	Year ended 30/06/18
Salaries and short term benefits paid to key management personnel	8	5

The table below shows the amount of loans to and deposits from key management personnel within the Banking Group.

Dollars in millions	30/06/19	30/06/18
Loans to key management personnel	2	-
Deposits from key management personnel	1	1

30. Fiduciary activities, securitisation and funds under management



Accounting policy

A subsidiary of the Banking Group acts as manager for a number of unit trusts and investment funds.

The assets and liabilities of these trusts and funds are not included in the consolidated financial statements when the Banking Group does not have control of the trusts and funds. Fees earned in respect of these activities are included in Other Income. Assets purchased by any member of the Banking Group from entities which conduct insurance, securitisation, funds management, and other fiduciary activities, or on whose behalf the Banking Group conducts those activities, have been purchased on arm's length terms and conditions.

Securitised assets are derecognised when the right to receive cash flows have expired or the Banking Group has transferred substantially all the risks and rewards of ownership (see note 24).

Insurance business

The Banking Group does not market or distribute its own insurance products.

Securitised assets

The Banking Group has an in house RMBS facility and covered bond programme, which are discussed further in Note 24.

Funds management

The Kiwibank KiwiSaver Scheme commenced accepting members and subscriptions on the 1st of July 2010 and closed to new members on 5 December 2012. During the year ended 30 June 2015, the Banking Group transferred the members and assets of the Kiwibank KiwiSaver Scheme to the Kiwi Wealth KiwiSaver Scheme, operated by Kiwi Wealth Limited, a fellow subsidiary of KGHL.

A subsidiary of Kiwibank also acts as the manager for the Kiwibank PIE Unit Trust. These funds are invested in products of Kiwibank and are recorded as liabilities in the balance sheet (note 17). At 30 June 2019, \$4,438m of funds under management were invested in Kiwibank's own products or securities (30 June 2018: \$3,856m).

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30. Fiduciary activities, securitisation and funds under management continued

Provision of financial services

Financial services provided by Kiwibank to entities which are involved in trust, custodial, funds management and other fiduciary activities, are at fair value, except that Kiwibank does not charge Kiwibank Investment Management Limited, the Manager of the Kiwibank PIE Unit Trust, any bank fees. Further, the Kiwibank PIE Unit Trust bank account used for tax payments does not earn interest.

The Banking Group has not provided any funding to entities which conduct the following activities during the years ended 30 June 2019 and 30 June 2018:

- trust, custodial, funds management or other fiduciary activities established, marketed and/or sponsored by a member of the Banking Group;
- marketing and distribution of insurance products.

Risk management

With regards to the activities identified above, the Banking Group has in place policies and procedures to ensure that those activities are conducted in an appropriate manner. Should adverse conditions arise, it is considered that these policies and procedures will minimise the possibility that these conditions will adversely impact the Banking Group. The policies and procedures include comprehensive and prominent disclosure of information regarding products, and formal and regular review of operations and policies by management and auditors.

31. Segment analysis



Accounting policy

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments has been identified as the Kiwibank Executive Committee (“EXCO”), which consists of the Chief Executive and his direct reports. A reportable business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments.

The EXCO reviews the Banking Group’s internal reporting pack on a regular basis to assess performance and to allocate resources. Within the pack, operating segments have primarily been determined with reference to differences in products and services.

Operating segments have been aggregated for reporting purposes where the following criteria have been met:

- a) Aggregation is consistent with the core principle of NZ IFRS 8 Operating Segments;
- b) Segments have similar economic characteristics; and
- c) Segments are similar in each of the following respects:
 - nature of the product and services;
 - nature of production process;
 - type or class of customer for their products and services;
 - methods used to distribute their products or provide their services; and
 - nature of the regulatory environment.

For the purposes of this note, an operating segment is a distinguishable part of the Banking Group, engaged in providing products and services which are subject to risks and returns that are different from those of other business segments. The business segments are defined by the customers that they service and the services they provide.

The EXCO assesses the performance of the operating segments based on a measure of profit before tax. This measurement basis includes a reallocation of internal overhead expenses from non-income generating cost centres of the business. Net interest income at a segmental level includes an allocation for internal transfer pricing which eliminates to zero at a Banking Group level. Transfer pricing is allocated on a basis which reflects intersegment funding arrangements. A summarised description of each business unit is shown below:

- Personal- Provides banking products and services to the personal banking segment via the Banking Group and NZP distribution channels.

Notes to the financial statements

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31. Segment analysis continued

- Business- Provides banking products and services to the business sector, via the Banking Group and NZP distribution channels. Included within the segment are Business and Treasury services.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Banking Group's total revenue (2018: Nil).

The Banking Group operates predominantly within New Zealand with no significant portion of assets or operations located outside New Zealand.

Dollars in millions	30/06/19			30/06/18		
	Personal	Business	Total	Personal	Business	Total
External net interest income	430	15	445	429	(18)	411
Net intersegment interest	(140)	140	-	(170)	170	-
Net interest income	290	155	445	259	152	411
Other external operating income	71	22	93	91	37	128
Segmental revenue	361	177	538	350	189	539
Profit before impairment and taxation	85	78	163	80	86	166
Profit before taxation	80	71	151	71	83	154
Total assets	18,520	4,214	22,734	16,724	3,991	20,715
Total liabilities	15,343	5,842	21,185	13,453	5,775	19,228
Acquisition of intangible assets	17	4	21	15	4	19
Acquisition of property, plant and equipment	14	4	18	22	5	27
Amortisation expense	19	6	25	18	7	25
Depreciation expense	10	2	12	7	2	9
Other impairment losses	-	-	-	9	2	11
Credit impairment losses	7	5	12	-	1	1

32. Risk management

Risk management

The Banking Group's exposure to risk arises primarily from its business activities as a financial intermediary and financial markets participant. The Banking Group recognises the importance of effective risk management to its business success and to its customers. Risk management enables the Banking Group to both increase its financial and organisational growth opportunities and mitigate potential loss or damage.

Organisational perspective

The Banking Group approaches the management of risk using an organisational framework that is characterised by:

- The Board approving risk appetites, business strategies, and monitoring progress;
- Business unit level accountability for the management of risks in accordance with agreed strategies and the Banking Group's risk management framework;
- The Risk Management function is responsible for implementing an enterprise risk management framework and providing assurance around the management of various elements of risk; and
- Independent oversight of business unit risk management by both internal and external audit functions to i) provide regular risk evaluation and reporting; and ii) assess the adequacy and effectiveness of management's control of risk.

Notes to the financial statements

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32. Risk management continued

The directors of Kiwibank are responsible for the stewardship of the Banking Group. To help discharge this obligation, the Board has established the Finance, Audit and Disclosures Committee, (which includes members who have appropriate financial experience and understanding of the banking industry in which the Banking Group operates) and the Risk, Credit and Compliance Committee, which collectively are responsible for:

- Review and approval of the Banking Group's frameworks and policies for managing business, credit, market and operational risk and maintaining an effective enterprise risk management framework.
- Monitoring the Banking Group's key risks, performance, exposures against limits, capital levels and management of the Banking Group's risks.
- Monitoring anticipated changes in the economic and business environment and other factors relevant to the Banking Group's risk profile.
- Review and approval of limits and conditions that apply to risk taking.
- Review of internal audit activities and significant audit issues.
- Review of financial and disclosure statements.

The following specialised principal management committees have been formed to translate Board risk appetite into appropriate strategies, policies, controls, processes and procedures for identifying, measuring and managing risk:

- i) the Asset-Liability Committee ("**ALCO**"), which is concerned with balance sheet structure, capital, funding and market risk;
- ii) the Executive Risk Committee, which is focused on business, credit and operational risk including reputation and conduct risk as well as continuous disclosure requirements;
- iii) the Customer Conduct Committee which is responsible for ensuring good customer outcome principles are embedded across the Bank; and
- iv) the Organisational Change Committee, which considers certain risks associated with the Banking Group's key strategic projects and investment portfolio.

Independent Credit and Market risk-control units operate alongside the Banking Group's lending business units and Treasury business unit. These risk-control functions are accountable for identifying and quantifying credit and market risks respectively, and for working with the lending and Treasury business units to implement appropriate policies, procedures and controls to manage those risks. The Banking Group's Risk Management Unit has been assigned the role of internal monitor. The Risk Management Unit is tasked with ensuring that risk based reporting of financial and non-financial threats to the Banking Group is undertaken on a regular basis. The unit provides an independent appraisal of business units' risk positions and the overall control environment, reporting on the Banking Group's key risks through the Executive Risk Committee, and onto the Board Risk, Credit and Compliance Committee and the Board Finance, Audit and Disclosures Committee as appropriate. No formal reviews of the Banking Group's risk management system were undertaken by external parties during the year ended 30 June 2019.

Internal audit

The Banking Group has an independent internal audit function, which appraises the adequacy and effectiveness of the internal control environment, and reports results to Management and the Board Finance, Audit and Disclosures Committee. The internal audit function reports functionally to the Chair of the Board Finance, Audit and Disclosures Committee and administratively to the Chief Executive Officer.

In planning audit activities, internal audit adopts a risk-based approach that directs and concentrates resources to those areas of greatest significance, strategic concern and risk to the business. This encompasses reviews of major credit, market, technology, programmes, projects and operating risks within the Banking Group. Significant findings are reported quarterly to the Board Finance, Audit and Disclosures Committee. The audit plan is approved by the Board Finance, Audit and Disclosures Committee. All issues and recommendations reported to management are tracked and monitored internally to ensure completion and agreed actions are undertaken where appropriate.

Notes to the financial statements

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32. Risk management continued

Risk management framework

The Banking Group's risk management framework revolves around four key functions. Namely:

- **Strategic risk management** – A framework and set of processes that the Banking Group uses to plan, organise, lead and control risk management activities in an effort to minimise the effects and impacts of risk events on the Banking Group's capital and earnings. This reflects the Basel III accord requirements for a properly framed structure from which risk management strategies and policy can be devolved. This framework provides:
 - (i) A high level "risk structure" for the classification and categorisation of all risks deemed material to the Banking Group, which forms the basis of reporting the Banking Group's risk profile.
 - (ii) Risk appetite – the Banking Group's willingness to take on financial risks and a basic operational pre-requisite for the establishment of consistent risk limits.
 - (iii) Risk policies – these explicitly articulate the Banking Group's fundamental attitude towards risk and risk management. The risk policy statements are intended to ensure employees understand the Banking Group's risk management goals throughout the organisation.
 - (iv) Risk principles – these are central rules for risk management decision-making and form the basis for maximum uniformity in risk management decision-making.
- **Capital management and capital adequacy** – the Banking Group's capital management strategy seeks to ensure the Banking Group is adequately capitalised while recognising capital is often an expensive form of funding or insurance. The Banking Group seeks to maintain and acquire capital in an economically effective manner so as to: i) support future development and growth aspirations; ii) comply with regulatory capital requirements; iii) maintain a strong internal capital base to cover all material inherent risks; and iv) maintain an investment grade credit rating.

The Banking Group undertakes a programme of activities designed to ensure that it has sufficient financial resources to continue as a going concern even if it suffers a material unforeseen or unexpected risk event(s). This programme, called the Internal Capital Adequacy Assessment Programme ("ICAAP"), deals primarily with assessing the Banking Group's capacity to absorb risk based on: i) identification and quantification of its immediate risks; and ii) comparison of those risks with its financial capital (that may have to be sacrificed if these risks materialise).

The Board of Directors has ultimate responsibility for capital adequacy and approves capital policy and minimum internal capital levels and limits.

In ensuring that the Banking Group has adequate overall capital in relation to its risk profile, a mixture of risk capital estimates and judgement based estimates have been made relating to all material risks, even where they are hard to quantify. Included in these estimates is also a trade-off between the importance of allocating capital to such risks and the robustness of the Banking Group's approach to mitigating and managing these risks.

The Banking Group monitors its key risks and internal and regulatory capital adequacy, and reports on these to the Board Risk, Credit and Compliance Committee and the Finance, Audit, and Disclosure Committee. In the event of large, unexpected losses, the Banking Group is committed to restoring its capital position. Management have developed plans accordingly.

- **Risk assessment and risk prioritisation** – This function administered by the Risk Management Unit is designed to identify and assess the real risks facing the Banking Group. The prioritisation process is intended to ensure that management focus and appropriate resources are directed at isolating, reducing or controlling expected (probable) risk events. The risk prioritisation process involves assessing the probability and severity of losses using (where possible) quantitative risk and control data.
- **Enterprise risk management** – Irrespective of their relative significance, the majority of risk situations facing the Banking Group occur in the day-to-day operations of the business. These risks (referred to as enterprise risks - as they arise from operating the business) are not confined to formal risk domains (i.e. credit, market, or operational risk) or business lines. As it is considered desirable to manage risk in a consistent and comprehensive manner across the whole of the Banking Group, a decision support model exists for any manager needing to make a risk management decision about a specific risk matter arising in their current or proposed operations (i.e. day-to-day business activities).

