Registered Bank Disclosure Statement

For the year ended 30 June 2017.

Kiwi bank.

Number 64

Disclosure statement

For the year ended 30 June 2017

This Disclosure Statement has been issued by Kiwibank Limited (the "**Bank**" or "**Kiwibank**") for the year ended 30 June 2017 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.

Contents

General matters

Details of incorporation

Kiwibank 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 8, New Zealand Post House, 7 Waterloo Quay, Wellington 6011, New Zealand.

Address for service

The address for service is: Kiwibank Limited, Ground Floor, New Zealand Post House, 7 Waterloo 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 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 is of the opinion that, other than outlined below, there are no matters relating to the business or affairs of the Bank or the Banking Group, which would, if disclosed in this Disclosure Statement, materially affect the decision of a person to subscribe for debt securities of which the Bank or any member of the Banking Group is the issuer.

Group structure

On 31 October 2016, NZP, formerly the sole shareholder of KGHL, completed the sale of a 47% share of KGHL to NZSF (as to 25%) and ACC (as to 22%) (the "**Partial Sale Transaction**"). Both NZSF and ACC are Crown entities. The Partial Sale Transaction reflects the Government's policy position that the Crown remains the sole ultimate shareholder of Kiwibank.

Deconsolidation of Kiwi Capital Funding Limited ("KCFL")

On 30 March 2017, changes were made to the KGHL Group governance arrangements which resulted in KCFL being deconsolidated from the Banking Group effective 30 March 2017 and the Banking group no longer recognising KCFL's assets and liabilities as at 31 March 2017. The effect of the deconsolidation is disclosed in note 32.

RBNZ's decision on Kiwibank's convertible capital instruments

On 29 May 2017, Kiwibank was informed by the RBNZ that Kiwibank's Tier 2 convertible subordinated bond ("Kiwibank Bonds") and Additional Tier 1 perpetual capital bond issued to KCFL did not comply with certain requirements in Document BS2A, Capital Adequacy Framework (Standardised Approach). In March 2017 Kiwibank made changes to address the RBNZ's concerns raised, as noted above in relation to the deconsolidation of KCFL. On 10 August 2017, after considering the changes made, the RBNZ re-issued notices of non-objection to the treatment of the bonds issued to KCFL as capital instruments as at that date.

General matters continued

Transformation strategy review

The change in Kiwibank's ownership structure has provided the opportunity for a review of Kiwibank's future growth and transformation strategy, which aims to deliver enhanced customer experiences. This strategy is expected to be finalised before the end of the next financial year.

As part of this review, Kiwibank will look to further align its information technology and digital strategies. This includes reviewing the project underway to modernise Kiwibank's core banking system against the new transformational objectives. A number of options are being considered to deliver that alignment. While this review has not been completed, based on the work done to date, the Board considers it highly unlikely that the current delivery path will meet key transformational objectives of the Bank and therefore the current project will not proceed without significant changes in the delivery path. Impairment details can be found in intangibles assets note 25 on page 48.

Kaikoura earthquake

On 14 November 2016 Kaikoura and the surrounding areas including Wellington were hit by a significant earthquake resulting in damage to businesses, buildings and homes across this area. The head office of Kiwibank was impacted and employees have been moved to various new buildings however the earthquake is not ultimately expected to have a material financial impact on the Banking Group.

Pending proceedings or arbitration

The Board are of the opinion that there are no 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

(appointed 28 November 2016)

Qualifications: BSc (Maths), B.Com, 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.

Robert William Bentley Morrison resigned 13 April 2017.

Independent non-executive directors

Michael Charles John O'Donnell

(appointed 15 November 2016)

Qualifications: BA (Hons), COP Photography & Film, Cert. Journalism, Dip. Business Administration
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 MOD Associates Limited, Serato Audio Research Limited, Timely Limited, NZ Government to Government Knowhow, Tourism New Zealand, Raygun Limited, vWork Limited, GMI Wealth Limited, Kiwi Wealth Limited, GMI General Partner Limited, Portfolio Custodial Nominees Limited.

Kevin Mark Malloy

(appointed 28 November 2016)

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.

General matters continued

Directorate continued

Independent non-executive directors continued

Alistair Bruce Ryan

(appointed 1 August 2017)

Qualifications: M Comm, CA
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 Lewis Road Creamery Limited, Lewis Road Butters Limited, Evolve Education Group Limited, Barramundi Limited, Metlifecare Limited, Metlifecare LTIP Trustee Limited, Christchurch Casinos Limited, Kingfish Limited, Marlin Global Limited.

Ian Cameron Blair

(appointed 31 July 2017)

Primary occupation: Managing director
Country of residence: New Zealand
Finance, Audit and Disclosures Committee member: No
Risk, Credit and Compliance Committee member: Yes

External Directorships: Director of Sapience Limited.

Alison Rosemary Gerry resigned 31 December 2016.
Lindsay Wright resigned 31 October 2016.
Rhoda Phillipo resigned 13 April 2017.

Non-executive directors

Carol Anne Campbell

Qualifications: B. Com, CA
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 New Zealand Post Limited, Hick Bros Holdings Limited, AlphaXRT Limited, Woodford Properties Limited, Kingfish Limited, Marlin Global Limited, Barramundi Limited, Key Assets NZ Limited, Fostering First New Zealand Limited, Matata Limited, Galavest Holdings Limited, Michelle Alexander Trustees Limited, TBAG Trustees Me Limited, TBAG Trustees KA Limited, MH2 Trustees Limited, Hodhop Trustee Company Limited, Morrow Trustees Limited, Multiply Publishing Holdings Limited, Farrimond Trustees Limited, Moore Nominees Limited, Munio Holdings Limited, Hick Bros Earthmoving Limited, Hick Earthmoving Contractors Limited, Hick Bros Earthmoving Contractors Limited, HBI Limited, Hick Bros Civil Construction Limited, Hick Bros Heavy Haulage Limited, Shortland Trustees (Mawhiti 2010) Limited, Forge Fleet Services Limited, Alilou Trustees Limited, Spencer Street Trustees Limited, TBAG Trustees (Glanfield) Limited, NPT Limited, Earnslaw Lodge Limited, Sonoma Limited, Meridian Properties Limited, Hick Bros Infrastructure Limited, Cloudbreak Trustees Limited, The National Property Trust No. 2 Limited, 22 Stodart Road Limited, 99 Albert Street Limited, Eastgate Shopping Centre Limited, NPT 10 Limited, NPT Management Team Limited, NPT Capital Limited, Seahorse Trust Company Limited, NZME Limited, T & G Global Limited, Hydraulink Investment Trustee Limited, NPT 11 Limited, Cordbank Limited, Nica Consulting Limited, Bankside Chambers Limited.

General matters continued

Directorate continued

Non-executive directors continued

Scott John Pickering
(appointed 8 November 2016)

Qualifications: Associate Certified Insurance Professional, Certificate of Insurance (Non-Life)
Primary occupation: Chief Executive, 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 Insurance Company of Australia Ltd.

Deborah Jane Taylor
(appointed 31 October 2016)

Qualifications: LLB (Hons), LLM (First Class Honours), BForSc (Hons) Dip. Acc. CA CFInstD
Primary occupation: Company 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 New Zealand Post Limited, OTPP New Zealand Forest Investments Ltd, OTPP Forests (No1) Limited, OTPP Forests (No2) Limited, Silver Fern Farms Venison Limited, Silver Fern Farms Beef Limited, Landcare Research New Zealand Limited, Tassenberg Limited, Radio New Zealand Limited, Predator Free 2050 Limited, Silver Fern Farms Sheepmeat Limited, Silver Fern Farms Co-operative Limited, Silver Fern Farms Holdings Limited, Silver Fern Farms Management Limited, Silver Fern Farms Limited, Silver Fern Farms Joint Ventures Limited

Hon. Sir Michael John Cullen resigned on 31 October 2016.

Alternate directors

David James Walsh
(appointed 9 August 2016)

Alternate to: Carol Anne Campbell and Deborah Jane Taylor
Qualifications: BCA, CA
Primary occupation: CEO
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 Kiwi Group Holdings Limited, New Zealand Post Holdings Limited, Datam Limited, New Zealand Post CX Limited, New Zealand Post Group Finance Limited, New Zealand Post Australia Holdings Pty Limited, Reach Media New Zealand Limited, Kiwi Financial Services Retail Limited.

David James Walsh was appointed as an alternate director to Carol Anne Campbell and Deborah Jane Taylor on 9 August 2016.

Finance, Audit and Disclosures Committee

The charter of the Finance, Audit and Disclosures Committee provides that the membership of the Committee shall be at least three members of the Board who are non-executive directors, a majority of whom must also be independent.

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.

General matters continued

Directorate continued

Policy for avoiding and dealing with conflicts of interests

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. Nor can they be counted in the quorum for the part of the Board meeting in respect of which they have a conflict, 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.

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.

Auditors

The auditor whose report is referred to in this Disclosure Statement is Chris Barber assisted by PricewaterhouseCoopers, acting as agent on behalf of the Office of the Auditor-General. His address for service is: PricewaterhouseCoopers, 113-119 The Terrace, Wellington, 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 Stable
Moody's Investors Service ("**Moody's**")	A1	Outlook Stable
Fitch Ratings (**Fitch**)	AA	Outlook Stable

On 28 February 2017, S&P affirmed Kiwibank's credit rating of A with a stable outlook.

On 28 February 2017, Fitch granted Kiwibank a 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 unsecured debt obligations payable in other currencies.

On 1 March 2017, Moody's granted Kiwibank a 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 – 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 Investor Services 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 $1,042m as recorded in NZP's most recent Annual Report for the financial year ended 30 June 2016. 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.

For an explanation of S&P's credit rating scale see page 6.