Notes to the financial statements

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32. Risk management continued

The Banking Group's high level risk structure recognises eight main types of risk (or risk domains). Specifically:

- **Credit risk** – the risk of financial loss arising from the failure of a customer or counterparty to honour any financial or contractual obligation.
- **Market risk** – the potential for losses arising from adverse movements in the level and volatility of market factors, such as interest rates and foreign exchange rates. This risk domain also includes the risk that the Banking Group will not have sufficient funds available to meet financial and transactional cash-flow obligations.
- **Operational risk** – the risk of direct or indirect losses resulting from inadequate or failed internal processes, people, and systems, or from external events. This risk domain includes legal and regulatory risk, which includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from regulatory actions, as well as private settlements.
- **Balance Sheet Use risk** – the risk that we have insufficient capital or sub-optimal quality of capital so that strategic initiatives can't be adopted or that capital is inefficiently deployed.
- **Business risk** – macro or micro environmental events that could impede or prevent the Bank achieving its stated business goals or strategies, including missed opportunities and potential losses/damage arising from poor strategic business decisions. This risk includes material changes in the global and domestic economic environment impacting credit and liquidity flows.
- **Customer risk** – the risk the Bank is unable to adapt sufficiently to meet the changing demands and expectations of current and future customers so that it cannot achieve its business goals and strategies. This includes the risk of material customer attrition and loss of brand value.
- **Conduct risk** – the risk of customer harm due to poor design and distribution of our products and services leading to negative customer outcomes, regulatory censure, and damage to reputation.
- **Delivery risk** – the risk that investments in new strategies and systems cost more, take longer to implement, and/or fail to deliver the expected benefits so that the Bank is disadvantaged when compared to peers.

Credit risk

The Banking Group's credit risks arise from lending to customers and from inter-bank, treasury, international and capital market activities. The Banking Group has clearly defined credit policies and frameworks for the approval and management of credit risk.

Key elements of the Credit risk management framework are:

- **Credit risk management** – the Board requires sound lending growth for appropriate returns. The Banking Group pursues this objective in a structured manner, managing credit risk through application of sector specific credit underwriting standards including scorecards, a robust control environment, monitoring of the portfolios, review of all major credit risks and risk concentrations and through a tiered structure of delegated lending authorities designed to control the multiple facets of credit risk management.

Notes to the financial statements

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32. Risk management continued

An independent credit management function staffed by credit risk specialists exists to; provide independent credit decisions; support front-line lending staff in the application of sound credit practices; provide centralised remedial management of troublesome and impaired accounts; and undertake portfolio monitoring and loan asset quality analysis and reporting.

The integrity and effectiveness of the Banking Group's credit risk management practices, asset quality and compliance with policy are supported by independent assessments by the Quality Assurance and Internal Audit functions.

- **Credit risk mitigation** – The Banking Group's Board-approved wholesale credit management policy sets out the parameters for which it can enter into credit exposures arising from on-and off-balance sheet transactions. The Banking Group also has legal arrangements with its major institutional counterparties to allow netting of off-balance sheet exposures, along with collateral management arrangements.
- **Portfolio structure and monitoring** – The Banking Group's credit portfolio is divided into two asset classes: retail and corporate. The retail asset class is comprised of housing loan, credit card and personal loan facilities and small-to-medium-enterprise business lending. This segment is managed on a delinquency band approach and on a behavioural basis. The corporate asset class consists of lending to middle market and corporate businesses. Each exposure is assigned an internal risk rating that is based on an in-depth assessment of the risk of default. These exposures are required to be reviewed on an annual basis. The overall composition and quality of the credit portfolios is monitored taking into account the potential changes in economic conditions.
- **Credit approval standards** – The Banking Group has clearly defined credit underwriting policies and standards for all lending, which incorporate income and repayment capacity, acceptable terms, security, and loan documentation criteria. In the first instance, the Banking Group relies on the assessed integrity and character of the customer or counterparty and their capacity to honour their financial obligations for repayment. Longer-term consumer lending is generally secured against real estate, while short-term revolving consumer credit (overdraft, credit card and personal lending) is generally unsecured. The Banking Group requires adequate and sustainable debt servicing capacity, and may also require security cover within loan-to-security ratios as set out in the Banking Group's credit policy. Collateral security in the form of real property and/or general security interest over business assets is generally taken for business credit, except for government, bank and corporate counterparties of strong financial standing. The Banking Group uses ISDA agreements to document derivative activities and limit exposures to credit losses. Under ISDA protocols, in the event of default, all contracts with the counterparty are terminated and settled on a net basis.
- **Problem credit facility management** – Credit exposures are monitored regularly through the examination of irregular and delinquent accounts. This enables doubtful debts to be immediately identified so that specific provisions for potential losses can be established as early as possible. Problem credit facilities are monitored to ensure workout and collection and recovery strategies are established and enacted promptly to minimise risk of potential losses. Credit risk portfolios are regularly assessed for objective evidence of impairment. The Banking Group maintains a collective impairment allowance where there is objective evidence that the portfolio contains probable losses that will be identified in future periods. The Banking Group also creates an individual allowance for impairment against specific credit exposures when there is objective evidence that it will not be able to collect all amounts due.
- **Operations control environment** – Operationally, credit risk is controlled through a combination of approvals, limits, monitoring and review procedures which are carried out on a regular basis. Functions are segregated so that no one person is able to control all significant stages of the credit process, thereby reducing the chance of error or defalcation escaping detection. Preparation of formal lending documentation only occurs after an independent officer in the operations area has verified that the credit facility has been properly approved and the facility documentation matches the terms of the credit approval.

Notes to the financial statements

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32. Risk management continued

The table below shows significant exposures to credit risk to which the ECL model is applied, for recognised and unrecognised financial assets at amortised cost, based on the following risk grades:

- 0 – 3: Strong;
- 4 – 5: Good;
- 6 – 7: Satisfactory;
- 8 – 9: Weak;
- 10 – 12: Credit impaired.

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Credit exposure by risk grade					
Risk bands:					
0 - 3	12,655	46	-	-	12,701
4 - 5	5,219	360	-	-	5,579
6 - 7	1,796	284	-	-	2,080
8 - 9	6	91	-	-	97
10 - 12	-	-	21	5	26
Total credit exposure by risk grade	19,676	781	21	5	20,483

Market risk

Market risk arises from the mismatch between assets and liabilities in the banking business. In order to manage its own exposure to market risk, the Banking Group transacts in derivative instruments such as swaps, options, futures and forward rate agreements. These activities are managed using structural limits (including volume and basis point value limits) in conjunction with scenario analysis. Market risk limits are allocated based on business strategies, modelling and experience, in addition to market liquidity and risk concentration analysis.

Key elements of the Banking Group's market risk management framework are:

Interest rate risk management

The Board expects reasonable stability in the Banking Group's net interest income over time. The Banking Group's treasury business unit has been tasked with managing the sensitivity of net income to changes in wholesale market interest rates. This sensitivity (known as structural interest rate risk) arises from the Banking Group's lending and deposit-taking activities and investment of capital and other liabilities. The provision of loans and accepting deposits at both fixed and variable rates gives rise to the risk that the Banking Group could have unmatched positions leading to material exposures in a shifting interest rate environment. Other activities such as current account facilities and trading financial instruments such as swaps, options and forward-rate agreements also incur interest rate risks.

The main objective of the management of interest rate risk is to achieve a balance between reducing risk to earnings from the adverse effect of interest rate movements and enhancing net interest income through the correct anticipation of the direction and extent of interest rate changes.

The ALCO (comprising of executive management) is responsible for implementing and monitoring interest rate risk management policies within Board-defined policy guidelines and limits. Interest rate risk is managed by the treasury business unit within pre-approved limits.

Interest rate risk is measured in terms of the Banking Group's notional exposure to potential shifts in future interest rates relative to the timescale within which assets and liabilities can be repriced. A separate independent Market Risk Management Unit ("MRMU") is responsible for the daily measurement and monitoring of market risk exposures.

Notes to the financial statements

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32. Risk management continued

The Banking Group reduces interest rate risk by seeking to match the re-pricing of assets and liabilities. A substantial portion of customer deposits and lending is at variable rates, which are periodically adjusted to reflect market movements. Where natural hedging still leaves a resultant interest rate mismatch, the residual risks are hedged within predefined limits through the use of physical financial instruments, interest rate swaps and other derivative financial instruments.

The following tables summarise the Banking Group's exposure to interest rate risk. They include the financial instruments at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

Interest rate repricing schedule

Dollars in millions	30/06/19						
	Total	Non-interest bearing	Up to 3 months	3 to 6 months	6 months to 1 year	Between 1 and 2 years	Over 2 years
Financial assets							
Cash and cash equivalents	421	38	383	-	-	-	-
Due from related parties	85	9	76	-	-	-	-
Due from other financial institutions	71	-	71	-	-	-	-
Investment securities	1,176	-	192	-	486	344	154
Derivative financial instruments	358	358	-	-	-	-	-
Loans and advances	20,443	68	5,732	2,600	4,502	6,344	1,197
Other financial assets	25	25	-	-	-	-	-
Total financial assets	22,579	498	6,454	2,600	4,988	6,688	1,351
Financial liabilities							
Due to other financial institutions	(126)	(58)	(68)	-	-	-	-
Due to related parties	(9)	(9)	-	-	-	-	-
Deposits and other borrowings	(18,240)	(2,314)	(9,696)	(3,361)	(2,261)	(394)	(214)
Derivative financial instruments	(343)	(343)	-	-	-	-	-
Debt securities issued	(2,078)	-	(790)	(157)	(286)	(279)	(566)
Other financial liabilities	(63)	(63)	-	-	-	-	-
Subordinated debt	(253)	-	(104)	-	(149)	-	-
Total financial liabilities	(21,112)	(2,787)	(10,658)	(3,518)	(2,696)	(673)	(780)
On-balance sheet gap	1,467	(2,289)	(4,204)	(918)	2,292	6,015	571
Net derivative notional principals	35	-	3,389	829	(906)	(4,178)	901
Net effective interest rate gap	1,502	(2,289)	(815)	(89)	1,386	1,837	1,472

Notes to the financial statements

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32. Risk management continued

Interest rate repricing schedule continued

Dollars in millions	30/06/18						
	Total	Non-interest bearing	Up to 3 months	3 to 6 months	6 months to 1 year	Between 1 and 2 years	Over 2 years
Financial assets							
Cash and cash equivalents	447	34	413	-	-	-	-
Due from related parties	87	12	45	-	30	-	-
Due from other financial institutions	132	-	112	20	-	-	-
Investment securities	1,220	-	376	26	214	396	208
Derivative financial instruments	344	344	-	-	-	-	-
Loans and advances	18,304	70	5,419	2,036	4,358	5,167	1,254
Other financial assets	27	27	-	-	-	-	-
Total financial assets	20,561	487	6,365	2,082	4,602	5,563	1,462
Financial liabilities							
Due to other financial institutions	(128)	(37)	(91)	-	-	-	-
Due to related parties	(8)	(8)	-	-	-	-	-
Deposits and other borrowings	(16,173)	(2,031)	(8,956)	(2,154)	(2,399)	(400)	(233)
Derivative financial instruments	(293)	(293)	-	-	-	-	-
Debt securities issued	(2,265)	-	(945)	(17)	(263)	(223)	(817)
Other financial liabilities	(69)	(69)	-	-	-	-	-
Subordinated debt	(254)	-	-	-	-	(254)	-
Total financial liabilities	(19,190)	(2,438)	(9,992)	(2,171)	(2,662)	(877)	(1,050)
On-balance sheet gap	1,371	(1,951)	(3,627)	(89)	1,940	4,686	412
Net derivative notional principals	76	-	3,549	433	(1,627)	(2,980)	701
Net effective interest rate gap	1,447	(1,951)	(78)	344	313	1,706	1,113

Notes to the financial statements

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32. Risk management continued

Currency risk management

Currency risk results from the mismatch of foreign currency assets and liabilities. These mismatches can arise from the day-to-day purchase and sale of foreign currency and from deposit and lending activity in foreign currencies. The Banking Group has a policy of hedging all foreign currency borrowing into New Zealand dollars. Residual currency risks are monitored daily in terms of open positions in each currency and are managed within pre-approved limits.

The Banking Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in aggregate for overnight positions, which are monitored daily. The table below summarises the Banking Group's exposure to foreign currency exchange rate risk as at the reporting date. Included in the table are financial instruments at NZD carrying amounts, categorised by currency.

Dollars in millions	30/06/19							Total
	NZD	CHF	AUD	USD	GBP	EUR	Other	
Assets								
Cash and cash equivalents	351	1	5	24	13	19	8	421
Due from related parties	85	-	-	-	-	-	-	85
Due from other financial institutions	71	-	-	-	-	-	-	71
Investment securities	1,176	-	-	-	-	-	-	1,176
Derivative financial instruments	(412)	479	152	45	(8)	(2)	104	358
Loans and advances	20,437	-	1	3	-	2	-	20,443
Other financial assets	25	-	-	-	-	-	-	25
Total financial assets	21,733	480	158	72	5	19	112	22,579
Liabilities								
Due to other financial institutions	(68)	-	-	(58)	-	-	-	(126)
Due to related parties	(9)	-	-	-	-	-	-	(9)
Deposits and other borrowings	(18,047)	(1)	(42)	(107)	(24)	(14)	(5)	(18,240)
Derivative financial instruments	(645)	-	153	137	18	(5)	(1)	(343)
Debt securities issued	(1,229)	(472)	(251)	(22)	-	-	(104)	(2,078)
Other financial liabilities	(63)	-	-	-	-	-	-	(63)
Subordinated debt	(253)	-	-	-	-	-	-	(253)
Total financial liabilities	(20,314)	(473)	(140)	(50)	(6)	(19)	(110)	(21,112)
Net on balance sheet financial position	1,419	7	18	22	(1)	-	2	1,467

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32. Risk management continued

Currency risk management continued

Dollars in millions	30/06/18							Total
	NZD	CHF	AUD	USD	GBP	EUR	Other	
Assets								
Cash and cash equivalents	376	-	11	24	20	12	4	447
Due from related parties	87	-	-	-	-	-	-	87
Due from other financial institutions	132	-	-	-	-	-	-	132
Investment securities	1,220	-	-	-	-	-	-	1,220
Derivative financial instruments	(783)	497	81	434	(2)	(1)	118	344
Loans and advances	18,299	-	1	2	-	2	-	18,304
Other financial assets	27	-	-	-	-	-	-	27
Total financial assets	19,358	497	93	460	18	13	122	20,561
Liabilities								
Due to other financial institutions	(90)	-	-	(38)	-	-	-	(128)
Due to related parties	(8)	-	-	-	-	-	-	(8)
Deposits and other borrowings	(16,023)	-	(50)	(61)	(24)	(11)	(4)	(16,173)
Derivative financial instruments	(703)	229	263	(87)	6	(2)	1	(293)
Debt securities issued	(882)	(716)	(286)	(264)	-	-	(117)	(2,265)
Other financial liabilities	(69)	-	-	-	-	-	-	(69)
Subordinated debt	(254)	-	-	-	-	-	-	(254)
Total financial liabilities	(18,029)	(487)	(73)	(450)	(18)	(13)	(120)	(19,190)
Net on balance sheet financial position	1,329	10	20	10	-	-	2	1,371

Liquidity and funding risk management

Liquidity risk is the risk that the Banking Group will not have sufficient funds available to meet its financial and transactional cash-flow obligations. Management of liquidity risk is designed to ensure that the Banking Group has the ability to generate or obtain sufficient cash in a timely manner and at a reasonable price to meet its financial commitments on a daily basis. The treasury business unit has responsibility for liquidity management, under oversight of the ALCO.

The Banking Group monitors this risk daily, primarily by forecasting future cash requirements, both under normal conditions and during crisis situations. The Banking Group manages this by: holding readily tradable, investment assets that are eligible for the RBNZ's repurchase facilities, and short term investments with high-credit quality counterparties to provide for any unexpected patterns in cash movements; and seeking a stable funding base.

The Banking Group maintains liquidity crisis contingency plans defining an approach for responding to liquidity-threatening events. Funding risk is allied to liquidity risk, but is concerned with the Banking Group's capacity to fund increases in assets while meeting its payment obligations, including repaying depositors and managing maturing wholesale debt.

The Banking Group employs asset and liability cash flow modelling to determine appropriate liquidity and funding strategies. This modelling helps ensure that an appropriate portion of the Banking Group's assets is funded by customer liabilities, bank borrowing, and equity. This approach also recognises the favourable liquidity characteristics of long-term customer liabilities and wholesale debt funding, in reducing the impact or volatility of short-term funding.

Notes to the financial statements

Continued...

32. Risk management continued

Under normal business conditions, the Banking Group seeks to satisfy the majority of its funding needs from retail liabilities. The Banking Group's borrowing capacity is an estimate of the amount of funding that can be raised in the wholesale markets. The Banking Group's funding strategy is designed to deliver a sustainable portfolio of wholesale funds.

The treasury business unit (under oversight of the ALCO) is responsible for monitoring the Banking Group's funding base and ensuring that this base is prudently maintained and adequately diversified.

Liquidity risk management process

The Banking Group's liquidity management responsibilities include:

- Day-to-day liquidity requirements. The RBNZ's liquidity ratios are calculated and monitored daily to ensure that the Group:
 - is compliant with part 13 of the conditions of registration and the RBNZ's "Liquidity policy" (BS13);
 - maintains a prudent level of cash and highly liquid assets ("primary liquid assets") and marketable assets of limited credit risk ("secondary liquid assets") to meet both expected and projected outflows under severe funding stress from the wholesale and retail balance sheet over a one-week and one-month period; and
 - maintains a diversified stable funding base.
- Securing an appropriately matched profile of future cash flows from maturing assets and liabilities.
- Implementing the Banking Group's funding plan, which includes the development of sustainable wholesale funding capacity.
- Stress-testing the Banking Group's funding and liquidity position with a range of adverse events covering:
 - a Kiwibank name crisis
 - an international credit crisis
 - a Kiwibank name event, combined with domestic funding stress.

The Banking Group holds a diversified portfolio of high-quality liquid securities to support its liquidity risk management. The size of the Banking Group's liquidity portfolio is based on the amount required to meet its liquidity policy and includes items both classified as cash and cash equivalents and those classified as operating assets in the cash flow statement. Amounts below are presented net of any appropriate 'haircut' where applicable.

	30/06/19	30/06/18
Cash, balances with central bank, and certain foreign currency deposits	398	378
Certificates of deposit	18	130
Government bonds and treasury bills	470	407
Local body stock and bonds	4	6
Other bonds	625	597
Total	1,515	1,518

The Bank also held unencumbered internal residential mortgage-backed securities which would entitle the Banking Group to enter into repurchase transactions with a value of \$855m at 30 June 2019 (30 June 2018: \$855m).

Notes to the financial statements

Continued...

32. Risk management continued

Non-derivative cash flows

The tables on the following pages summarise the cash flows payable by the Banking Group under non-derivative financial liabilities by remaining contractual maturities at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows. The Banking Group does not manage liquidity risk on the basis of the information provided below.

Derivative cash flows

a) Derivatives settled on a net basis

The tables on the following pages analyse the Banking Group's derivative financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows using forward rates.

b) Derivatives settled on a gross basis

The tables on the following pages analyse the Banking Group's derivative financial instruments that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows using forward rates.

Notes to the financial statements

Continued...

32. Risk management continued

Dollars in millions	30/06/19						Carrying amount
	On demand	Up to 3 months	3 to 12 months	Between 1 and 5 years	More than 5 years	Gross nominal inflow/outflow	
Non-derivative cash flows							
Liabilities							
Due to other financial institutions	(126)	-	-	-	-	(126)	(126)
Due to related parties	(9)	-	-	-	-	(9)	(9)
Deposits and other borrowings	(6,841)	(5,022)	(5,843)	(681)	-	(18,387)	(18,240)
Debt securities issued	(5)	(234)	(679)	(1,096)	(184)	(2,198)	(2,078)
Other financial liabilities	(63)	-	-	-	-	(63)	(63)
Subordinated debt	(103)	-	-	-	(150)	(253)	(253)
Total financial liabilities	(7,147)	(5,256)	(6,522)	(1,777)	(334)	(21,036)	(20,769)
Assets							
Cash and cash equivalents	421	-	-	-	-	421	421
Due from related parties	9	1	2	79	-	91	85
Due from other financial institutions	71	-	-	-	-	71	71
Investment securities	42	14	559	587	-	1,202	1,176
Loans and advances	198	391	1,250	4,590	32,528	38,957	20,443
Other financial assets	25	-	-	-	-	25	25
Total financial assets	766	406	1,811	5,256	32,528	40,767	22,221
Net non-derivative cash flows	(6,381)	(4,850)	(4,711)	3,479	32,194	19,731	
Derivative cash flows - net							
Interest rate derivatives	(3)	(4)	(23)	(11)	(1)	(42)	
Total	(3)	(4)	(23)	(11)	(1)	(42)	
Derivative cash flows - gross							
Foreign exchange derivatives							
Inflow	178	191	304	725	184	1,582	
Outflow	(183)	(191)	(303)	(662)	(191)	(1,530)	
Total	(5)	-	1	63	(7)	52	
Off-balance sheet cash flows							
Capital commitments	-	(3)	-	-	-	(3)	
Undrawn credit commitments	(3,411)	-	-	-	-	(3,411)	
Lease commitments	-	(3)	(10)	(36)	(44)	(93)	
Total	(3,411)	(6)	(10)	(36)	(44)	(3,507)	
Net cash flows	(9,800)	(4,860)	(4,743)	3,495	32,142	16,234	
Cumulative net cash flows	(9,800)	(14,660)	(19,403)	(15,908)	16,234	16,234	

Included within subordinated debt are perpetual capital bonds which have no fixed maturity date. The repayment of the principal amount of the perpetual capital bonds has been included in the "more than 5 years" column.

Notes to the financial statements

Continued...

32. Risk management continued

Dollars in millions	30/06/18						Gross nominal inflow/outflow	Carrying amount
	On demand	Up to 3 months	3 to 12 months	Between 1 and 5 years	More than 5 years			
Non-derivative cash flows								
Liabilities								
Due to other financial institutions	(128)	-	-	-	-	-	(128)	(128)
Due to related parties	(8)	-	-	-	-	-	(8)	(8)
Deposits and other borrowings	(6,656)	(4,279)	(4,686)	(696)	-	-	(16,317)	(16,173)
Debt securities issued	(164)	(199)	(589)	(1,061)	(455)	-	(2,468)	(2,265)
Other financial liabilities	(69)	-	-	-	-	-	(69)	(69)
Subordinated debt	(3)	(3)	(11)	(187)	(260)	-	(464)	(254)
Total financial liabilities	(7,028)	(4,481)	(5,286)	(1,944)	(715)	-	(19,454)	(18,897)
Assets								
Cash and cash equivalents	447	-	-	-	-	-	447	447
Due from related parties	12	1	77	-	-	-	90	87
Due from other financial institutions	52	60	20	-	-	-	132	132
Investment securities	85	193	259	724	-	-	1,261	1,220
Loans and advances	187	368	1,155	4,144	30,290	-	36,144	18,304
Other financial assets	27	-	-	-	-	-	27	27
Total financial assets	810	622	1,511	4,868	30,290	-	38,101	20,217
Net non-derivative cash flows	(6,218)	(3,859)	(3,775)	2,924	29,575	-	18,647	
Derivative cash flows - net								
Interest rate derivatives	1	(2)	(16)	(8)	-	-	(25)	
Total	1	(2)	(16)	(8)	-	-	(25)	
Derivative cash flows - gross								
Foreign exchange derivatives								
Inflow	231	355	502	510	455	-	2,053	
Outflow	(226)	(348)	(479)	(502)	(432)	-	(1,987)	
Total	5	7	23	8	23	-	66	
Off-balance sheet cash flows								
Capital commitments	-	(9)	-	-	-	-	(9)	
Undrawn credit commitments	(3,032)	-	-	-	-	-	(3,032)	
Lease commitments	-	(2)	(6)	(25)	(53)	-	(86)	
Total	(3,032)	(11)	(6)	(25)	(53)	-	(3,127)	
Net cash flows	(9,244)	(3,865)	(3,774)	2,899	29,545	-	15,561	
Cumulative net cash flows	(9,244)	(13,109)	(16,883)	(13,984)	15,561	-	15,561	

Notes to the financial statements

Continued...

32. Risk management continued

Equity risk

Equity risk results from the repricing of equity investments. The Banking Group does not undertake equity trading and there are no significant exposures to equity instruments.

OPERATIONAL AND COMPLIANCE RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk. Operational risk is mitigated by implementing the necessary process, systems and training regimes.

Compliance risk, a subset of operational risk, is the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory standards and codes of conduct applicable to its banking activities.

Operational risk is inherent in the Banking Group's activities. Inadequate practices to identify and assess operational risk can lead to non-compliance, sanctions fines/penalties and losses due to errors, compensation and internal fraud. Failure of processes/systems or human error could result in poor customer service or experience.

Operational risk covers a broad spectrum of activities, and is categorised into seven specific 'event types':

- Internal fraud;
- external fraud;
- employment practices and workplace safety;
- clients, products and business practices (Note: This category includes a large proportion of Kiwibank's compliance risks.);
- damage to physical assets;
- business disruption and system failures; and
- execution, delivery and process management.

Operational risk management within the Banking Group is based on the following core elements:

- Operational risk management relies on the support and participation of all Banking Group staff. Senior management is accountable to the Board for maintaining an adequate and effective control environment that is commensurate with the Banking Group's risk appetite and business objectives.
- Business units are responsible for the management of their operational risks. Each business area is responsible for the identification, measurement, monitoring and mitigation of operational risk in their areas of responsibility.
- A central Risk Management Unit owns and manages the operational risk and compliance framework and provides guidance, assurance, review and challenge and bank-wide risk reporting to relevant governance committees.