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, 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 2017:
    i. Kiwibank has complied with the conditions of registration applicable during the period;
    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 Alistair Bruce Ryan and Susan Carrel Macken as directors and responsible persons on behalf of all the directors listed in the Directorate of this Disclosure Statement:

8 September 2017

Historical summary of financial statements

Audited Dollars in millions	**Year ended 30/06/17**	Year ended 30/06/16	Year ended 30/06/15	Year ended 30/06/14	Year ended 30/06/13
Financial performance					
Interest income	**831**	898	957	798	790
Interest expense	**(463)**	(525)	(596)	(505)	(514)
Net gains on financial instruments at fair value	**8**	3	5	3	-
Net fee income	**118**	101	107	104	106
Operating expenses	**(339)**	(301)	(284)	(265)	(240)
Impairment reversals/(losses) on loans and advances	**6**	(11)	(13)	4	(7)
Other impairment losses	**(90)**	-	-	-	-
Profit before taxation	**71**	165	176	139	135
Income tax expense	**(18)**	(41)	(49)	(39)	(38)
Net profit after taxation	**53**	124	127	100	97
Net profit after taxation attributable to non-controlling interests	**-**	-	-	-	-
Dividends paid to non-controlling interest	**(1)**	-	-	-	-
Dividends paid on ordinary shares	**(5)**	(29)	(22)	-	-
Distributions to holders of perpetual capital	**(12)**	(11)	-	-	-
Dividends paid to holders of perpetual shares	**-**	-	(9)	(9)	(9)

Audited Dollars in millions	**Year ended 30/06/17**	Year ended 30/06/16	Year ended 30/06/15	Year ended 30/06/14	Year ended 30/06/13
Balance sheet					
Total assets	**20,616**	19,357	18,344	16,676	15,209
Of which individually impaired assets	**12**	15	23	44	54
Total liabilities	**19,236**	18,228	17,311	15,673	14,351
Equity attributable to owners of parent	**1,380**	1,129	1,033	854	709
Non-controlling interest	**-**	-	-	149	149

Financial statements

Income statement

For the year ended 30 June 2017

Dollars in millions	Note	**Year ended 30/06/17**	Year ended 30/06/16
Interest income	3	**831**	898
Interest expense	3	**(463)**	(525)
Net interest income		**368**	373
Net gains on financial instruments at fair value	4	**8**	3
Gross fee and other income	5	**201**	195
Direct fee expenses	5	**(83)**	(94)
Net fee and other income	5	**118**	101
Total operating income		**494**	477
Operating expenses	6	**(339)**	(301)
Profit before impairment and taxation		**155**	176
Impairment reversals/(losses) on loans and advances	9	**6**	(11)
Other impairment losses	25	**(90)**	-
Profit before taxation		**71**	165
Income tax expense	7	**(18)**	(41)
Profit after taxation		**53**	124

Statement of comprehensive income

For the year ended 30 June 2017

Dollars in millions	Note	**Year ended 30/06/17**	Year ended 30/06/16
Profit after taxation		**53**	124
Other comprehensive income			
Net (loss)/gain from changes in reserves that may subsequently be reclassified to profit or loss			
- Available-for-sale reserve (net of tax)	28	**(6)**	3
- Cash flow hedge reserve (net of tax)	28	**32**	9
Other comprehensive income for the year		**26**	12
Total comprehensive income for the year		**79**	136

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 2017

Dollars in millions	Note	Fully Paid Ordinary Shares	Retained earnings	Available-For-Sale Reserve	Cash Flow Hedge Reserve	Perpetual Capital Reserve	Total Equity Attributable to Owners of the Parent
Balance at 1 July 2015		400	532	8	(54)	147	1,033
Year ended 30 June 2016							
Profit for the year		-	124	-	-	-	124
Other comprehensive income							
Available-for-sale financial assets (net of tax)		-	-	3	-	-	3
Cash flow hedges (net of tax)		-	-	-	9	-	9
Total other comprehensive income		-	-	3	9	-	12
Total comprehensive income		-	124	3	9	-	136
Transactions with owners							
Dividends paid on ordinary shares		-	(29)	-	-	-	(29)
Distributions to holders of perpetual capital		-	(11)	-	-	-	(11)
Balance at 30 June 2016		400	616	11	(45)	147	1,129
Year ended 30 June 2017							
Profit for the year		**-**	**53**	**-**	**-**	**-**	**53**
Other comprehensive income							
Available-for-sale financial assets (net of tax)		**-**	**-**	**(6)**	**-**	**-**	**(6)**
Cash flow hedges (net of tax)		**-**	**-**	**-**	**32**	**-**	**32**
Total other comprehensive income		**-**	**-**	**(6)**	**32**	**-**	**26**
Total comprehensive income		**-**	**53**	**(6)**	**32**	**-**	**79**
Deconsolidation of subsidiary	32	**-**	**-**	**-**	**-**	**(147)**	**(147)**
Transactions with owners							
Issue of share capital	28	**337**	**-**	**-**	**-**	**-**	**337**
Dividends paid to non-controlling interest	28	**-**	**(1)**	**-**	**-**	**-**	**(1)**
Dividends paid on ordinary shares	28	**-**	**(5)**	**-**	**-**	**-**	**(5)**
Distributions to holders of perpetual capital		**-**	**(12)**	**-**	**-**	**-**	**(12)**
Balance at 30 June 2017		**737**	**651**	**5**	**(13)**	**-**	**1,380**

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

Financial statements continued

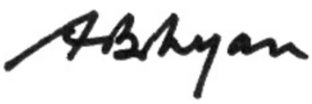
Balance sheet

As at 30 June 2017

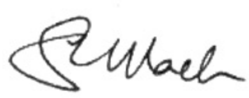
Dollars in millions	Note	**30/06/17**	30/06/16
Assets			
Cash and cash equivalents	12	**464**	509
Due from related parties	29	**80**	77
Due from other financial institutions	13	**228**	247
Available-for-sale assets	14	**1,474**	955
Loans and advances	8	**17,815**	16,689
Derivative financial instruments	15	**370**	658
Property, plant and equipment		**28**	23
Intangible assets	25	**97**	158
Deferred taxation	7	**34**	25
Other assets	26	**26**	16
Total assets		**20,616**	19,357
Total interest earning and discount bearing assets		***20,044***	*18,434*
Liabilities			
Due to other financial institutions	16	**59**	135
Due to related parties	29	**12**	4
Deposits and other borrowings	17	**15,983**	14,782
Derivative financial instruments	15	**416**	725
Debt securities issued	18	**2,258**	2,207
Current tax liability		**9**	15
Other liabilities	27	**94**	102
Subordinated debt	19	**405**	258
Total liabilities		**19,236**	18,228
Total interest and discount bearing liabilities		***16,926***	*15,872*
Equity attributable to owners of the parent			
Share capital	28	**737**	400
Reserves	28	**643**	729
Total equity attributable to owners of the parent		**1,380**	1,129
Total liabilities and shareholders' equity		**20,616**	19,357

The Board of Directors of Kiwibank Limited authorised these financial statements for issue on 8 September 2017.

Alistair Bruce Ryan



Susan Carrel Macken



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 2017

Dollars in millions	Note	Year ended 30/06/17	Year ended 30/06/16
Cash flows from operating activities			
Interest received		**860**	928
Interest paid		**(455)**	(535)
Fees and other income received		**199**	195
Direct fee expenses paid		**(83)**	(94)
Operating expenses paid		**(328)**	(255)
Taxes paid		**(43)**	(45)
Net cash flows from operating activities before changes in operating assets and liabilities		**150**	194
Net changes in operating assets and liabilities			
Decrease in financial assets held for trading		**-**	97
(Increase)/decrease in available-for-sale assets		**(519)**	280
(Increase) in loans and advances		**(1,168)**	(1,140)
Decrease/(increase) in amounts due from related parties		**5**	(2)
Decrease/(increase) in balances due from other financial institutions		**19**	(53)
Increase in deposits and other borrowing		**1,193**	1,059
(Decrease) in balances due to other financial institutions		**(76)**	(190)
Net cash flows from operating activities		**(396)**	245
Cash flows from investing activities			
Purchase of property, plant and equipment		**(12)**	(10)
Purchase of intangible assets		**(52)**	(65)
Net cash flows from investing activities		**(64)**	(75)
Cash flows from financing activities			
Issue of share capital		**337**	-
Increase/(decrease) in debt securities issued		**98**	(109)
Dividends paid on ordinary shares		**(5)**	(29)
Distributions to holders of perpetual capital		**(12)**	(11)
Dividends paid to non-controlling interest		**(1)**	-
Net cash flows from financing activities		**417**	(149)
Increase in cash and cash equivalents		**(43)**	21
Cash and cash equivalents at beginning of the year		**509**	492
Effect of exchange translation adjustments		**(2)**	(4)
Cash and cash equivalents at end of the year	12	**464**	509

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 2017

Dollars in millions	**Year ended 30/06/17**	Year ended 30/06/16
Reconciliation of net profit after taxation to net cash flows from operating activities		
Net profit after taxation	**53**	124
Non cash movements and non-operating activities		
Unrealised fair value adjustments	**(7)**	4
Depreciation	**7**	7
Amortisation of intangibles	**24**	23
Net decrease in deferred expenditure and accrued income	**31**	28
(Decrease) in provision for credit impairment	**(13)**	-
Lending losses written off	**7**	11
Intangible work in progress written off	**3**	-
Other impairment losses	**90**	-
(Increase)/decrease in deferred taxation asset	**(9)**	3
Movements in operating assets and liabilities		
Decrease in financial assets held for trading	**-**	96
(Increase)/decrease in available-for-sale assets	**(524)**	272
(Increase) in loans and advances	**(1,165)**	(1,139)
Decrease/(increase) in balances due from other financial institutions	**19**	(53)
Increase in deposits and other borrowing	**1,193**	1,059
(Increase) in balances with related parties	**(5)**	(3)
(Decrease) in balances due to other financial institutions	**(76)**	(190)
(Decrease)/increase in accrued operating expenses	**(14)**	17
Increase/(decrease) in interest payable	**8**	(10)
(Increase)/decrease in interest receivable	**(3)**	2
(Decrease) in current taxation	**(6)**	(7)
(Increase)/decrease in other assets	**(9)**	1
Net cash flows from operating activities	**(396)**	245

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. Kiwi Capital Funding Limited ("**KCFL**") was previously consolidated as a subsidiary of Kiwibank but, effective 30 March 2017, KCFL was deconsolidated due to changes made to the Kiwi Group Holdings Limited ("**KGHL**") Group governance arrangements as noted in 'Other material matters' on page 1. The effect of the deconsolidation is disclosed in note 32.

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 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 shareholder of Kiwibank is the New Zealand Crown (the "**Crown**").

These financial statements for the year ended 30 June 2017 have been approved for issue by the Board of Directors on 8 September 2017.

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.

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.

Measurement base

These financial statements are based on the general principles of historic cost accounting, modified by the application of fair value measurements for available-for-sale financial assets, financial instruments held at fair value through profit or loss and all derivative contracts. 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 2017. Comparative amounts are from the audited financial statements for the year ended 30 June 2016. Certain amounts in the comparative information have been reclassified or amended to ensure consistency with the current year's presentation including the loans and advances and related entities notes which use different categories from the prior year (notes 8 and 29 respectively) and the concentration of credit risk and concentration of funding notes within which there has been a reclassification of certain amounts between New Zealand and overseas categories (notes 11 and 23 respectively). The prior year comparatives for credit exposure concentrations and related entities have been amended to include derivative exposures (notes 22 and 29 respectively). Where appropriate, further information has been included within the relevant note disclosures.

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 9	Impairment losses – loans and advances
Note 20	Fair value estimation
Note 25	Intangible assets
Note 29	Securitisation and the consolidation of SPVs

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 2017. 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.

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 polices.

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.

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.5 New Accounting Standards and Interpretations

Standards and interpretations effective in the current period:

Management have considered amendments to NZ IFRS's which became applicable to the Banking Group for the first time during the year ended 30 June 2017 and have concluded they have no material impact on the financial position or performance of the Banking Group.

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.

At the date of authorisation, the following new standards or amendments to existing standards were in issue but not yet effective:

Standard	*Effective for annual reporting periods beginning on or after:*
Amendments to NZ IAS 7 – *Statement of Cash Flows*	1 January 2017
NZ IFRS 9 – *Financial Instruments*	1 January 2018
NZ IFRS 15 – *Revenue from Contracts with Customers*	1 January 2018
NZ IFRS 16 – *Leases*	1 January 2019

The Directors expect to adopt the above standards and amendments in the period in which they become mandatory.

NZ IFRS 9: *Financial Instruments*

NZ IFRS 9, issued in September 2014, replaces existing guidance in NZ IAS 39 *Financial Instruments*: *Recognition and Measurement*. NZ IFRS 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairments on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from NZ IAS 39.

The Banking Group currently has an ongoing project to implement the adoption of NZ IFRS 9. Given the nature of the Bank and the Banking Group's operations, NZ IFRS 9 is expected to have a significant impact on the financial statements. In particular the calculation of impairment of financial instruments on an expected credit loss basis may change the overall level of impairment allowances. However, as the impact of adoption depends on the financial instruments held by the Banking Group and the credit environment at the date of adoption, it is not practical to quantify the impact.

NZ IFRS 9 will change hedge accounting by increasing the eligibility of both hedged items and hedging instruments and applying a principles-based approach to hedge effectiveness. Adoption of the new hedge accounting model is optional until the International Accounting Standards Board completes its Accounting for Dynamic Risk Management project. The Banking Group is yet to determine whether to apply the new hedge accounting model when NZ IFRS 9 is adopted.

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 replaces existing revenue recognition guidance, including NZ IAS 18 *Revenue*, NZ IAS 11 *Construction Contracts* and NZ IFRIC 13 *Customer Loyalty Programmes*. The Banking Group is assessing the potential impact of adoption of NZ IFRS 15 however initial findings indicate that it is not expected to have a material impact on the Banking Group.

NZ IFRS 16: *Leases*

NZ IFRS 16 introduces a single, on-balance sheet accounting model for lessees. The Banking Group is assessing the potential impact of adopting NZ IFRS 16 but it is anticipated it will result in the Banking Group recognising a right-of-use asset on its balance sheet in relation to the majority of its leases with an offsetting liability recognised for the value of future lease payments. NZ IFRS 16 is also expected to result in a shift from lease payments being recognised as expenses on a straight-line basis over the lease term to a depreciation expense on the right-of-use asset and interest expense on the outstanding balance of the liability. This will result in changes in certain expense and profit measures however it is not yet practical to quantify the impact as it will be determined by the leases that have been entered in to as at the date of adoption.

NZ IAS 7: *Statement of Cash Flows amendmen*t

Amendments to NZ IAS 7 *Statement of Cash Flows* require additional disclosures regarding both cash and non-cash changes in liabilities arising from financing activities. The amendments are not expected to have a material impact on the Banking Group.

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.6 Financial instruments

Designation of financial assets and financial liabilities into instrument categories is determined by the business purpose of the financial instruments, policies and practices for their management, their relationship with other instruments and the reporting costs and benefits associated with each designation.

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.

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 statements

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

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 which 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, available-for-sale assets, 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.

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

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 consolidated financial statements are provided throughout the notes to the consolidated financial statements.

3. Interest income and expense

Accounting policy

Interest income and expense recognition

Interest income and expense for all interest bearing financial assets and liabilities is recognised using the effective interest method.

The effective interest rate is the rate that exactly discounts the estimated future cash receipts and payments through the expected life of the financial asset or liability to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Banking Group estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

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 upon 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 30/06/17**	Year ended 30/06/16
Interest income		
Loans and advances at amortised cost	**837**	882
Government and local authority securities	**13**	18
Other securities ❶	**(33)**	(20)
Cash and liquid assets	**7**	10
Balances with related parties	**6**	7
Interest income on impaired assets	**1**	1
Total interest income	**831**	898
Interest expense		
Deposits by customers	**363**	411
Other issues	**91**	109
Balances with related parties	**9**	5
Total interest expense	**463**	525

❶ Interest income from other securities includes the net income and expenses on interest rate swaps which may result in a debit balance.

The total interest income and expense that relates to financial assets or liabilities that are not carried at fair value through profit or loss is $830.9m (2016: $896.2m) and $451.0m (2016: $509.3m) 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 30/06/17	Year ended 30/06/16
Derivative financial instruments held for trading	**(3)**	(1)
Financial assets held for trading	**-**	1
Net ineffectiveness on qualifying fair value hedges	**13**	-
Cumulative gain transferred from available-for-sale reserve	**6**	8
Cumulative loss transferred from cash flow hedge reserve	**(9)**	(5)
Net foreign exchange gains	**1**	-
Total gains on financial instruments	**8**	3

Net ineffectiveness on qualifying cash flow hedges is $0.0m (2016: ($0.0m)). Net ineffectiveness on qualifying fair value hedges is $13.5m (2016: ($0.2m)).

5. Net fee and other income

Accounting policy

Revenue recognition

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

Direct fee expenses

Direct fee expenses consist of those expenses directly attributable to the generation of revenue such as transaction fees or commissions paid, and are expensed as the services are received.

Dollars in millions	Year ended 30/06/17	Year ended 30/06/16
Lending and credit fee income	**65**	64
Transaction and other income	**103**	95
Agency services fee income	**33**	36
Gross fee and other income	**201**	195
Direct fee expenses	**(83)**	(94)
Total fee and other income	**118**	101

Notes to the financial statements continued

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.

Dollars in millions	**Year ended 30/06/17**	Year ended 30/06/16
Salaries and wages	**141**	122
Computer and office costs	**49**	44
Amortisation of intangibles	**24**	23
Depreciation	**7**	7
Operating lease and rental costs	**13**	12
Other expenses	**105**	93
Total operating expenses	**339**	301

Dollars in thousands	**Year ended 30/06/17**	Year ended 30/06/16
Directors' fees	**746**	379

Notes to the financial statements continued

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 available-for-sale assets 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.

Income tax expense

Dollars in millions	**Year ended 30/06/17**	Year ended 30/06/16
Profit before taxation	**71**	165
Tax calculated at a rate of 28%	**(20)**	(46)
Tax effect of:		
Deductible distributions recognised through equity	**-**	3
Income not subject to tax and non-deductible expenses	**(2)**	-
Derecognition of deferred tax liability upon deconsolidation of subsidiary	**1**	-
Transfer of tax losses from other KGHL subsidiaries	**3**	2
Tax charge as per the income statement	**(18)**	(41)
Represented by:		
Current income tax	**(39)**	(39)
Deferred income tax	**21**	(2)
Tax charge as per the income statement	**(18)**	(41)
The deferred tax charge in the income statement comprises the following temporary differences:		
Accelerated tax depreciation	**-**	(2)
Other provisions and accruals	**(1)**	-
Allowances for credit and impairment losses	**21**	-
Derecognition of deferred tax liability upon deconsolidation of subsidiary	**1**	-
Total temporary differences	**21**	(2)

Notes to the financial statements continued

7. Taxation continued

Deferred taxation

Dollars in millions	**30/06/17**	30/06/16
Deferred tax		
Balance at beginning of year	**25**	32
Prior period adjustment	**2**	(1)
Temporary differences for the year	**18**	(2)
Tax on profits taken to reserves	**(12)**	(4)
Derecognition of deferred tax liability upon deconsolidation of subsidiary	**1**	-
Balance at end of year	**34**	25
Deferred income tax assets		
Cash flow hedges	**5**	18
Other provisions and accruals	**2**	3
Allowance for loan impairment	**11**	15
Impairment of intangible assets	**25**	-
Total deferred income tax assets	**43**	36
Deferred income tax liabilities		
Accelerated tax depreciation	**(9)**	(9)
Fair value losses not recognised on consolidation	**-**	(2)
Total deferred income tax liabilities	**(9)**	(11)
Net deferred taxation	**34**	25
Deferred tax assets and liabilities expected to be realised within 12 months	**17**	32
Deferred tax assets and liabilities expected to be realised after 12 months	**17**	(7)

Notes to the financial statements continued

8. Loans and advances

Accounting policy

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and advances are initially recognised at fair value and subsequently measured at amortised cost using the effective interest method. Loans and advances issued with an initial duration of less than 12 months are recognised at cost less impairment. Allowances for estimated irrecoverable amounts are recognised when there is objective evidence that the asset is impaired (note 9). Interest income and impairment losses are recognised in the income statement.