General managers provide attestations regarding their operational risk and compliance systems and any weaknesses. A summary of the responses and any issues identified is reported to the Executive Risk Committee and to the Board's Finance, Audit and Disclosure Committee.

BUSINESS RISK

There are numerous external and internal uncertainties that may derail the business strategies or goals of the Banking Group. Success in managing business risk is intrinsically more difficult than managing financial risks (i.e. credit, market and operational risks).

It is only through sound business strategies and skilful execution of these business strategies that the Banking Group's business goals/objectives will be achieved. Risk management strategies are not a substitute for good business strategies but aid in the selection of appropriate strategies and in their successful execution.

Notes to the financial statements

Continued...

32. Risk management continued

CUSTOMER RISK

Customers continually challenge banks to improve products and services and they increasingly measure bank performance against service levels provided by organisations with quite different business models. New entrants seek to disrupt existing industries also, including payments processing and banking and finance, with offerings that are not tied to existing physical channels or operational practices.

The Bank seeks to place the customer at the centre of its business transformation strategies but there remains some uncertainty as to whether those strategies will be successful over the longer term.

The Banking Group has three core business risk management strategies aimed at supporting its business strategies, specifically:

- establishment and maintenance of an internal organisational environment in which business and strategic risk can meaningfully be managed;
- establishment and maintenance of structures, measurement basis and risk management processes for the evaluation and management of business and strategic risks; and
- building capability within the Banking Group to enable both the pursuit of opportunities and mitigation of vulnerabilities.

RISK GOVERNANCE

Risk Governance encompasses the roles and responsibilities of the Board, Chief Risk Officer (“CRO”) and the risk management function, and an independent assessment of the key risks facing the enterprise as well as the effectiveness of policies and processes in place to manage those risks.

Support is provided in the Risk Division led by the CRO and the Enterprise Risk Management team, which provides frameworks, methodologies and tools that quantify and communicate the level of risk the Banking Group is willing to accept to management.

Key elements of the Enterprise Risk Management function are:

- **Risk appetite and supporting policy frameworks** - Risk appetite and culture are embedded in a range of frameworks and policy statements. This includes the Enterprise Risk Management Framework, the Bank’s Risk Appetite Statements, and credit risk policies including the principles of lending. The granular risk appetite is also expressed by a series of risk tolerances that guide day-to-day decision-making. Risk appetite is ultimately defined and approved by the Board of Directors, and implemented by Kiwibank’s management.
- **Quality assurance of credit activities** – This provides assurance that the Credit Policy, processes and systems are being used as designed, both by individual staff and systematically across the Banking Group.
- **The risk governance function** - This includes reviewing material credit change initiatives to ensure they are working as designed and producing the intended outcomes.
- **Model assurance** – This provides assurance that models are fit for purpose and working as intended. The function is tasked with developing model validation and verification standards with the primary focus on models used for rating credit exposure or for regulatory reporting.

Notes to the financial statements

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33. Sensitivity analysis

The tables below summarise the pre-tax sensitivity of financial assets and financial liabilities to changes in two risk variables, interest rate and currency risks. The sensitivity to interest rate movements models the impact of a 1% parallel movement, both up and down, in the yield curve on fair values and earnings.

Fair value sensitivity assesses whether changes in the fair value impact the net profit (e.g., financial assets held for trading) or equity (e.g., investment securities and cash flow hedges) only; market values are used as the basis for this calculation.

Earnings sensitivity calculates the impact on net profit for the previous year of a 1% movement in interest rate based on financial assets and liabilities that have repriced over the previous year that were held at the reporting date.

The sensitivity to currency movements models the impact on net profit of a 10% movement, both up and down, in the New Zealand dollar relative to all currencies where Kiwibank held a material exposure at the reporting date. Any changes in the value of financial assets and financial liabilities due to currency movements are considered to impact the net profit and, therefore, equity equally.

Interest rate risk - fair value	Carrying amounts	30/06/19			
		-1% Net profit	+1% Net profit	-1% Equity	+1% Equity
Dollars in millions					
Financial assets					
Cash and cash equivalents	421	-	-	-	-
Due from related parties	85	-	-	-	-
Due from other financial institutions	71	-	-	-	-
Investment securities	1,176	-	-	16	(16)
Derivative financial instruments	358	136	(129)	174	(166)
Loans and advances	20,443	-	-	-	-
Other financial assets	25	-	-	-	-
Total financial assets	22,579	136	(129)	190	(182)
Financial liabilities					
Due to other financial institutions	126	-	-	-	-
Due to related parties	9	-	-	-	-
Deposits and other borrowings	18,240	-	-	-	-
Derivative financial instruments	343	(104)	99	(195)	188
Debt securities issued	2,078	(29)	28	(29)	28
Other financial liabilities	63	-	-	-	-
Subordinated debt	253	(1)	1	(1)	1
Total financial liabilities	21,112	(134)	128	(225)	217

Notes to the financial statements

Continued...

33. Sensitivity analysis continued

Interest rate risk - fair value	Carrying amounts	30/06/18			
		-1% Net profit	+1% Net profit	-1% Equity	+1% Equity
Dollars in millions					
Financial assets					
Cash and cash equivalents	447	-	-	-	-
Due from related parties	87	-	-	-	-
Due from other financial institutions	132	-	-	-	-
Investment securities	1,220	-	-	15	(15)
Derivative financial instruments	344	155	(147)	179	(171)
Loans and advances	18,304	2	(1)	2	(1)
Other financial assets	27	-	-	-	-
Total financial assets	20,561	157	(148)	196	(187)
Financial liabilities					
Due to other financial institutions	128	-	-	-	-
Due to related parties	8	-	-	-	-
Deposits and other borrowings	16,173	-	-	-	-
Derivative financial instruments	293	(114)	109	(189)	182
Debt securities issued	2,265	(37)	35	(37)	35
Other financial liabilities	69	-	-	-	-
Subordinated debt	254	(1)	1	(1)	1
Total financial liabilities	19,190	(152)	145	(227)	218

Notes to the financial statements

Continued...

33. Sensitivity analysis continued

Interest rate risk - earnings	Carrying amounts	30/06/19			
		-1%	+1%	-1%	+1%
Dollars in millions		Net profit	Net profit	Equity	Equity
Financial assets					
Cash and cash equivalents	421	(4)	4	(4)	4
Due from related parties	85	(1)	1	(1)	1
Due from other financial institutions	71	(1)	1	(1)	1
Investment securities	1,176	(6)	6	(6)	6
Derivative financial instruments	358	60	(60)	60	(60)
Loans and advances	20,443	(153)	153	(153)	153
Other financial assets	25	-	-	-	-
Total financial assets	22,579	(105)	105	(105)	105
Financial liabilities					
Due to other financial institutions	126	1	(1)	1	(1)
Due to related parties	9	-	-	-	-
Deposits and other borrowings	18,240	155	(155)	155	(155)
Derivative financial instruments	343	(83)	83	(83)	83
Debt securities issued	2,078	11	(11)	11	(11)
Other financial liabilities	63	-	-	-	-
Subordinated debt	253	-	-	-	-
Total financial liabilities	21,112	84	(84)	84	(84)

Notes to the financial statements

Continued...

33. Sensitivity analysis continued

Interest rate risk - earnings	Carrying amounts	30/06/18			
		-1% Net profit	+1% Net profit	-1% Equity	+1% Equity
Dollars in millions					
Financial assets					
Cash and cash equivalents	447	(4)	4	(4)	4
Due from related parties	87	-	-	-	-
Due from other financial institutions	132	(1)	1	(1)	1
Investment securities	1,220	(9)	9	(9)	9
Derivative financial instruments	344	76	(76)	76	(76)
Loans and advances	18,304	(128)	128	(128)	128
Other financial assets	27	-	-	-	-
Total financial assets	20,561	(66)	66	(66)	66
Financial liabilities					
Due to other financial institutions	128	1	(1)	1	(1)
Due to related parties	8	-	-	-	-
Deposits and other borrowings	16,173	139	(139)	139	(139)
Derivative financial instruments	293	(115)	115	(115)	115
Debt securities issued	2,265	15	(15)	15	(15)
Other financial liabilities	69	-	-	-	-
Subordinated debt	254	-	-	-	-
Total financial liabilities	19,190	40	(40)	40	(40)

Notes to the financial statements

Continued...

33. Sensitivity analysis continued

Currency risk	Carrying amounts	30/06/19			
		-10%	+10%	-10%	+10%
Dollars in millions		Net profit	Net profit	Equity	Equity
Financial assets					
Cash and cash equivalents	421	7	(6)	7	(6)
Due from related parties	85	-	-	-	-
Due from other financial institutions	71	-	-	-	-
Investment securities	1,176	-	-	-	-
Derivative financial instruments	358	77	(70)	77	(70)
Loans and advances	20,443	1	(1)	1	(1)
Other financial assets	25	-	-	-	-
Total financial assets	22,579	85	(77)	85	(77)
Financial liabilities					
Due to other financial institutions	126	(6)	5	(6)	5
Due to related parties	9	-	-	-	-
Deposits and other borrowings	18,240	(19)	17	(19)	17
Derivative financial instruments	343	30	(28)	30	(28)
Debt securities issued	2,078	(85)	77	(85)	77
Other financial liabilities	63	-	-	-	-
Subordinated debt	253	-	-	-	-
Total financial liabilities	21,112	(80)	71	(80)	71

Notes to the financial statements

Continued...

33. Sensitivity analysis continued

Currency risk	30/06/18				
	Carrying amounts	-10% Net profit	+10% Net profit	-10% Equity	+10% Equity
Dollars in millions					
Financial assets					
Cash and cash equivalents	447	7	(6)	7	(6)
Due from related parties	87	-	-	-	-
Due from other financial institutions	132	-	-	-	-
Investment securities	1,220	-	-	-	-
Derivative financial instruments	344	113	(102)	113	(102)
Loans and advances	18,304	-	-	-	-
Other financial assets	27	-	-	-	-
Total financial assets	20,561	120	(108)	120	(108)
Financial liabilities					
Due to other financial institutions	128	(4)	3	(4)	3
Due to related parties	8	-	-	-	-
Deposits and other borrowings	16,173	(15)	14	(15)	14
Derivative financial instruments	293	40	(38)	40	(38)
Debt securities issued	2,265	(139)	126	(139)	126
Other financial liabilities	69	-	-	-	-
Subordinated debt	254	-	-	-	-
Total financial liabilities	19,190	(118)	105	(118)	105

34. Auditor's remuneration

Dollars in thousands	Year ended	Year ended
	30/06/19	30/06/18
Auditor's remuneration		
Audit and review of financial statements	967	1,058
Other services:		
Other assurance services ¹	59	70
Tax compliance services ²	30	32
Other services ³	74	94
Total auditor's remuneration	1,130	1,254

¹Other assurance services relate to a registry audit, trustee reporting, solvency statement relating to Kiwibank Subordinated Bonds and a controls assurance report (2018: registry audit, trustee reporting, a limited assurance engagement relating to the September 2017 off-quarter disclosure statement, solvency statement relating to Kiwibank Subordinated Bonds and a controls assurance report).

²Tax compliance services relate to the review of tax returns and GST apportionment methodology (2018: review of tax returns and GST apportionment methodology).

³Other services include other agreed-upon procedures, capital models review and Kiwibank whistle-blower policy services review (2018: other agreed-upon procedures, and IT support services).

Notes to the financial statements

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35. Operating lease commitments



Accounting policy

Payments made under operating leases, where the lessor substantially retains the risks and rewards of ownership, are recognised in the income statement in a systematic manner over the term of the lease. Leasehold improvements are capitalised and the cost is amortised over the unexpired period of the lease or the estimated useful life of the improvements, whichever is shorter. Lease incentives received are recognised evenly over the term of the lease as a reduction in rental expense.

As at the reporting date, commitments under non-cancellable property and vehicle operating leases in respect of payments due to be made were:

Dollars in millions	30/06/19	30/06/18
Less than one year	13	8
Between one and two years	12	6
Between two and five years	24	19
Greater than five years	44	53
Total lease commitments	93	86

36. Capital expenditure commitments

Capital expenditure commitments contracted for as at 30 June 2019, but not provided for in these financial statements, total \$3.1m (30 June 2018: \$9.2m) and are analysed by expected maturity in note 32.

37. Contingent liabilities and credit commitments



Accounting policy

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefits is not probable or cannot be reliably measured. Contingent liabilities are not recognised in the balance sheet, but are disclosed unless the likelihood of payment is remote.

The Banking Group enters into lending arrangements with customers with loan commitments which are only recognised in the balance sheet as loans and advances when cash is advanced. Letters of credit and performance-related contingencies include transactions where the Banking Group is obliged to make payments to a third party if a customer fails to fulfil its obligations under a contract.

The Bank has uncovered disclosure issues in relation to the Credit Contracts and Consumer Finance Act and has proactively discussed these with the Commerce Commission. At this stage, the possible impact of the Commission's position cannot be determined with any certainty (30 June 2018: no material contingent liabilities).

Undrawn credit commitments as at the reporting date are as follows:

Dollars in millions	30/06/19	30/06/18
Letters of credit and performance-related contingencies	48	16
Loan commitments	3,363	3,016
Total undrawn credit commitments	3,411	3,032

¹ The comparative prior period amounts have been reclassified to align with the more granular categories used in the current period's presentation.

38. Contingent assets

The Banking Group held insurance policies at the date of the 2016 Kaikoura earthquake that provided cover for Material Damage and Business Interruption. It is probable that the policies will enable the Banking Group to obtain a further reimbursement for various costs incurred as a result of the earthquake, however, there is insufficient information to form a reliable estimate of the financial effect.

Notes to the financial statements

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39. Changes in accounting policies

This note explains the nature and effect of the changes in accounting policies for the Banking Group due to the adoption of NZ IFRS 9 *Financial Instruments* and NZ IFRS 15 *Revenue from Contracts with Customers* effective from 1 July 2018.

IMPACT OF ADOPTION OF NEW ACCOUNTING STANDARDS ON THE FINANCIAL STATEMENTS

The following table is an extract of the financial statements showing each individual line item that was adjusted on 1 July 2018 as a result of the adoption of the new accounting standards. Comparative amounts have not been restated as permitted by the standards.

Dollars in millions	Audited 30/06/18	Transitional adjustments resulting from the adoption of:*		Audited 1/07/18
		NZ IFRS 15	NZ IFRS 9	
Assets				
Loans and advances	18,304	-	1	18,305
Deferred taxation	11	1	-	12
Total assets	20,715	1	1	20,717
Liabilities				
Contract liabilities	-	6	-	6
Total liabilities	19,228	6	-	19,234
Shareholder's equity				
Reserves	750	(5)	1	746
Total shareholder's equity	1,487	(5)	1	1,483
Total liabilities and shareholder's equity	20,715	1	1	20,717

*The impact of transitional adjustments resulting from the adoption of NZ IFRS 15 and NZ IFRS 9 has been applied retrospectively by adjusting the opening balance of loans and advances, deferred taxation, and contract liabilities. The total cumulative effect of remeasurement due to the transition has been recognised by adjusting opening retained earnings without restating comparatives as permitted by the standards.

NZ IFRS 9: *Financial Instruments*

Summary

NZ IFRS 9 replaced guidance in NZ IAS 39 *Financial Instruments: Recognition and Measurement* on the classification and measurement of financial instruments, impairment on financial assets, and new general hedge accounting requirements. The guidance on recognition and derecognition of financial instruments has been carried forward from NZ IAS 39.

Impairment of financial assets

NZ IFRS 9 replaced the incurred loss model under NZ IAS 39 with a forward-looking expected loss model. This model is now applied to financial assets measured at amortised cost, debt instruments measured at fair value through other comprehensive income, lease receivables, and certain loan commitments and financial guarantees. Under NZ IFRS 9, a three-stage approach is applied to measuring expected credit losses ("ECL") based on credit migration between the stages as follows:

Stage 1 - At initial recognition, a provision equivalent to 12 months ECL is recognised.

Stage 2 - Where there has been a significant increase in credit risk since initial recognition, a provision equivalent to full lifetime ECL is recognised.

Stage 3 - This stage comprises all accounts that are impaired or in default. Lifetime ECL is recognised for loans where there is objective evidence of impairment.

Notes to the financial statements

Continued...

39. Changes in accounting policies continued

ECLs are probability weighted and determined by evaluating a range of possible outcomes, taking into account the time value of money, past events, current conditions and forecasts of future economic conditions. The new ECL models therefore involve a greater use of judgement than the previous impairment model.

The ECL models use three main components to determine expected credit loss (as well as time value of money) including:

- probability of default (“**PD**”): the probability that a counterparty will default;
- loss-given default (“**LGD**”): the loss that is expected to arise in the event of default; and
- exposure at default (“**EAD**”): the estimated outstanding amount of credit exposure at the time of default.

These models incorporate past experience, current conditions and multiple probability-weighted macroeconomic scenarios to generate credit loss estimates under reasonably supportable future economic conditions.

Changes to ECL are assessed through four economic scenarios which include a central scenario reflecting the expected track for the economy and alternative scenarios incorporating upside and downside risks to that central scenario. The probability weightings attached to each scenario are reviewed by executive management half-yearly, although more frequent reviews may be undertaken should macroeconomic conditions change materially.

The Bank’s governance framework has been developed to implement appropriate controls to address the new requirements of NZ IFRS 9, including key areas of judgement such as the determination of a significant increase in credit risk and the use of forward-looking information in future economic scenarios.

The determination of a significant deterioration of credit risk (i.e. the movement from stage 1 to stage 2) is based on changes in internally-assessed customer risk characteristics since origination of the facility. The movement between stages 2 and 3 is based on whether financial assets are credit impaired at the reporting date.

Classification and measurement

NZ IFRS 9 contains a classification and measurement approach for financial assets that reflects the business model in which assets are managed and their contractual cash flow characteristics. Financial assets are now measured at:

- amortised cost where the business model is to hold the financial assets in order to collect contractual cash flows and those cash flows solely represent payments of principal and interest;
- fair value through other comprehensive income (“**FVOCI**”) where the business model is to both collect contractual cash flows and sell financial assets and the cash flows solely represent payments of principal and interest. Non-traded equity instruments can also be measured at fair value through other comprehensive income; or
- fair value through profit or loss (“**FVTPL**”) if they are held for trading or if the cash flows of the asset do not solely represent payments of principal and interest. An entity can also elect to measure a financial asset at fair value through profit or loss if it eliminates or reduces an accounting mismatch.

The classification and measurement requirements for financial liabilities under NZ IFRS 9 are largely consistent with NZ IAS 39 with the exception that for financial liabilities designated as measured at fair value, gains or losses relating to changes in the entity’s own credit risk are now included in other comprehensive income.

Notes to the financial statements

Continued...

39. Changes in accounting policies continued

The following table shows the original measurement categories in accordance with NZ IAS 39 and the new measurement categories under NZ IFRS 9 of the financial assets and liabilities as at 30 June 2018 and 1 July 2018 respectively.

Dollars in millions	NZ IAS 39		NZ IFRS 9	
	Audited as at 30/06/18		Audited as at 1/07/18	
Financial assets	Classification	Amount	Classification	Amount
Cash and cash equivalents	Loans and receivables	447	Amortised cost	447
Due from related parties	Loans and receivables	87	Amortised cost	87
Due from other financial institutions	Loans and receivables	132	Amortised cost	132
Investment securities	Available-for-sale	1,220	FVOCI	1,220
Loans and advances	Loans and receivables	18,304	Amortised cost	18,305
Derivative financial instruments:				
Held for trading	FVTPL	244	FVTPL	244
Used for hedging	Derivatives used for hedging	100	Derivatives used for hedging	100
Other financial assets	Loans and receivables	27	Amortised cost	27
Total financial assets		20,561		20,562
Financial liabilities				
Due to other financial institutions	Amortised cost	128	Amortised cost	128
Due to related parties	Amortised cost	8	Amortised cost	8
Deposits and other borrowings	Amortised cost	16,173	Amortised cost	16,173
Derivative financial instruments:				
Held for trading	FVTPL	235	FVTPL	235
Used for hedging	Derivatives used for hedging	58	Derivatives used for hedging	58
Debt securities issued:				
Commercial paper at FVTPL	Designated at FVTPL	298	FVTPL	298
Excluding commercial paper	Amortised cost	1,967	Amortised cost	1,967
Subordinated debt	Amortised cost	254	Amortised cost	254
Other financial liabilities	Amortised cost	69	Amortised cost	69
Total financial liabilities		19,190		19,190

General hedge accounting

NZ IFRS 9 introduced general hedge accounting requirements which more closely align with risk management activities undertaken when hedging financial and non-financial risks. The new NZ IFRS model no longer requires specific quantitative measures for effectiveness testing and does not permit revocation of hedge designation.

NZ IFRS 9's approach to hedge accounting increases the eligibility of both hedged items and hedging instruments and applies a more principles-based approach to hedge effectiveness. Adoption of NZ IFRS 9's new hedge accounting model is optional until the International Accounting Standards Board ("IASB") completes its Accounting for Dynamic Risk Management project.

The Banking Group has elected to continue to apply the existing hedge accounting requirements of NZ IAS 39, as a policy choice permitted under NZ IFRS 9 although has applied the amended NZ IFRS 7 hedge accounting disclosure requirements.

Notes to the financial statements

Continued...

39. Changes in accounting policies continued

Impact of transition

The total financial impact of the adoption of NZ IFRS 9 was a \$0.5m increase in opening retained earnings (net of tax). The transition to NZ IFRS 9 resulted in an increase in loans and advances of \$0.6m due to the adjustment to credit impairment provisions using the new ECL models with the balance being an adjustment to deferred tax.

In addition, the Banking Group has adopted consequential amendments to NZ IFRS 7: *Financial Instruments: Disclosures* that are applied to disclosures for the year ended 30 June 2019, but these have not been applied to the comparative information as permitted by the standard.

Additional or amended disclosures as a result of adopting NZ IFRS 9 and the amendments to NZ IFRS 7 are included in the following notes:

- Note 9 – Credit impairment losses;
- Note 10 – Asset quality;
- Note 15 – Derivative financial instruments and hedging activities;
- Note 20 – Financial instruments; and
- Note 32 – Risk management.

NZ IFRS 15: *Revenue from Contracts with Customers*

NZ IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced previous revenue recognition guidance, including NZ IAS 18: *Revenue*, NZ IAS 11: *Construction Contracts* and NZ IFRIC 13: *Customer Loyalty Programmes*.

NZ IFRS 15 requires identification of distinct performance obligations within contracts with customers and allocation of the transaction price of the contract to those performance obligations. Revenue is recognised as each performance obligation is satisfied. Variable amounts of revenue can only be recognised if it is highly probable that a significant reversal of each variable amount will not be required in future periods.

The Banking Group completed an assessment on all material revenue streams by applying the five-step model framework of NZ IFRS 15 to all contracts with customers that are not specifically excluded from the scope of NZ IFRS 15. The majority of the Banking Group's revenue is outside the scope of NZ IFRS 15 due to the exclusion of revenue covered by other accounting standards including NZ IFRS 9; however, certain revenue streams have been impacted by the adoption of NZ IFRS 15.

Impact of transition

The revenue streams impacted include certain fees for card products and long-term contracts where the recognition of income is now required to be spread consistently with the fulfilment of the relevant performance obligations. The total financial impact of the adoption of NZ IFRS 15 was a \$4.5m reduction in opening retained earnings (net of tax). The transition to NZ IFRS 15 resulted in the recognition of contract liabilities of \$6.3m, representing unfulfilled performance obligations where revenue has already been received and previously recognised under NZ IAS 18: *Revenue*, and a related deferred tax asset of \$1.8m.

Additional or amended disclosures as a result of adopting NZ IFRS 15 are included in note 5 – Net fee and other income and contracts with customers.

40. Events subsequent to the reporting date

On 15 July 2019, at the first call date, Kiwibank repaid in full \$100m of Kiwibank bonds. The Kiwibank bonds are disclosed as part of Tier 2 capital and recognised within subordinated debt as at 30 June 2019.

On 21 August 2019 a dividend of \$5.6m was declared by the Kiwibank Board. This equates to 0.75 cents per share.

There were no other material events that occurred subsequent to the reporting date which require recognition or additional disclosure in these financial statements.

Capital adequacy and regulatory liquidity ratios

Kiwibank Limited (“**Kiwibank**” or the “**Bank**”) is subject to the capital adequacy requirements for registered banks as specified by the Reserve Bank of New Zealand (“**RBNZ**”). Following an internationally agreed framework (commonly known as Basel III) developed by the Basel committee on Banking supervision, the RBNZ has set minimum acceptable regulatory capital requirements and provided methods for estimating or measuring the risks incurred by the Bank. As a bank adopting a Standardised Approach under the Basel III regime, Kiwibank applies the RBNZ’s BS12 - *Guidelines on a Bank’s Internal Capital Adequacy Assessment Process (“ICAAP”)* as a basis for estimating adequate prudential capital and BS2A - *Capital Adequacy Framework (Standardised Approach)* for calculating regulatory capital requirements. In accordance with Kiwibank’s banking conditions of registration, Kiwibank applies the RBNZ’s Basel III framework.

Regulatory capital adequacy ratios are calculated by expressing capital as a percentage of risk-weighted exposures. As a condition of registration, the Banking Group must comply with the following minimum capital requirements set by the RBNZ:

- Total capital ratio must not be less than 8.0% of risk-weighted exposures.
- Tier 1 capital ratio must not be less than 6.0% of risk-weighted exposures.
- The Common Equity Tier 1 capital ratio is not less than 4.5%.
- Capital of the Banking Group must not be less than NZ\$30m.