The table below presents gross loans and advances by type of product. Total gross residential mortgage loans at 30 June 2017 were $16,646m (2016: $15,573m). This includes *term loans – housing* and residentially secured lending within *other term lending* (see note 10).

Dollars in millions	**30/06/17**	30/06/16
Overdrafts	**64**	56
Credit card outstandings	**393**	382
Term loans - housing	**15,729**	14,702
Other term lending	**1,551**	1,511
Other lending	**118**	93
Gross loans and advances	**17,855**	16,744
Collective allowance for impairment losses	**(34)**	(44)
Allowance for individually impaired assets	**(6)**	(9)
Fair value hedge adjustments	**-**	(2)
Net loans and advances	**17,815**	16,689
Current	**1,319**	1,267
Non-current	**16,496**	15,422

9. Impairment reversals/(losses) on loans and advances

Accounting policy

At each reporting date an assessment is made as to whether there is objective evidence that a loan or advance (a "**loan**") or group of loans is impaired. A loan or a group of loans is impaired and impairment losses are recognised if, and only if, there is 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) has an impact on the estimated future cash flows of the loan or group of loans that can be reliably estimated. Objective evidence that a loan or group of loans is impaired includes observable data that comes 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 borrowers 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 is 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 assesses whether objective evidence of impairment exists individually for loans that are individually significant, and individually or collectively for loans that are not individually significant. If no objective evidence of impairment exists for an individually assessed loan, whether significant or not, the loan is included in a group of loans with similar credit risk characteristics and collectively assessed for impairment.

Notes to the financial statements continued

9. Impairment reversals/(losses) on loans and advances continued

Loans that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment. If there is objective evidence that an impairment loss on a loan carried at amortised cost has been incurred, the amount of the loss is 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 is reduced through the use of an impairment allowance account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

For the purposes of a collective evaluation of impairment, loans are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Banking Group's grading process that considers 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 uses loan mortgage insurance on origination of loans where the loan to valuation ratio is greater than 80%.

Future cash flows for a group of loans that are collectively evaluated for impairment are 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 is 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 is 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 are 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 is reversed. The amount of the reversal, not exceeding what the amortised cost would have been had the impairment not been recognised, is recognised in the income statement.

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

Critical accounting estimates and judgements

Loan portfolios are assessed for impairment on at least a quarterly 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 in a group, 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.

The total provision comprises an individual impairment and collective impairment provision. Individual provisions have been raised where objective evidence of impairment exists. If no objective evidence of impairment exists exposures are included in a group of loans (personal markets and business markets lending) and collectively assessed for impairment. Collective impairment calculations have 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 are geographical concentration risk, personal savings levels, unemployment levels, property price discounts and insurance recoveries.

Notes to the financial statements continued

9. Impairment reversals/(losses) on loans and advances continued

Dollars in millions	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Year ended 30 June 2017				
Collective impairment (reversals)	**(2)**	**(6)**	**(2)**	**(10)**
Individual impairment losses/(reversals)	**5**	**(1)**	**-**	**4**
Total impairment losses/(reversals) per income statement	**3**	**(7)**	**(2)**	**(6)**
Year ended 30 June 2016				
Collective impairment losses/(reversals)	2	8	(7)	3
Individual impairment losses/(reversals)	8	1	(1)	8
Total impairment losses/(reversals) per income statement	10	9	(8)	11

10. Asset quality

Summary of lending

Dollars in millions	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
As at 30 June 2017				
Neither past due nor impaired	**453**	**16,569**	**713**	**17,735**
Past due but not impaired	**35**	**70**	**3**	**108**
Impaired	**1**	**7**	**4**	**12**
Gross loans and advances	**489**	**16,646**	**720**	**17,855**
Collective allowance for impairment	**(9)**	**(19)**	**(6)**	**(34)**
Individual allowance for impairment	**-**	**(3)**	**(3)**	**(6)**
Fair value hedge adjustments	**-**	**-**	**-**	**-**
Net loans and advances	**480**	**16,624**	**711**	**17,815**
As at 30 June 2016				
Neither past due nor impaired	443	15,495	683	16,621
Past due but not impaired	35	70	3	108
Impaired	2	8	5	15
Gross loans and advances	480	15,573	691	16,744
Collective allowance for impairment	(11)	(25)	(8)	(44)
Individual allowance for impairment	(1)	(4)	(4)	(9)
Fair value hedge adjustments	-	(2)	-	(2)
Net loans and advances	468	15,542	679	16,689

Notes to the financial statements continued

10. Asset quality continued

a: Loans and advances past due but not impaired

Dollars in millions	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
As at 30 June 2017				
Past due less than 30 days	**26**	**52**	**3**	**81**
Past due 30 - 59 days	**5**	**10**	**-**	**15**
Past due 60 - 89 days	**2**	**3**	**-**	**5**
Past due 90 days or greater	**2**	**5**	**-**	**7**
Total	**35**	**70**	**3**	**108**
As at 30 June 2016				
Past due less than 30 days	25	54	3	82
Past due 30 - 59 days	5	8	-	13
Past due 60 - 89 days	3	3	-	6
Past due 90 days or greater	2	5	-	7
Total	35	70	3	108

b: Impaired assets

Dollars in millions	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Year ended 30 June 2017				
Gross impaired assets				
Balance at beginning of the year	**2**	**8**	**5**	**15**
Transfers from performing	**6**	**2**	**7**	**15**
Transfers to performing	**-**	**-**	**(1)**	**(1)**
Asset realisations and loans repaid	**(1)**	**(3)**	**(6)**	**(10)**
Amounts written off	**(6)**	**-**	**(1)**	**(7)**
Balance at end of the year	**1**	**7**	**4**	**12**
Individual allowance for impairment	**-**	**(3)**	**(3)**	**(6)**
Total net impaired assets	**1**	**4**	**1**	**6**
Year ended 30 June 2016				
Gross impaired assets				
Balance at beginning of the year	1	11	11	23
Transfers from performing	9	15	3	27
Transfers to performing	-	-	(6)	(6)
Asset realisations and loans repaid	-	(16)	(2)	(18)
Amounts written off	(8)	(2)	(1)	(11)
Balance at end of the year	2	8	5	15
Individual allowance for impairment	(1)	(4)	(4)	(9)
Total net impaired assets	1	4	1	6

Notes to the financial statements continued

10. Asset quality continued

c: Reconciliation of collective allowance for impairment by asset class

Dollars in millions	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Collective allowance for impairment losses				
Year ended 30 June 2017				
Balance at beginning of the year	**11**	**25**	**8**	**44**
Impairment (reversals) on loans not at fair value through profit or loss	**(2)**	**(6)**	**(2)**	**(10)**
Balance at end of the year	**9**	**19**	**6**	**34**
Year ended 30 June 2016				
Balance at beginning of the year	9	17	15	41
Impairment losses/(reversals) on loans not at fair value through profit or loss	2	8	(7)	3
Balance at end of the year	11	25	8	44

d: Reconciliation of the individual allowance for impairment

Dollars in millions	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Individual allowance for impairment losses				
Year ended 30 June 2017				
Balance at beginning of the year	**1**	**4**	**4**	**9**
Impairment losses on loans not at fair value through profit or loss	**6**	**1**	**3**	**10**
Amounts written off	**(6)**	**-**	**(1)**	**(7)**
Reversals of previously recognised impaired assets	**(1)**	**(2)**	**(3)**	**(6)**
Balance at end of the year	**-**	**3**	**3**	**6**
Year ended 30 June 2016				
Balance at beginning of the year	1	5	6	12
Impairment losses on loans not at fair value through profit or loss	8	6	4	18
Amounts written off	(8)	(2)	(1)	(11)
Reversals of previously recognised impaired assets	-	(5)	(5)	(10)
Balance at end of the year	1	4	4	9

e: 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 2017 (30 June 2016: nil). There were no assets under administration as at 30 June 2017 (30 June 2016: nil).

There were no unrecognised impaired assets as at 30 June 2017 (30 June 2016: nil). The aggregate amount of undrawn limits on lending commitments to counterparties for whom drawn balances were classified as individually impaired was $1.0m at 30 June 2017 (30 June 2016: $2.9m).

Notes to the financial statements continued

10. Asset quality continued

f: 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 credit scored based on a combination of debt servicing ability, behavioural loan characteristics and loan-to-valuation ("**LVR**") ratios. Non-retail advances are individually risk graded against similar characteristics. These credit scoring 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.

All of the financial assets of the Banking Group as at 30 June 2017 and 2016, other than loans and advances, are considered of high credit quality and are neither past due nor impaired.

Definitions

"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.