Regulatory capital

The Basel III standards for bank capital distinguish between Tier 1 and Tier 2 capital. Tier 1 capital is permanently and freely available to absorb losses without the bank being obliged to cease trading, while Tier 2 capital generally only absorbs losses in a winding up. Within Tier 1 capital, Common Equity Tier 1 capital (“**CET 1**”) has greater loss-absorbing capability than the other Tier 1 instruments referred to as Additional Tier 1 capital (“**AT 1**”).

Capital ratios are used to define minimum capital requirements for each of: Common Equity Tier 1 capital (CET 1 plus AT 1), and Total capital (Tier 1 plus Tier 2), as a percentage of risk-weighted assets. There are increasing constraints on capital distributions where a bank’s capital level falls within the buffer range. The following table shows the current capital ratio requirements and conservation buffers (as a percentage of risk-weighted assets).

Capital ratios

	The Banking Group	
	30/06/19	30/06/18
Capital adequacy ratios		
Common Equity Tier 1 capital ratio	12.4%	13.4%
Tier 1 capital ratio	13.7%	14.8%
Total capital ratio	14.5%	15.8%
RBNZ’s minimum ratios		
Common Equity Tier 1 capital ratio	4.5%	4.5%
Tier 1 capital ratio	6.0%	6.0%
Total capital ratio	8.0%	8.0%
Buffer ratios		
Buffer ratio	6.5%	7.8%
Buffer ratio requirement	2.5%	2.5%
<hr/>		
	Kiwibank Limited	
	30/06/19	30/06/18
Capital adequacy ratios		
Common Equity Tier 1 capital ratio	12.1%	12.9%
Tier 1 capital ratio	13.3%	14.2%
Total capital ratio	14.1%	15.1%

Capital adequacy and regulatory liquidity ratios

Continued...

Ordinary shares

The ordinary shares issued by the Bank, which are fully paid, are included within CET 1 capital. The material terms and conditions of the ordinary shares are:

- a) each share contains a single right to vote;
- b) there are no redemption, conversion or capital repayment options/facilities;
- c) there is no predetermined dividend rate;
- d) there is no maturity date; and
- e) there are no options to be granted pursuant to any agreement.

Perpetual capital bonds

The perpetual capital bonds, issued by the Bank on 27 May 2015, and which are fully paid, are included within Additional Tier 1 capital ("AT1"). The perpetual capital bond issue is subordinate to other term subordinated debt issues and all other general liabilities of the Banking Group and is denominated in New Zealand dollars. The material terms and conditions are:

- a) the perpetual capital bonds constitute direct, perpetual, convertible, non-cumulative, unsecured, subordinated debt securities issued by Kiwibank;
- b) interest on the perpetual capital bonds is payable quarterly at an initial rate of 7.25% p.a. subject to the absolute discretion of Kiwibank;
- c) interest is non-cumulative;
- d) the perpetual capital bonds may be required to be converted into ordinary shares of Kiwibank Limited (or written off if conversion into ordinary shares is not possible) if certain events occur;
- e) the perpetual capital bonds do not have a maturity date; however, Kiwibank may elect to make early repayment on 27 May 2020 or any reset date thereafter (reset dates occur at five-yearly intervals, commencing on 27 May 2020); and
- f) the perpetual capital bonds are not guaranteed by any member of the Banking Group, Kiwibank's parent companies (including New Zealand Post), the Crown or by any other person.

Convertible subordinated bonds ("Kiwibank bonds")

The convertible subordinated bond issue, issued by the Bank on 6 June 2014 and which were fully paid, was included within Tier 2 capital as at 30 June 2019. On 15 July 2019, the first call date, the Kiwibank bonds were repaid in full. The issue was subordinate to all other general liabilities of the Banking Group and was denominated in New Zealand dollars. The material terms and conditions were:

- a) the convertible subordinated bonds constituted direct, unsecured, subordinated debt obligations of Kiwibank;
- b) interest on the convertible subordinated bonds was payable semi-annually at an initial rate of 6.61% p.a. subject to the condition that Kiwibank and the Banking Group were solvent after each payment;
- c) the convertible subordinated bonds may have been required to be converted into ordinary shares of Kiwibank Limited (or written off if conversion into ordinary shares is not possible) if certain events occurred;
- d) the convertible subordinated bonds had a maturity date of 15 July 2024; however, Kiwibank could elect to make early repayment on 15 July 2019 or any semi-annual interest payment date thereafter (this early repayment election was made at the first call date as noted above); and
- e) the convertible subordinated bonds were not guaranteed by any member of the Banking Group, Kiwibank's parent companies (including New Zealand Post), the Crown or by any other person.

Risk-weighted exposures

Risk-weighted exposures are derived by assigning risk-weight percentages to certain material risk categories of exposures. These exposures are measured or estimated from: selected balance sheet assets; off-balance-sheet exposures and market contracts; and business unit net income.

Capital adequacy and regulatory liquidity ratios

Continued...

The Bank's current Prudential capital requirements based on assessments of its material risk classes (commonly referred to as "Pillar I" risk classes under Basel III) can be summarised as follows:

- Credit risk - The vulnerability of the Banking Group's lending and investment portfolios to systemic counterparty default. The risk-based capital allocation is computed based on the RBNZ's Standardised Approach Credit Risk methodology (BS2A).
- Market risk - The vulnerability of earnings to movements in interest rates and currency volatility. The risk-based capital allocation is computed based on the RBNZ's Standardised Approach to Interest Rate Risk (BS2A).
- Operational risk - The risk of loss, resulting from inadequate or failed internal processes (including legal risks), people and systems and from external events. The risk-based capital allocation is computed based on RBNZ Standardised Approach to Operational Risk methodology (BS2A).

Kiwibank's Board is ultimately responsible for capital adequacy and approves capital plans and establishes minimum internal capital levels and limits. These are typically higher than the regulatory minimum.

The capital adequacy tables on the following pages summarise the composition of regulatory capital and capital adequacy ratios for the year ended 30 June 2019. Throughout the period, Kiwibank and the Banking Group complied with both regulatory and internal capital adequacy requirements.

Regulatory capital

The following table shows the qualifying capital for the Banking Group.

Dollars in millions	The Banking Group	
	30/06/19	30/06/18
Common Equity Tier 1 capital		
Issued and fully paid-up share capital	737	737
Retained earnings (net of appropriations)	823	755
Accumulated other comprehensive income and other disclosed reserves ^{1,2}	(11)	(5)
Less deductions from Common Equity Tier 1 capital		
Intangible assets	(74)	(78)
Cash flow hedge reserve	22	10
Deferred tax assets	(21)	(11)
Receivables from affiliated insurance group	(1)	(1)
Total Common Equity Tier 1 capital	1,475	1,407
Additional Tier 1 capital		
Perpetual capital bonds ³	149	149
Total Additional Tier 1 capital	149	149
Total Tier 1 capital	1,624	1,556
Tier 2 capital		
Subordinated bonds	100	100
Total Tier 2 capital	100	100
Total capital	1,724	1,656

¹Includes fair value reserve of \$11m. The fair value reserve includes the cumulative net change in the fair value of investment securities until the investment is derecognised or impaired.

²Includes cash flow hedge reserve of (\$22m). The cash flow hedging reserve comprises the effective portion of the cumulative net change in the fair value of foreign exchange and interest rate derivative contracts related to hedged forecasted transactions that have not yet occurred. The cash flow hedge reserve is not eligible for inclusion in capital under BS2A 7 (3)(c).

³Perpetual capital bonds are classified as debt of the Banking Group for financial reporting purposes.

Capital adequacy and regulatory liquidity ratios

Continued...

On-balance sheet exposures

Dollars in millions	The Banking Group 30/06/19			
	Total exposure	Risk weighting	Risk-weighted exposure	Minimum Pillar I capital requirement
On-balance sheet exposures				
Cash and gold bullion	38	0%	-	-
Sovereigns and central banks	872	0%	-	-
Multilateral development banks and other international organisations	308	0%	-	-
Public sector entities	-	20%	-	-
	-	100%	-	-
Banks	300	20%	60	5
	117	50%	59	5
Corporate	23	20%	5	-
	10	50%	5	-
	1,218	100%	1,218	97
Non-property investment residential mortgage loans				
<= 80% loan-to-value ratio ("LVR")	10,806	35%	3,782	303
80 <= 90% LVR	936	50%	468	37
90 <= 100% LVR	30	75%	23	2
> 100% LVR	103	100%	103	8
Non-property investment residential mortgage loans - Welcome Home loans and lenders mortgage insured loans				
<= 80% LVR	302	35%	106	8
80 <= 90% LVR	411	35%	144	12
90 <= 100% LVR	28	50%	14	1
Property investment residential mortgage loans				
<= 80% LVR	5,979	40%	2,392	191
80 <= 90% LVR	91	70%	64	5
90 <= 100% LVR	24	90%	22	2
> 100% LVR	45	100%	45	4
Property investment residential mortgage loans - Welcome Home loans and lenders mortgage insured loans				
<= 80% LVR	27	40%	11	1
80 <= 90% LVR	1	50%	1	-
Impaired assets	2	100%	2	-
Past due residential mortgages > 90 days	9	100%	9	1
	1	35%	-	-
Other past due assets	1	150%	2	-
Non-risk-weighted assets	454	0%	-	-
Other assets	598	100%	598	48
Total on-balance sheet exposures	22,734		9,133	730

Capital adequacy and regulatory liquidity ratios

Continued...

Off-balance sheet exposures and market-related contracts

The Banking Group						
30/06/19						
Dollars in millions	Total exposure	Credit conversion factor	Credit equivalent amount	Average risk-weighting	Risk-weighted exposure	Minimum Pillar I capital requirement
Direct credit substitute	38	100%	38	100%	38	3
Performance-related contingency	10	50%	5	100%	5	-
Other commitments where original maturity is greater than one year	2,279	50%	1,140	46%	524	42
Other commitments that cancel automatically when the creditworthiness of the counterparty deteriorates or that can be cancelled unconditionally at any time without prior notice	1,084	0%	-	0%	-	-
Market-related contracts: ¹						
(a) Foreign exchange contracts	1,413	N/A	119	43%	51	4
(b) Interest rate contracts	28,880	N/A	360	38%	137	11
(c) CVA		N/A			103	8
Total off-balance sheet exposures	33,704		1,662		858	68

¹ The credit equivalent amount for market-related contracts was calculated using the current exposure method.

Capital adequacy and regulatory liquidity ratios

Continued...

Residential mortgages by loan-to-value ratio

Dollars in millions	The Banking Group		
	30/06/19		
	On-balance sheet	Off-balance sheet	Total
LVR 0% - 80%	17,124	945	18,069
LVR 80% - 90%	1,440	42	1,482
LVR 90% +	231	24	255
Total	18,795	1,011	19,806

The LVR classification above is calculated in compliance with the Order.

At 30 June 2019, of the loans with an LVR greater than 80%, \$423m relates to "Welcome Home" loans, whose credit risk is mitigated by the New Zealand Crown (via underwriting by Housing New Zealand Corporation).

Reconciliation of mortgage-related amounts

Dollars in millions	The Banking Group
	30/06/19
Residential mortgages total on-balance sheet exposures	18,795
Provision for credit impairment	16
Deferred arrangement fees	83
Gross residential mortgage loans per asset quality (note 10)	18,894
Other term lending residentially secured including corporate lending	(917)
Gross term loans - housing per loans and advances (note 8)	17,977

Credit risk mitigation

Dollars in millions	The Banking Group			
	30/06/19			
	Total value of on- and off-balance sheet exposures covered by eligible collateral (after haircutting)	Total value of on- and off-balance sheet exposures covered by guarantees or credit derivatives	Risk weighted exposure	Minimum Pillar I capital requirement
Bank	(29,013)	-	(216)	(17)
	(29,013)	-	(216)	(17)

The Banking Group uses the comprehensive method to measure the mitigating effects of collateral.

Capital adequacy and regulatory liquidity ratios

Continued...

Operational risk

Dollars in millions	The Banking Group 30/06/19	
	Implied risk-weighted exposure	Total operational risk capital requirement
Operational risk	1,374	110

Market risk

Dollars in millions	The Banking Group 30/06/19			
	Implied risk-weighted exposure		Aggregate capital charge	
	End of period	Peak end-of-day	End of period	Peak end-of-day
Interest rate risk	696	798	56	64
- of which relates to trading book	26	36	2	3
Foreign currency risk	22	23	2	2
Equity risk	-	-	-	-

The aggregate market risk exposure above is derived in accordance with BS2A.

The peak end-of-day aggregate capital charge is the maximum over the half-year accounting period at the close of each business day.

Total capital requirements

Dollars in millions	The Banking Group 30/06/19		
	Total exposure after credit risk mitigation	Risk weighted exposure or implied risk weighted exposure	Total capital requirement
Total credit risk plus equity	27,425	9,775	781
Operational risk	n/a	1,374	110
Market risk	n/a	718	58
Total Pillar I risk	n/a	11,867	949

Capital adequacy and regulatory liquidity ratios

Continued...

Other material risk (Pillar II)

The Basel III capital adequacy regime intends to ensure that banks have adequate capital to support all material risk inherent in their business activities. Consequently, banks are required to maintain an ICAAP for assessing overall capital adequacy in relation to their risk profile. Kiwibank's ICAAP methodology requires it to hold capital against the following "other material risks" (Pillar II risks), including:

- Earnings risk – The current or prospective risk to earnings and growth targets arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment.
- Other risks – Including conduct and culture, project execution, and cyber risks.

The Bank has made an internal capital allocation of \$63m (30 June 2018: \$60m).

Regulatory liquidity ratios

The Bank calculates regulatory liquidity ratios in accordance with the RBNZ's 'Liquidity Policy' (BS13). Ratios are calculated daily and the quarterly averages of each daily ratio are disclosed below.

	3 months ended 30/06/19	3 months ended 31/03/2019
Average one-week mismatch ratio	7.8%	8.0%
Average one-month mismatch ratio	7.7%	8.3%
Average core funding ratio	89.2%	89.4%

Conditions of registration

The conditions of registration imposed on Kiwibank Limited by the Reserve Bank of New Zealand (“RBNZ”) pursuant to section 74 of the Reserve Bank of New Zealand Act 1989, which were applicable as at 30 June 2019, are as follows:

Conditions of registration for Kiwibank Limited

These conditions apply on and after 1 January 2019.

The registration of Kiwibank Limited (the “Bank”) as a registered bank is subject to the following conditions.

1. That:
 - a) the Total capital ratio of the Banking Group is not less than 8%;
 - b) the Tier 1 capital ratio of the Banking Group is not less than 6%;
 - c) the Common Equity Tier 1 capital ratio of the Banking Group is not less than 4.5%;
 - d) the Total capital of the Banking Group is not less than \$30m;
 - e) the bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued after 1 January 2013 in the calculation of its capital ratios unless it has received a notice of non-objection to the instrument from the RBNZ; and
 - f) the bank meets the requirements of Part 3 of the RBNZ document entitled “Application requirements for capital recognition or repayment and notification requirements in respect of capital” (BS16) dated November 2015 in respect of regulatory capital instruments.

For the purposes of this condition of registration:

- “Total capital ratio”, “Tier 1 capital ratio”, and “Common Equity Tier 1 capital ratio” have the same meaning as in Part 3 of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015;
- “Total capital” has the same meaning as in Part 2 of the Reserve Bank of New Zealand document “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015;
- an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 8(2)(a) or (c) of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015;
- a Tier 2 capital instrument is an instrument that meets the requirements of subsection 9(2)(a) or (c) of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015.

1A. That:

- 1) the Bank has an internal capital adequacy assessment process (“ICAAP”) that accords with the requirements set out in the document entitled “Guidelines on a bank’s internal capital adequacy assessment process (‘ICAAP’)” (BS12) dated December 2007;
- 2) under its ICAAP, the Bank identifies and measures its “other material risks” defined as all material risks of the Banking Group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015; and
- 3) the Bank determines an internal capital allocation for each identified and measured “other material risk”.

1B. That, if the buffer ratio of the Banking Group is 2.5% or less, the Bank must:

- a) according to the following table, limit the aggregate distributions of the Bank’s earnings to the percentage limit to distributions that corresponds to the Banking Group’s buffer ratio:

The Banking Group’s buffer ratio	Percentage limit to distributions of the Bank’s earnings
0% - 0.625%	0%
0.625% - 1.25%	20%
1.25% - 1.875%	40%
1.875% - 2.5%	60%

- b) prepare a capital plan to restore the Banking Group’s buffer ratio to above 2.5% within any timeframe determined by the RBNZ for restoring the buffer ratio; and
- c) have the capital plan approved by the RBNZ.

For the purpose of this condition of registration:

- “buffer ratio”, “distributions” and “earnings” have the same meaning as in Part 3 of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015.

Conditions of registration

Continued...

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

In this condition of registration, the meaning of “material” is based on New Zealand Generally Accepted Accounting Practice (“**NZ GAAP**”).

3. That the Banking Group’s insurance business is not greater than 1% of its total consolidated assets.

For the purposes of this condition of registration, the Banking Group’s insurance business is the sum of the following amounts for entities in the Banking Group:

- a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the Banking Group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and
- b) if the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the Banking Group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity’s insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business.

In determining the total amount of the Banking Group’s insurance business:

- a) all amounts must relate to on-balance sheet items only, and must comply with NZ GAAP; and
- b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

For the purposes of this condition of registration:

“insurance business” means the undertaking or assumption of liability as an insurer under a contract of insurance;

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

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

Credit rating of the Bank ¹	Connected exposure limit (% of the Banking Group’s Tier 1 capital)
AA/Aa2 and above	75
AA-/Aa3	70
A+/A1	60
A/A2	40
A-/A3	30
BBB+/Baa1 and below	15

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

For the purposes of this condition of registration, compliance with the rating-contingent connected exposure limit is determined in accordance with the RBNZ’s document entitled “Connected Exposure Policy” (BS8) dated November 2015.

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

¹This table uses the rating scales of S&P, Moody’s and Fitch (Fitch’s scale is identical to S&P’s.)

Conditions of registration

Continued...

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

- a) the board of the Bank must have at least five directors;
- b) the majority of the board members must be non-executive directors;
- c) at least half of the board members must be independent directors;
- d) an alternate director, -
 - (i) for a non-executive director must be non-executive; and
 - (ii) for an independent director must be independent;
- e) at least half of the independent directors of the Bank must be ordinarily resident in New Zealand;
- f) the chairperson of the board of the Bank must be independent; and
- g) the Bank's constitution must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the company (i.e. the Bank).

For the purposes of this condition of registration, "non-executive" and "independent" have the same meaning as in the RBNZ's document entitled "Corporate Governance" (BS14) dated July 2014.

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

- a) the RBNZ has been supplied with a copy of the curriculum vitae of the proposed appointee; and
- b) the RBNZ has advised that it has no objection to that appointment.

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

- a) the RBNZ has been supplied with a copy of the curriculum vitae of the proposed appointee; and
- b) the RBNZ has advised that it has no objection to that appointment.

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

- a) the mandate of the committee must include: ensuring the integrity of the Bank's financial controls, reporting systems and internal audit standards;
- b) the committee must have at least three members;
- c) every member of the committee must be a non-executive director of the Bank;
- d) the majority of the members of the committee must be independent; and
- e) the chairperson of the committee must be independent and must not be the chairperson of the Bank.

For the purposes of this condition of registration, "non-executive" and "independent" have the same meaning as in the RBNZ's document entitled "Corporate Governance" (BS14) dated July 2014.

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

11. That the Bank has legal and practical ability to control and execute any business, and any functions relating to any business, of the Bank that are carried out by a person other than the Bank, sufficient to achieve, under normal business conditions and in the event of stress or failure of the Bank or of a service provider to the Bank, the following outcomes:

- a) that the Bank's clearing and settlement obligations due on a day can be met on that day;
- b) that the Bank's financial risk positions on a day can be identified on that day;
- c) that the Bank's financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and
- d) that the Bank's existing customers can be given access to payments facilities on the day following any failure and on subsequent days.

This condition ceases to apply in respect of an existing outsourcing arrangement on the earlier of either 1 October 2022 or when the existing outsourcing arrangement becomes compliant with condition 24, from which point in time condition 24 will apply to that outsourcing arrangement.

For the purposes of this condition of registration:

- a) the term "legal and practical ability to control and execute" is explained in the RBNZ's document entitled "Outsourcing Policy" (BS11) dated January 2006; and
- b) the term "existing outsourcing arrangement" is defined in the RBNZ's document entitled "BS11: Outsourcing Policy for Registered Banks" dated September 2017.

Conditions of registration

Continued...

12. That:

- a) the business and affairs of the Bank are managed by, or under the direction or supervision of, the board of the Bank;
- b) the employment contract of the chief executive officer of the Bank or person in an equivalent position (together "CEO") is with the Bank, and the terms and conditions of the CEO's employment agreement are determined by, and any decisions relating to the employment or termination of employment of the CEO are made by, the board of the Bank; and
- c) all staff employed by the Bank shall have their remuneration determined by (or under the delegated authority of) the board or the CEO of the Bank and be accountable (directly or indirectly) to the CEO of the Bank.

13. That the Banking Group complies with the following quantitative requirements for liquidity risk management:

- a) the one-week mismatch ratio of the Banking Group is not less than 0% at the end of each business day;
- b) the one-month mismatch ratio of the Banking Group is not less than 0% at the end of each business day; and
- c) the one-year core funding ratio of the Banking Group is not less than 75% at the end of each business day.

For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the RBNZ's documents entitled "Liquidity Policy" (BS13) dated January 2018 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated October 2018.

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

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

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

For the purposes of this condition:

- "total assets" means all assets of the Banking Group plus any assets held by any SPV that are not included in the Banking Group's assets;
- "SPV" means a person
 - a) to whom any member of the Banking Group has sold, assigned, or otherwise transferred any asset;
 - b) who has granted, or may grant, a security interest in its assets for the benefit of any holder of any covered bond; and
 - c) who carries on no other business except for that necessary or incidental to guarantee the obligations of any member of the Banking Group under a covered bond;
- "covered bond" means a debt security issued by any member of the Banking Group, for which repayment to holders is guaranteed by an SPV, and investors retain an unsecured claim on the issuer.

16. That:

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

Conditions of registration

Continued...

For the purposes of this condition of registration, “qualifying acquisition or business combination”, “notification threshold” and “non-objection threshold” have the same meaning as in the RBNZ’s Banking Supervision Handbook document entitled “Significant Acquisitions Policy” (BS15) dated December 2011.

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

For the purposes of this condition of registration, “de minimis”, “partial freeze”, “customer liability account” and “frozen and unfrozen funds” have the same meaning as in the RBNZ’s document entitled “Open Bank Resolution (OBR) Pre-positioning Requirements Policy” (BS17) dated September 2013.

18. That the Bank has an Implementation Plan that:
- a) is up to date; and
 - b) demonstrates that the bank’s pre-positioning for Open Bank Resolution meets the requirements set out in the RBNZ’s document: “Open Bank Resolution Pre-positioning Requirements Policy” (BS17).

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

19. That the Bank has a compendium of liabilities that -
- a) at the product-class level lists all liabilities, indicating which are:
 - (i) pre-positioned for Open Bank Resolution; and
 - (ii) not pre-positioned for Open Bank Resolution;
 - b) is agreed by the RBNZ; and
 - c) if the RBNZ’s agreement is conditional, meets the RBNZ’s conditions.

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

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

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

21. That, for a loan-to-valuation measurement period, the total of the Bank’s qualifying new mortgage lending amounts in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 70% must not exceed 5% of the total of the qualifying new mortgage lending amounts in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
22. That, for a loan-to-valuation measurement period, the total of the Bank’s qualifying new mortgage lending amounts in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80% must not exceed 20% of the total of the qualifying new mortgage lending amounts in respect of non-property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
23. That the Bank must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the Bank’s agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.
24. That the Bank must comply with the RBNZ’s document entitled “Outsourcing Policy” (BS11) dated September 2017.

Conditions of registration

Continued...

In these conditions of registration:

- “Banking Group” means Kiwibank Limited (as a reporting entity) and all other entities included in the group as defined in section 6(1) of the Financial Markets Conduct Act 2013 for the purposes of Part 7 of that Act.

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

In conditions of registration 21 to 23:

- “loan-to-valuation ratio”, “non-property-investment residential mortgage loan”, “property-investment residential mortgage loan”, “qualifying new mortgage lending amount in respect of property-investment residential mortgage loans”, “qualifying new mortgage lending amount in respect of non-property-investment residential mortgage loans” and “residential mortgage loan” have the same meaning as in the RBNZ’s document entitled “Framework for Restrictions on High-LVR Residential Mortgage Lending” (BS19) dated January 2019:
- “loan-to-valuation measurement period” means:
 - a) the three-calendar-month period ending on the last day of March 2019; and
 - b) thereafter a period of three calendar months ending on the last day of the third calendar month, the first of which ends on the last day of April 2019.

Non-compliance with conditions of registration

As a result of a review the Bank initiated of its compliance with its conditions of registration, some discrepancies with the calculation of its regulatory liquidity and capital ratios were identified. The review is ongoing and further updates will be provided if necessary. The Bank remained above all Board and RBNZ ratio requirements at all times. The RBNZ has not required restatement of any previously reported ratios.