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	30/06/17	30/06/16
New Zealand		
Government, local authorities and services	**1,022**	966
Finance, investment and insurance	**877**	693
Households	**16,216**	15,053
Transport and storage	**115**	69
Professional, scientific and technical services	**56**	39
Electricity, gas and water	**4**	3
Construction	**182**	220
Property and business services	**936**	836
Agriculture	**27**	24
Health and community services	**80**	92
Personal and other services	**92**	183
Retail and wholesale trade	**96**	86
Food & other manufacturing	**101**	108
Overseas		
Finance, investment and insurance	**667**	816
	20,471	19,188
Less allowance for impairment losses	**(40)**	(53)
Other financial assets	**18**	10
Total financial assets	**20,449**	19,145

Notes to the financial statements continued

11. Concentration of credit risk continued

Maximum exposure to credit risk and collateral held

	30/06/17			30/06/16		
Dollars in millions	**Maximum exposure**	**Collateral**	**Net exposure**	Maximum exposure	Collateral	Net exposure
Credit risk relating to balance sheet assets						
Fixed rate lending	**13,626**	**(13,621)**	**5**	12,580	(12,573)	7
Variable rate lending	**3,818**	**(3,817)**	**1**	3,762	(3,760)	2
Unsecured lending	**411**	**-**	**411**	400	-	400
Due from other financial institutions	**228**	**-**	**228**	247	-	247
Balances with related parties	**80**	**-**	**80**	77	-	77
Derivative financial instruments	**370**	**(52)**	**318**	658	(78)	580
Financial assets held for trading	**-**	**-**	**-**	-	-	-
Available-for-sale assets	**1,474**	**-**	**1,474**	955	-	955
Cash and cash equivalents	**464**	**-**	**464**	509	-	509
Other financial assets	**18**	**-**	**18**	10	-	10
	20,489	**(17,490)**	**2,999**	19,198	(16,411)	2,787
Less allowance for impairment	**(40)**	**-**	**(40)**	(53)	-	(53)
Total financial assets	**20,449**	**(17,490)**	**2,959**	19,145	(16,411)	2,734

The table above represents a worst case scenario of credit risk exposure to the Banking Group at 30 June 2017.
The exposures set out are based on net carrying amounts as reported in the balance sheet.

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

The exposure of the Banking Group derived from loans and advances to retail and corporate customers is 87% of the total maximum exposure at 30 June 2017 (2016: 87%).

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 individual impairment allowance 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 38) for an amount equal to the undrawn balance.

12. Cash and cash equivalents

Accounting policy

Cash and cash equivalents is considered to be cash 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.

Dollars in millions	**30/06/17**	30/06/16
Cash in hand	**33**	30
Cash with central banks	**349**	400
Call and overnight advances to financial institutions	**82**	79
Total cash and cash equivalents - Current	**464**	509

Notes to the financial statements continued

13. Due from other financial institutions

Accounting policy

Balances due from other financial institutions are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method. If the initial duration is less than 12 months they are recognised at cost less impairment. Allowances for estimated irrecoverable amounts are recognised when there is objective evidence that the asset is impaired. Interest, impairment losses and foreign exchange gains and losses are 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	**30/06/17**	30/06/16
Unsettled receivables	**-**	42
Short term advances due from other financial institutions	**121**	40
Collateralised loans	**107**	165
Total amounts due from other financial institutions - Current	**228**	247

Included within the above balance, is $107.5m of collateral pledged by Kiwibank in respect of its credit support annex obligations to derivative counterparties (2016: $164.7m).

14. Available-for-sale assets

Accounting policy

Available-for-sale financial assets are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. Available-for-sale financial assets are held at fair value and gains and losses resulting from changes in their fair value are 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 are 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 include any related foreign exchange component. On derecognition the cumulative fair value gain or loss previously recognised directly in equity is taken to the income statement in net gains on financial instruments at fair value (note 4).

Impairment

The Banking Group assesses at each reporting date whether there is objective evidence that an available-for-sale asset is impaired. An available-for-sale asset is impaired and impairment losses are recognised if, and only if, there is 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) has an impact on the estimated future cash flows of the available-for-sale asset that can be reliably estimated.

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

Dollars in millions	**30/06/17**	30/06/16
Government stock and multilateral development banks	**866**	727
Treasury bills	**-**	11
Local authority securities	**121**	9
Other debt securities	**487**	208
Total available-for-sale assets – Current	**1,474**	955

Notes to the financial statements continued

15. Derivative financial instruments

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 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.

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 are 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 continued

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

- Currency forwards represent commitments to purchase foreign and domestic 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 (for example, 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, 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.

Fair value hedges

Gain/(loss) on fair value hedges attributable to the hedged risk

Dollars in millions	**Year ended 30/06/17**	Year ended 30/06/16
Gain/(loss) arising from fair value hedges:		
Hedged item	**17**	(10)
Hedging instrument	**(4)**	10
Net ineffectiveness on qualifying fair value hedges	**13**	-

Notes to the financial statements continued

15. Derivative financial instruments continued

	30/06/17			30/06/16		
	Notional Principal	Fair values		Notional Principal	Fair values	
Dollars in millions	Amount	Assets	Liabilities	Amount	Assets	Liabilities
Derivatives held for trading						
Foreign exchange derivatives	**1,084**	**5**	**(32)**	1,020	9	(20)
Interest rate derivatives	**29,877**	**280**	**(291)**	37,006	531	(544)
Total derivatives held for trading	**30,961**	**285**	**(323)**	38,026	540	(564)
Derivatives held for hedging						
Designated as cash flow hedges						
Interest rate derivatives	**10,828**	**24**	**(66)**	9,797	30	(123)
Exchange rate derivatives	**662**	**53**	**(23)**	675	77	(14)
Total derivatives designated as cash flow hedges	**11,490**	**77**	**(89)**	10,472	107	(137)
Designated as fair value hedges						
Interest rate derivatives	**1,159**	**8**	**(4)**	1,552	11	(24)
Total derivatives designated as fair value hedges	**1,159**	**8**	**(4)**	1,552	11	(24)
Total derivatives held for hedging	**12,649**	**85**	**(93)**	12,024	118	(161)
Total derivative financial instruments	**43,610**	**370**	**(416)**	50,050	658	(725)
Current		**60**	**(133)**		544	(623)
Non-current		**310**	**(283)**		114	(102)

Fair value hedges

The Banking Group uses interest rate swaps to hedge interest rate risk exposure of a portion of its portfolio of fixed rate mortgage loans and fixed rate bonds. The Banking Group hedges this risk through the use of pay fixed interest rate swaps. The designated hedging relationships result in fair value gains and losses on the fixed rate financial instruments and interest rate swaps. The fair value gains and losses are 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 fixed rate financial instrument.

The Banking Group also partially hedges the interest rate risk arising from any potential change in the fair value of fixed rate subordinated debt issuances and medium term notes. The Banking Group hedges this risk through the use of receive fixed interest rate swaps. The designated hedging relationships result in fair value gains and losses on the fixed rate liability and interest rate swap. The fair value gains and losses are 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 fixed rate liability.

Cash flow hedges

The Banking Group hedges the short term future reissuance of fixed rate loan customers and future retail term deposits through the use of interest rate swaps. Gains and losses deferred in the cash flow hedge reserve will be reclassified to the income statement over the next one to five years, as the cash flows under the hedged transactions occur.

Dual fair value and cash flow hedges

The Banking Group hedges fixed rate foreign currency denominated medium term debt issuances using cross currency swaps, designated as fair value hedges of foreign interest rates and cash flow hedges of foreign exchange rates.

Notes to the financial statements continued

16. Due to other financial institutions

Accounting policy

Amounts due to financial institutions are designated as financial liabilities at amortised cost. They are recognised initially at fair value 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	**30/06/17**	30/06/16
Repurchase agreements	**-**	53
Cash collateral received	**52**	78
Transaction balances with other financial institutions	**7**	4
Total amounts due to other financial institutions - Current	**59**	135

17. Deposits and other borrowings

Accounting policy

Deposits and other borrowings are designated as financial liabilities at amortised cost. They are recognised initially at fair value 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	**30/06/17**	30/06/16
Demand deposits non-interest bearing	**1,771**	1,505
Demand deposits bearing interest	**3,137**	3,135
Term deposits	**11,075**	10,142
Total deposits from customers	**15,983**	14,782
Current	**15,612**	14,340
Non-current	**371**	442

In the event of the liquidation of Kiwibank, deposit holders will rank equally with all other creditors but ahead of subordinated debt holders and shareholders. 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 2017, $3,196m of the Trust's funds were invested in Kiwibank products or securities (30 June 2016: $3,525m).

Kiwibank guarantees the payment obligations of the Manager and any amounts owing to Unitholders 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.

Notes to the financial statements continued

18. Debt securities issued

Accounting policy

Debt securities issued, with the exception of commercial paper at fair value through profit or loss, are designated as financial liabilities at amortised cost. They are recognised initially at fair value 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.

Commercial paper at fair value through profit or loss consists of European Commercial Paper ("**ECP**") and 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 Group holds related derivatives at fair value through profit or loss, and designation therefore eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Dollars in millions	**30/06/17**	30/06/16
Short term debt		
Commercial paper at fair value through profit or loss	**647**	290
Certificates of deposit	**41**	227
Long term debt		
Medium term notes	**1,338**	1,441
Covered bonds	**214**	215
Fair value hedge adjustment	**18**	34
Total debt securities issued	**2,258**	2,207
Current	**977**	810
Non-current	**1,281**	1,397

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 shareholders. 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 2016: none).

Notes to the financial statements continued

19. Subordinated debt

Accounting policy

Subordinated debt issues are designated as financial liabilities at amortised cost. They are recognised initially at fair value 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	**30/06/17**	30/06/16
Subordinated bonds	**150**	150
Kiwibank bonds	**107**	-
Perpetual capital bonds	**148**	-
Capital notes	**-**	108
Total subordinated debt	**405**	258
Current	**3**	3
Non-current	**402**	255

During the year, the Banking Group did not issue or call subordinated debt (year ended 30 June 2016: $nil issued and $nil called).

As at 30 June 2017, $108m (30 June 2016: $208m) of subordinated debt qualified as Tier 2 capital for Capital Adequacy calculation purposes. The perpetual capital bonds were previously eliminated on consolidation as explained further below. The contractual terms of subordinated debt instruments on issue expressly provide that they do not have the benefit of a deed poll guarantee (the "**NZP Guarantee**") provided by NZP. The NZP Guarantee was terminated with an effective date of 28 February 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 2016: none).

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

Effect of deconsolidation of Kiwi Capital Funding Limited ("KCFL") on subordinated debt

KCFL, which is 100% owned by KGHL, was established solely for the purpose of issuing debt securities to the market and using the proceeds to subscribe for capital instruments issued by Kiwibank. On 30 March 2017, changes were made to the KGHL Group governance arrangements which resulted in KCFL being deconsolidated from the Banking Group. Therefore, the Banking Group no longer recognises KCFL's assets and liabilities as at 30 June 2017.

As a consequence of deconsolidation, debt instruments issued by Kiwibank to KCFL, previously eliminated on consolidation, are now recognised as part of the Banking Group and similarly, debt instruments issued by KCFL are no longer recognised as part of the Banking Group.

This resulted in the derecognition of capital notes issued by KCFL and recognition of subordinated bonds issued by Kiwibank to KCFL ("**Kiwibank Bonds**") that were funded by KCFL's issuance of the capital notes. Perpetual capital bonds issued to KCFL by Kiwibank are also now recognised by the Banking Group having been previously eliminated on consolidation. The recognition of the perpetual capital bonds issued to KCFL was offset by the derecognition of perpetual capital notes that were previously recognised as equity of the Banking Group. The effect of the deconsolidation of KCFL is further disclosed in note 32.

Terms and conditions of the subordinated debt instruments on issue

Instrument	Issue date	Amount ($m)	Coupon rate	Call date	Maturity date
Subordinated bonds	10 December 2012	150	5.80% p.a.	15 December 2017	15 December 2022
Kiwibank bonds	6 June 2014	100	6.61% p.a.❶	15 July 2019	15 July 2024
Perpetual capital bonds	27 May 2015	150	7.25%p.a.❷	27 May 2020	None

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

❷ Fixed interest rate which will be reset on 27 May 2020 and at 5-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. Additionally, 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 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 has occurred by re-assessing categorisation at the end of each reporting period.

For the purposes of fair value disclosures, the Banking Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

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.

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 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

Carrying amounts of financial assets and liabilities by category

30 June 2017 Dollars in millions	Loans and receivables	Available-for-sale	Assets at fair value through profit or loss Held for trading	Assets at fair value through profit or loss Designated at FVTPL	Derivatives used for hedging	Total
Cash and cash equivalents	**464**	**-**	**-**	**-**	**-**	**464**
Due from other financial institutions	**228**	**-**	**-**	**-**	**-**	**228**
Available-for-sale assets	**-**	**1,474**	**-**	**-**	**-**	**1,474**
Loans and advances	**17,815**	**-**	**-**	**-**	**-**	**17,815**
Derivative financial instruments	**-**	**-**	**285**	**-**	**85**	**370**
Due from related parties	**80**	**-**	**-**	**-**	**-**	**80**
Other financial assets	**18**	**-**	**-**	**-**	**-**	**18**
Total financial assets	**18,605**	**1,474**	**285**	**-**	**85**	**20,449**

Dollars in millions	Liabilities at fair value through profit or loss Held for trading	Liabilities at fair value through profit or loss Designated at FVTPL	Derivatives used for hedging	Other financial liabilities at amortised cost	Total
Due to other financial institutions	**-**	**-**	**-**	**59**	**59**
Deposits and other borrowings	**-**	**-**	**-**	**15,983**	**15,983**
Derivative financial instruments	**323**	**-**	**93**	**-**	**416**
Debt securities issued	**-**	**647**	**-**	**1,611**	**2,258**
Subordinated debt	**-**	**-**	**-**	**405**	**405**
Due to related parties	**-**	**-**	**-**	**12**	**12**
Other financial liabilities	**-**	**-**	**-**	**67**	**67**
Total financial liabilities	**323**	**647**	**93**	**18,137**	**19,200**

Notes to the financial statements continued

20. Financial instruments continued

Carrying amounts of financial assets and liabilities by category continued

30 June 2016 Dollars in millions	Loans and receivables	Available-for-sale	Assets at fair value through profit or loss Held for trading	 Designated at FVTPL	Derivatives used for hedging	Total
Cash and cash equivalents	509	-	-	-	-	509
Due from other financial institutions	247	-	-	-	-	247
Financial assets held for trading	-	-	-	-	-	-
Available-for-sale assets	-	955	-	-	-	955
Loans and advances	16,689	-	-	-	-	16,689
Derivative financial instruments	-	-	540	-	118	658
Due from related parties	77	-	-	-	-	77
Other financial assets	10	-	-	-	-	10
Total financial assets	17,532	955	540	-	118	19,145

Dollars in millions	Liabilities at fair value through profit or loss Held for trading	 Designated at FVTPL	Derivatives used for hedging	Other financial liabilities at amortised cost	Total
Due to other financial institutions	-	-	-	135	135
Deposits and other borrowings	-	-	-	14,782	14,782
Derivative financial instruments	564	-	161	-	725
Debt securities issued	-	290	-	1,917	2,207
Subordinated debt	-	-	-	258	258
Due to related parties	-	-	-	4	4
Other financial liabilities	-	-	-	77	77
Total financial liabilities	564	290	161	17,173	18,188

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	30/06/17 Carrying amount	30/06/17 Estimated fair value	30/06/16 Carrying amount	30/06/16 Estimated fair value
Financial assets				
Available-for-sale assets	**1,474**	**1,474**	955	955
Loans and advances	**17,815**	**17,844**	16,689	16,804
Derivative financial instruments	**370**	**370**	658	658
Due from related parties	**80**	**80**	77	77
Financial liabilities				
Deposits and other borrowings	**(15,983)**	**(15,996)**	(14,782)	(14,796)
Derivative financial instruments	**(416)**	**(416)**	(725)	(725)
Debt securities issued	**(2,258)**	**(2,271)**	(2,207)	(2,213)
Subordinated debt	**(405)**	**(411)**	(258)	(261)
Due to related parties	**(12)**	**(12)**	(4)	(4)

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, for example 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 2016: no transfers). There were also no transfers into/out of level 3 during the year (year ended 30 June 2016: no transfers).

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.

Held for trading and available-for-sale securities

Estimates of fair value for both held for trading and available-for-sale 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.

Notes to the financial statements continued

20. Financial instruments continued

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.
- Foreign exchange derivatives that do not contain options which are priced using rates available from publicly quoted sources.

	30/06/17				30/06/16			
Dollars in millions	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets at fair value								
Derivative financial assets	-	370	-	370	-	658	-	658
Available-for-sale financial assets	530	944	-	1,474	462	493	-	955
Financial liabilities at fair value								
Derivative financial liabilities	-	416	-	416	-	725	-	725
Debt securities issued	-	647	-	647	-	290	-	290

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. 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.

Notes to the financial statements continued

20. Financial instruments continued

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.

	30/06/17				30/06/16			
Dollars in millions	**Level 1**	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
Financial assets at amortised cost								
Loans and advances	**-**	**-**	**17,844**	**17,844**	-	-	16,804	16,804
Due from related parties	**-**	**-**	**80**	**80**	-	-	77	77
Financial liabilities at amortised cost								
Deposits and other borrowings	**-**	**-**	**15,996**	**15,996**	-	-	14,796	14,796
Debt securities issued	**-**	**1,624**	**-**	**1,624**	-	1,923	-	1,923
Subordinated debt	**-**	**411**	**-**	**411**	-	261	-	261
Due to related parties	**-**	**-**	**12**	**12**	-	-	4	4

Notes to the financial statements continued

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.

30 June 2017					Related amounts not set off in the balance sheet		
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	Financial instruments	Cash collateral received	Net amount
Derivative financial assets	15	**370**	**-**	**370**	**(303)**	**(52)**	**15**
Total		**370**	**-**	**370**	**(303)**	**(52)**	**15**

					Related amounts not set off in the balance sheet		
	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 sheet	Financial instruments	Cash collateral pledged	Net amount
Derivative financial liabilities	15	**416**	**-**	**416**	**(303)**	**(107)**	**6**
Total		**416**	**-**	**416**	**(303)**	**(107)**	**6**

30 June 2016					Related amounts not set off in the balance sheet		
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	Financial instruments	Cash collateral received	Net amount
Derivative financial assets	15	658	-	658	(551)	(78)	29
Total		658	-	658	(551)	(78)	29

					Related amounts not set off in the balance sheet		
	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	Financial instruments	Cash collateral pledged	Net amount
Derivative financial liabilities	15	725	-	725	(551)	(165)	9
Repurchase agreements	16	53	-	53	(53)	-	-
Total		778	-	778	(604)	(165)	9

The 'Financial instruments' column identifies financial assets and liabilities that are subject to set off under netting arrangements such as 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 continued

22. Credit exposure concentrations

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 2017 and in the 3 months ended 30 June 2017, 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 (3 months ended 30 June 2016: 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 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 I 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 last 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 2017 (30 June 2016: nil).