Non-compliance with condition of registration 1

The Bank has recently reviewed its compliance with the calculation of its capital ratio requirements and has identified that it incorrectly calculated some off-balance sheet credit exposures which form part of the capital ratio calculations required under condition of registration 1. As a result of the errors the Bank was non-compliant with condition of registration 1 in prior periods and during the current financial year up until 31 December 2018. The errors do not result in non-compliance with condition of registration 1 after that time as a new version of the condition took effect from 1 January 2019. The net overall effect of the errors was a decrease of 8 basis points on the CET1 capital ratio as at 31 December 2018. The error which had the largest impact resulted from a change to the Bank’s terms and conditions for revolving mortgages that was made in 2015 and which resulted in the wrong credit conversion factor being applied to certain undrawn commitments. This had no impact on any customer with a revolving mortgage. The calculation errors have now been corrected and are reflected in the capital numbers for the year ending 30 June 2019.

Non-compliance with condition of registration 13

The Bank has also conducted a review of its compliance with the calculations of the regulatory liquidity ratios (core funding, one-week mismatch and one-month mismatch) required under condition of registration 13. The findings of that review identified some errors in respect of the calculation of contractual inflows and outflows, funding outflows (in-funds accounts) and committed lines. As a result, the Bank has been non-compliant with condition of registration 13 since 2010, when the liquidity requirements came into effect. The maximum impact of these errors to the liquidity ratios were reductions in the one-week mismatch ratio of 33 basis points and one-month mismatch ratio of 58 basis points. The impact of these errors was an increase in the core funding ratio.

The Bank also clarified some liquidity interpretation issues with the RBNZ and changed its practice with respect to the treatment of some items as a result of the review. The Bank corrected one of the calculation errors in April 2019. Other changes are being implemented from 1 July 2019. The overall effect going forward is estimated to be a minor increase to the Bank’s regulatory liquidity ratios.

Amendments to conditions of registration

The RBNZ issued revisions to the conditions of registration imposed on Kiwibank Limited effective from 1 October 2018 and from 1 January 2019. The new conditions:

- refer to a revised version of *BS13A: Liquidity Policy Annex* which includes minor technical amendments (effective from 1 October 2018);
- refer to a revised version of *BS19: Framework for Restrictions on High-LVR Residential Mortgage Lending* which amends some of the terms and conditions relating to the LVR conditions of registration (effective from 1 January 2019).



Independent auditor's report

To the readers of the Banking Group's financial statements for the year ended 30 June 2019

This report is for the Banking Group, comprising Kiwibank Limited (the 'Bank'), its New Zealand domiciled subsidiaries and the other entities it controlled at 30 June 2019 or from time to time during the financial year.

The Auditor-General is the auditor of Kiwibank Limited (the 'Bank') and the Banking Group (the 'Banking Group'). The Auditor-General has appointed me, Michele Embling, using the staff and resources of PricewaterhouseCoopers, to carry out the audit of the financial statements of the Banking Group on his behalf.

This report includes:

- our audit opinion on the financial statements prepared:
 - in accordance with Clause 24 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the 'Order'); and
 - in compliance with generally accepted accounting practice in New Zealand in accordance with New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS').
- our audit opinion on the supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements) for the year ended 30 June 2019 prepared in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order;
- our audit opinion on other legal and regulatory requirements in accordance with Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order; and
- our review conclusion on the supplementary information relating to capital adequacy and regulatory liquidity requirements prepared in accordance with Schedule 9 of the Order.

Report on the audit of the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)

We have audited the Banking Group's financial statements required by Clause 24 of the Order and the supplementary information required by Schedules 4, 7, 13, 14, 15 and 17 of the Order which comprise:

- the balance sheet as at 30 June 2019;
- the income statement for the year then ended;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the cash flow statement for the year then ended;
- the notes to the financial statements, which include the basis of preparation and general accounting policies; and
- the supplementary information required by Schedules 4, 7, 13, 14, 15 and 17 of the Order.

Our audit opinion

In our opinion:

- The Banking Group's financial statements (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order):
 - (i) comply with generally accepted accounting practice in New Zealand;
 - (ii) comply with NZ IFRS and IFRS; and
 - (iii) present fairly, in all material respects, the financial position of the Banking Group as at 30 June 2019, and its financial performance and cash flows for the year then ended.
- The supplementary information disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order and included in the balance sheet and notes 10, 11, 22, 30, 32 and 33 of the financial statements and on page 111 within the capital adequacy and regulatory liquidity disclosures:
 - (i) has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;
 - (ii) is in accordance with the books and records of the Banking Group; and
 - (iii) fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

Basis for audit opinion

We conducted our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)* section of our report.

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

Our audit approach

Overview



An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement.

Overall quantitative Banking Group materiality was \$7.5 million which represents 5% of profit before taxation.

We chose profit before taxation as the benchmark because, in our view, it is the benchmark against which the performance of the Banking Group is most commonly measured by readers, and is a generally accepted benchmark. We chose 5% based on our professional judgement, noting that it is also within the range of commonly accepted profit-related thresholds.

The following have been determined as Key Audit Matters:

- Provision for credit impairment
- Operation of Information Technology (IT) systems and controls



Materiality

The scope of our audit was influenced by our application of materiality.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Banking Group materiality for the financial statements as a whole as set out above. We also assess qualitative materiality, which includes other matters that, in our judgement, and in the context of our audit, might influence the economic decisions of the readers of the financial statements. Quantitative materiality and qualitative considerations helped us to determine the scope of our audit, the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Audit scope

We designed our audit by assessing the risks of material misstatement in the financial statements and our application of materiality. As in all of our audits, we also addressed the risk of management override of internal controls including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the Banking Group, the IT systems, accounting processes and controls, and the industry in which the Banking Group operates.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current year. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matter	How our audit addressed the Key Audit Matter
<p><i>Provision for credit impairment</i></p> <p>NZ IFRS 9 Financial Instruments was adopted by the Banking Group for the financial year beginning 1 July 2018.</p> <p>As detailed in note 8 to the financial statements, the Banking Group has loans and advances totalling \$20,443 million. These are net of provision for credit impairment of \$40 million which includes both individually assessed and collectively assessed provision for credit impairment.</p> <p>NZ IFRS 9 introduces an expected credit loss (ECL) impairment model which takes into account forward-looking information reflecting potential future economic events.</p> <p>Loans and advances that exceed specific thresholds are individually assessed by management. If an individually assessed loan and advance is not impaired, it is then included in a group of loans and advances with similar risk characteristics and, along with those loans and advances below the specific thresholds referred to above, is collectively assessed on a portfolio basis</p>	<p>We developed an understanding of the controls implemented by the management over the ECL impairment model.</p> <p>For a sample of individually assessed credit impaired assets, we</p> <ul style="list-style-type: none"> • Understood the latest circumstances of the borrowers and the basis of measuring the credit impairment and considered whether the key judgements were appropriate given the borrowers' circumstances; and • Considered, in relation to testing of collateral valuations, whether valuations were up to date and consistent with the strategy being followed in respect of the particular borrower. <p>For the collectively assessed impaired assets, where credit impairment is calculated using models, we engaged our own actuarial expert and performed the following procedures:</p> <ul style="list-style-type: none"> • Assessed the ECL model methodology and approach taken by the Banking Group against the requirements of the new



using the new ECL models developed by management.

The Banking Group developed new models which are reliant on large volumes of data as well as a number of estimates including the impact of multiple economic scenarios, definition of significant increase in credit risk and other assumptions.

We considered this a key audit matter due to the subjective judgements made by the Banking Group in determining when to recognise allowances for expected credit losses including:

- Models used to calculate ECLs are inherently complex and judgement is applied in determining the appropriate construct of model to be applied; and
- A number of assumptions are made by the Banking Group concerning the values of inputs to the ECL models and how inputs correlate with one another.

See note 9 to the financial statements which explains the critical accounting estimates and judgements in determining the impairment of loans and advances and note 10 to the financial statements.

accounting standard and the results of model monitoring performed;

- Considered the Banking Group's judgements including the reasonableness of forward-looking information incorporated into the ECL models by assessing the forecasts, assumptions and probability weightings applied in the multiple economic scenarios against current market conditions and other available evidence;
- On a sampling basis, agreed key data input to the ECL models to relevant source and underlying model documentation;
- Recalculated the ECL model results for a sample of loans and advances;
- For overlays to the modelled output, assessed the events covered by the overlays and challenged management to provide evidence that the overlays were appropriate; and
- Performed a peer bank comparison and considered whether, with the inclusion of the overlays, the overall collective allowances for impairment sit within a range of acceptable outcomes.

We have no material matters to report.

Operation of Information Technology (IT) systems and controls

The Banking Group's operations and financial reporting processes are heavily reliant on IT systems, including automated processes and controls over the processing and recording of significant volumes of transactions.

In considering the complexity of the Banking Group's processes and the design of the internal control environment, there are certain areas of the audit where we seek to place reliance on automated controls or reports. The effective operation of these areas is dependent on the Banking Group's IT General Control environment.

For significant financial statement transactions and balances, we gained an understanding of the business processes, key controls and IT systems used to generate and support those transactions and balances.

Where relevant to our planned audit approach, we validated the design and operating effectiveness of the key controls that support the continued integrity of the IT systems relevant to financial reporting together with tests of system-generated reports for the financial reporting period.

Where we identified design or operating effectiveness matters relating to IT systems, we performed additional audit procedures.

Key Audit Matter

How our audit addressed the Key Audit Matter

For example:

- change management internal controls are important because they help ensure that changes to applications and data are authorised and made appropriately;
- IT operations are important as they help ensure errors in processing are resolved in a timely manner; and
- user access controls are important to help ensure staff have appropriate access to IT systems and that access is monitored.

Information other than the financial statements, supplementary information and auditor's report

The Directors are responsible, on behalf of the Bank, for the other information included in the Disclosure Statement. The other information comprises the information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order included on pages 1 to 8 and on pages 114 to 119. Our opinion on the financial statements and supplementary information does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon.

In connection with our audit of the financial statements and supplementary information, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)

The Directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the financial statements in accordance with Clause 24 of the Order, NZ IFRS and IFRS and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible for the preparation and fair presentation of the supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 13, 14, 15 and 17 of the Order.

In preparing the financial statements, the Directors are responsible for assessing the Banking Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Banking Group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole and the supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 106 to 113) disclosed in accordance with Clause 24 and Schedules 4, 7, 13, 14, 15 and 17 of the Order, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of readers taken on the basis of these financial statements.

As part of an audit in accordance with the Auditor-General's Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Banking Group's internal control;
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors;
- Conclude on the appropriateness of the use of the going concern basis of accounting by the Directors and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Banking Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Banking Group to cease to continue as a going concern;
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation; and
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Banking Group to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the Banking Group audit. We remain solely responsible for our opinion.

We communicate with the Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during the audit.

We also provide the Directors with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Our responsibilities arise from the Public Audit Act 2001.

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

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 106 to 113) for the year ended 30 June 2019:

- (i) we have obtained all the information and explanations that we have required; and
- (ii) in our opinion, proper accounting records have been kept by the Banking Group as far as appears from an examination of those records.

Report on the review of the supplementary information relating to capital adequacy and regulatory liquidity requirements

We have examined the supplementary information relating to capital adequacy and regulatory liquidity requirements required by Schedule 9 of the Order as disclosed on pages 106 to 113 of the Disclosure Statement of the Banking Group for the year ended 30 June 2019.

Our conclusion

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 106 to 113, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

This conclusion is to be read in the context of what we say in the remainder of this report.

Basis for our conclusion

We conducted our review in accordance with the New Zealand Standard on Review Engagements 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* (NZ SRE 2410).

Our responsibilities under this standard are further described in the *Auditor's responsibilities for the review of the supplementary information relating to capital adequacy and regulatory liquidity requirements* section of our report.

Responsibilities of the Directors for the supplementary information relating to capital adequacy and regulatory liquidity requirements

The Directors are responsible, on behalf of the Bank, for the preparation of the supplementary information relating to capital adequacy and regulatory liquidity requirements that is disclosed in accordance with Schedule 9 of the Order. The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of the supplementary information relating to capital adequacy and regulatory liquidity requirements that is free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the review of the supplementary information relating to capital adequacy and regulatory liquidity requirements

Our responsibility is to express a conclusion, whether, based on our review, the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 106 to 113 of the Disclosure Statement, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.



A review of the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 106 to 113 in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with the Auditor-General's Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). Accordingly, we do not express an audit opinion on the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 106 to 113.

Auditor independence

We are independent of the Banking Group in accordance with the Auditor-General's Auditing Standards, which incorporate Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our firm carries out other services for the Banking Group in the areas of other assurance services, agreed-upon procedures engagements, tax compliance services, a capital models integrity check and provision of Kiwibank whistle-blower services. In addition, certain partners and employees of our firm may deal with the Banking Group on normal terms within the ordinary course of trading activities of the Banking Group. These matters have not impaired our independence as auditor of the Banking Group. We have no other interests in the Banking Group.

A handwritten signature in black ink, appearing to read 'Michele Embling', written over a faint circular watermark.

Michele Embling
On behalf of the Auditor-General
Wellington, New Zealand

A handwritten signature in black ink, appearing to read 'PricewaterhouseCoopers', written over a faint circular watermark.

PricewaterhouseCoopers

21 August 2019

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