Dollars in millions	**Year ended 30/06/17**	Year ended 30/06/16
Credit exposures to non-bank connected persons at year end	**85**	82
Credit exposures to non-bank connected persons at year end expressed as a percentage of Tier 1 capital	**6.7%**	8.1%
Peak credit exposures to non-bank connected persons during the year	**99**	85
Peak credit exposures to non-bank connected persons during the year expressed as a percentage of Tier 1 capital	**7.9%**	8.4%

Notes to the financial statements continued

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	**30/06/17**	30/06/16
New Zealand		
Transport and storage	**136**	131
Finance, investment and insurance	**3,186**	3,674
Electricity, gas and water	**15**	11
Food & other manufacturing	**77**	65
Construction	**122**	91
Communications	**30**	24
Government, local authorities and services	**632**	393
Agriculture	**38**	26
Health and community services	**204**	157
Personal and other services	**315**	235
Property and business services	**400**	415
Education	**252**	182
Retail and wholesale trade	**70**	55
Households	**11,732**	10,877
Overseas		
Finance, investment and insurance - Australia	**199**	268
Finance, investment and insurance - rest of world	**1,449**	1,237
Households - Australia	**38**	35
Households - rest of world	**238**	231
	19,133	18,107
Other financial liabilities	**67**	81
Total financial liabilities	**19,200**	18,188

Notes to the financial statements continued

24. Transfers 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 2017 is $1,100m (30 June 2016: $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 2017 is $316m (30 June 2016: $316m). These securities are ring fenced to ensure they are not used as collateral outside of agreements established with the Covered Bond Trust.

The consolidated 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. The Banking Group has recognised liabilities for outstanding repurchase agreements of $0.0m as at 30 June 2017 (30 June 2016: $53.0m).

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

As at 30 June 2017, the Banking Group has not derecognised any financial assets where they have a continuing involvement (30 June 2016: 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).

Critical accounting estimates and judgements

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.

As part of a review of the transformation strategy of the Bank, the Board is in the process of reviewing the existing core banking system project. While this review has not been completed, based on the work done to date, the Board considers it highly unlikely that the current delivery path of the core banking system project will meet key transformational objectives of the Bank and therefore the current project will not proceed without significant changes in the delivery path. As a result, the carrying amount of the asset may not represent the future economic benefits expected from its use. Based on an assessment of the remaining assets' value-in-use, an impairment charge of $90m has been recognised for the year ended 30 June 2017 (30 June 2016: nil) to reflect the estimated impact of this.

An amount of $97m (30 June 2016: $158m) remains capitalised on the balance sheet in relation to total software and licences of the Banking Group.

	30/06/17			30/06/16		
Dollars in millions	**Computer software**	**Computer software work in progress**	**Total**	Computer software	Computer software work in progress	Total
Cost at beginning of year	**204**	**81**	**285**	154	66	220
Accumulated amortisation at beginning of year	**(127)**	**-**	**(127)**	(104)	-	(104)
Carrying value at beginning of year	**77**	**81**	**158**	50	66	116
Additions	**4**	**52**	**56**	5	60	65
Transfers from computer software work in progress	**13**	**(13)**	**-**	45	(45)	-
Amortisation	**(24)**	**-**	**(24)**	(23)	-	(23)
Written off	**-**	**(3)**	**(3)**	-	-	-
Other impairment	**-**	**(90)**	**(90)**	-	-	-
Carrying value at end of year	**70**	**27**	**97**	77	81	158
Cost at end of year	**221**	**117**	**338**	204	81	285
Accumulated amortisation at end of year	**(151)**	**-**	**(151)**	(127)	-	(127)
Accumulated impairment at end of year	**-**	**(90)**	**(90)**	-	-	-
Carrying value at end of year	**70**	**27**	**97**	77	81	158

Notes to the financial statements continued

26. Other assets

Accounting policy

Prepayments and trade and other receivables are designated as loans and receivables. Prepayments include costs paid relating to subsequent financial years and are measured at cost. Trade and other receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method. If the initial duration is less than 12 months they are recognised at cost less impairment. Allowances for estimated irrecoverable amounts are recognised when there is objective evidence that the asset is impaired. Interest, impairment losses and foreign exchange gains and losses are recognised in the income statement.

Dollars in millions	**30/06/17**	30/06/16
Prepayments	**8**	6
Trade and other receivables	**18**	10
Total other assets - Current	**26**	16

27. Other liabilities

Accounting policy

Other liabilities designated as financial liabilities are measured at amortised cost. They are recognised initially at fair value 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.

Deferred settlement liabilities

Deferred settlement liabilities are recognised in the balance sheet at fair value and are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Dollars in millions	**30/06/17**	30/06/16
Trade and other payables	**39**	47
Employee entitlements	**20**	19
Deferred settlement obligation to non-controlling interest	**-**	4
Other liabilities	**35**	32
Total other liabilities	**94**	102
Current	**94**	100
Non-current	**-**	2

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

Kiwibank disposed of a 30% shareholding in Kiwi Asset Finance Limited ("**KAFL**"); 20% in October 2011, and 10% in October 2012. Kiwibank repurchased this non-controlling shareholding in August 2016. A deferred settlement liability was previously recognised for this obligation as at 30 June 2016. The value of the liability is nil at 30 June 2017 (2016: $3.7m) and was previously calculated by applying discounted cash flows analysis.

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) Perpetual preference shares
Perpetual preference shares are recognised at the amount paid up per perpetual preference share, net of directly attributable issue costs.

iii) 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 reserve

i) Perpetual capital notes
Amounts received on the issue of perpetual capital notes are recognised in equity, net of directly attributable issue costs.

ii) Discretionary distributions
Discretionary distributions made in respect of perpetual capital notes are recognised as a liability in the financial statements in the reporting period in which the distribution is approved and are recognised as deductions from equity.

Other reserves

i) Available-for-sale reserve
The available-for-sale reserve includes changes in the fair value of available-for-sale financial assets, net of tax. When the asset is derecognised these changes in fair value are transferred to the income statement. If an available-for-sale financial asset 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 2016: 400 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	**30/06/17**	30/06/16
Balance at beginning of the year (2017: 400m shares; 2016: 400m shares)	**400**	400
Issued in year (2017: 337m shares; 2016: nil shares)	**337**	-
Balance at end of the year (2017: 737m; 2016: 400m shares)	**737**	400

Notes to the financial statements continued

28. Equity continued

Reserves

Dollars in millions	**30/06/17**	30/06/16
Balance at beginning of the year	**729**	633
Net profit for the year	**53**	124
Dividends paid on ordinary shares	**(5)**	(29)
Dividends paid to non-controlling interest	**(1)**	-
Distributions to holders of perpetual capital	**(12)**	(11)
Net movement in available for sale reserve	**(6)**	3
Net movement in cash flow hedge reserve	**32**	9
Net movement in perpetual capital reserve	**(147)**	-
Balance at end of the year	**643**	729

Perpetual capital reserve

On 27 May 2015 KCFL issued 150,000,000 perpetual, non-cumulative, unsecured, subordinated, loss absorbing debt securities (“**PCN**”) for cash at $1 per PCN and utilised the proceeds to purchase all 150,000,000 Perpetual Capital Bonds (“**PB**”) issued by Kiwibank, for cash at $1 per Perpetual Capital Bond. The PCNs are perpetual in nature and do not have a maturity date, however, some or all of the PCNs may be repaid on a reset date (reset dates occur at 5-yearly intervals, commencing 27 May 2020). KCFL’s obligation to pay interest on the PCNs is dependent on the receipt of a payment of interest from Kiwibank on the Perpetual Capital Bonds on an equivalent payment date. Therefore, KCFL has no contractual obligation in respect of the PCNs and they are classified as equity. The costs associated with the issue are netted against the perpetual capital reserve in the balance sheet. As a result of the deconsolidation of KCFL, the PCN’s and perpetual capital reserve are no longer recognised as part of the Banking Group’s balance sheet (2016: $147m). The Banking Group now recognises the PB as subordinated debt having been previously eliminated on consolidation. The deconsolidation of KCFL is further disclosed in note 32.

Nil of the perpetual capital bonds qualified as Additional Tier 1 capital as at 30 June 2017 (2016: $147m).

Dollars in millions	**30/06/17**	30/06/16
Balance at beginning of the year	**147**	147
Deconsolidation of subsidiary	**(147)**	-
Balance at end of the year	**-**	147

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	**30/06/17**	30/06/16
Balance at beginning of the year	**(45)**	(54)
Gross changes in fair value	**36**	7
Tax on changes in fair value	**(10)**	(2)
Cumulative loss transferred to the income statement	**9**	5
Tax effect of items transferred to income statement	**(3)**	(1)
Balance at end of the year	**(13)**	(45)

Notes to the financial statements continued

28. Equity continued

Available-for-sale reserve

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

Dollars in millions	**30/06/17**	30/06/16
Balance at beginning of the year	**11**	8
Gross changes in fair value	**(3)**	12
Tax on changes in fair value	**1**	(3)
Cumulative gain transferred to the income statement on disposal of financial assets	**(6)**	(8)
Tax effect of items transferred to income statement	**2**	2
Balance at end of the year	**5**	11

Capital

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

- Tier 1 capital, which includes ordinary shares, retained earnings including current year profit, and the available-for-sale reserve.
- Tier 2 capital, which includes subordinated debt.

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 2017, Kiwibank was in compliance with all of its externally imposed conditions of registration.

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 shareholders, return capital to shareholders 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	**30/06/17**	30/06/16
Declared and paid during the year to non-controlling interests in a subsidiary:		
91 cents per ordinary share in Kiwi Asset Finance Limited	**1**	-
Declared and paid during the year on ordinary shares:		
1.25 cents per share (2016: 7.25 cents per share)	**5**	29
Total dividends paid	**6**	29

If for any reason an interest payment on the PBs 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 PBs:

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 PBs (unless the payment is made in respect of capital instruments that rank equally with the PBs and a pro rata payment is made in respect of the PBs 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 PCNs are paid in full on those dates; or

   ii) there are no PCNs outstanding.

Notes to the financial statements continued

29. Related entities

The Banking Group

Critical accounting estimates and judgements
The Banking Group sponsors the formation of SPVs 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:

		Interest held by Kiwibank Limited	
Name of entity	Principal activity	**30/06/17**	30/06/16
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	**100%**	100%
Kiwi Asset Finance Limited	Asset finance company	**100%**	70%
Kiwibank PIE Unit Trust ❶("PIE Unit Trust")	Provision of investment management services	**-**	-
Kiwibank RMBS Trust Series 2009-1❶	Securitisation finance entity	**-**	-
Kiwi Covered Bond Trust❶	Securitisation finance entity	**-**	-

❶ The Banking Group consolidates the 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 (Kiwi Capital Funding Limited was also consolidated as part of the Banking Group as at 30 June 2016 but was deconsolidated on 30 March 2017 as disclosed further in note 32).

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

In October 2011, Kiwibank disposed of a 20% shareholding in KAFL and in October 2012, Kiwibank disposed of a further 10% of its shareholding to the same non-controlling shareholder. In August 2016, Kiwibank repurchased the shareholding from the non-controlling shareholder. A deferred settlement liability was previously recorded as Kiwibank was obliged to repurchase the 30% holding between 2016 and 2018 (note 27).

Transactions with the NZP Group and KGHL Group

The "**NZP Group**" comprises NZP and its subsidiaries. The "**KGHL Group**" comprises KGHL and its subsidiaries. All transactions with the NZP Group and KGHL Group 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. Kiwi Financial Services Retail Limited ("**KFSRL**"), a subsidiary of KGHL, was set up during the current year to employ retail network staff for which Kiwibank and NZP will reimburse KFSRL.

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 entities within the NZP Group and KGHL Group 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 NZP's retail network in its provision of retail banking services to customers. The fee paid for this service is based upon activity and a mutually agreed fee. KFSRL transferred retail network staff contracts from NZP effective from 13 November 2016. The Banking Group reimbursed KFSRL for personnel costs of $16.9m for the year ended 30 June 2017 (2016: nil).
- During the year, NZP held a number of property leases on behalf of the Banking Group. The Banking Group reimbursed NZP for the lease charges. At 30 June 2017, the Banking Group holds property leases with NZP that are included in those disclosed in note 36.

Notes to the financial statements continued

29. Related entities continued

- Kiwibank was previously a member of the NZP consolidated tax group, and purchased tax losses from members of that group. On 31 October 2016, Kiwibank exited the NZP consolidated tax group and joined a new tax group with other KGHL group companies. Consequently, Kiwibank now purchases tax losses from members of the KGHL tax group.
- 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 identity verification services.
- The Crown previously entered into a $300m uncalled capital facility with NZP where NZP could drawdown capital for contingent events around Kiwibank's conditions of registration. This facility was replaced by one made with KGHL. The annualised cost of this facility on charged to the Banking Group by KGHL is $3.0m (2016: $3.6m on charged to the Banking Group by NZP).
- NZP has a credit facility with the Banking Group, allowing NZP to drawdown to the extent 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 the transaction is undertaken at market interest rates. As at 30 June 2017 the balance of the facility owed by NZP to the Banking Group was $75.8m (30 June 2016: $76.0m).
- There is a revolving credit agreement between the Banking Group and New Zealand Home Loans Limited ("**NZHL**"), a fellow subsidiary of KGHL, the balance of which was $3.5m at 30 June 2017 (30 June 2016: $3.3m).
- During the year NZHL received commissions from the Banking Group totalling $14.1m (year ended 30 June 2016: $13.5m).
- During the year the Banking Group received commissions from Kiwi Insurance Limited, a fellow subsidiary of KGHL, totalling $1.8m (year ended 30 June 2016: $1.6m).
- The table below shows balances outstanding at the reporting date with NZP, and other subsidiaries within the KGHL Group. No provision for credit impairment has been recognised for loans made to related parties.

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

Dollars in millions	**30/06/17**	30/06/16
Outstanding balances		
NZP	**10**	4
Other subsidiaries of KGHL	**2**	-
Total due to related parties per balance sheet	**12**	4
NZP (Deposits)	**41**	-
NZP Superannuation Plan (Deposits)	**13**	13
KGHL (Deposits)	**19**	10
Kiwi Insurance (Deposits)	**2**	14
Other subsidiaries of KGHL (Deposits)	**4**	2
Total due to related parties included in deposits	**79**	39
NZP (derivative financial instruments - liabilities)	**3**	5
Total due to related parties included in derivative financial instruments - liabilities	**3**	5
KCFL (subordinated debt)[1]	**255**	-
Total due to related parties included in subordinated debt	**255**	-
Total outstanding balances due to related parties	**349**	48
Receivables		
NZP	**79**	76
Other subsidiaries of KGHL	**1**	1
Total due from related parties per balance sheet	**80**	77
The New Zealand Home Loan Company Limited (Loans and advances)	**4**	3
Total due from related parties included in loans and advances	**4**	3
NZP (derivative financial instruments - assets)	**1**	2
Total due from related parties included in derivative financial instruments - assets	**1**	2
Total receivable from related parties	**85**	82
Balances with due to/from related parties per balance sheet		
Payables - Current	**12**	4
Payables - Non-current	**-**	-
Receivables - Current	**5**	31
Receivables - Non-current	**75**	46

[1] At 30 June 2016 KCFL was consolidated – see note 32

Notes to the financial statements continued

29. Related entities continued

The table below shows revenue and expenditure during the year with NZP, and other subsidiaries within the KGHL Group. The revenue and expenses amounts below include interest income and interest expense on balances with related parties as disclosed in note 3.

Dollars in millions	**Year ended 30/06/17**	Year ended 30/06/16
Revenue		
NZP	**48**	54
Other subsidiaries of KGHL	**2**	2
Expenditure		
NZP	**72**	84
Other subsidiaries of KGHL	**37**	15

In addition, Kiwibank undertakes some transactions with other State-Owned Enterprises and Government departments.

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 provision for credit impairment has been recognised for loans made to key management personnel (30 June 2016: $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. It also shows loans to and deposits from key management personnel.

Dollars in millions	**30/06/17**	30/06/16
Key management personnel		
Year ended 30 June		
Salaries and short term benefits	**6**	5
As at 30 June		
Loans to key management personnel	**1**	-
Deposits from key management personnel	**-**	4

Notes to the financial statements continued

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.

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 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 2017, $3,196m of funds under management were invested in Kiwibank's own products or securities (30 June 2016: $3,525m).
- is a distributor of the Kiwibank Investment Portfolio. The Banking Group is not the Issuer, Manager or Promoter of these Funds. Nor is it responsible for any decline in performance of the underlying assets of the investors due to market forces.

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 2017 and 30 June 2016:

- 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.

Notes to the financial statements continued

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 Leadership Team ("**KBLT**"), 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.

For the purposes of this note, the chief operating decision-maker has been identified as the Kiwibank Leadership Team ("**KBLT**"), which consists of the Chief Executive and his direct reports. The KBLT 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 KBLT 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.
- Business– Provides banking products and services to the business sector. 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 (2016: nil).

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

Notes to the financial statements continued

31. Segment analysis continued

Dollars in millions	30/06/17 Personal Markets	30/06/17 Business Markets	30/06/17 Total	30/06/16 Personal Markets	30/06/16 Business Markets	30/06/16 Total
External net interest income	**434**	**(66)**	**368**	442	(69)	373
Net intersegment interest	**(199)**	**199**	**-**	(212)	212	-
Net interest income	**235**	**133**	**368**	230	143	373
Other external operating income	**94**	**32**	**126**	80	24	104
Segmental revenue	**329**	**165**	**494**	310	167	477
Profit before impairment and taxation	**84**	**71**	**155**	95	81	176
Profit before taxation	**16**	**55**	**71**	76	89	165
Total assets	**16,276**	**4,340**	**20,616**	15,156	4,201	19,357
Total liabilities	**12,747**	**6,489**	**19,236**	11,708	6,520	18,228
Acquisition of intangible assets	**42**	**10**	**52**	52	13	65
Acquisition of property, plant and equipment	**10**	**2**	**12**	8	2	10
Amortisation expense	**17**	**7**	**24**	16	7	23
Depreciation expense	**6**	**1**	**7**	5	2	7
Other impairment losses	**72**	**18**	**90**	-	-	-
Impairment (reversals)/losses on loans and advances	**(4)**	**(2)**	**(6)**	19	(8)	11

Notes to the financial statements continued

32. Deconsolidation of subsidiary

On 30 March 2017, changes were made to the KGHL Group governance arrangements which resulted in KCFL being deconsolidated from the Banking Group effective 30 March 2017 and the Banking group no longer recognising KCFL's assets and liabilities. No consideration was received in relation to the changes that led to the deconsolidation of KCFL.

KCFL, which is 100% owned by KGHL, was established solely for the purpose of issuing debt securities to the market and using the proceeds to subscribe for capital instruments issued by Kiwibank. The debt issued by KCFL has substantially the same terms as the debt issued by Kiwibank to KCFL and the impact of deconsolidation is limited to differences in accounting treatment of the debt issuances before and after deconsolidation.

Perpetual capital notes issued by KCFL were previously treated as equity of the Banking Group and deconsolidation resulted in a reduction of $147m in the Banking Group's perpetual capital reserve. This decrease in equity was offset by an increase in subordinated debt liabilities due to the recognition of the perpetual capital bonds issued by Kiwibank to KCFL that were previously eliminated upon consolidation. The perpetual capital bonds were carried at amortised cost with a value at the date of deconsolidation of $148m including unamortised issuance costs of $2m.

The subordinated debt issued had the same accounting treatment before and after deconsolidation therefore there was no effect on the Banking Group in relation to the subordinated debt.

Dollars in millions	**30/06/17**	30/06/16
Effect of deconsolidation of subsidiary		
Liabilities		
Perpetual capital bonds	**(148)**	-
Equity		
Perpetual capital reserve (perpetual capital notes)	**147**	-
Net assets deconsolidated	**(1)**	-
Loss on deconsolidation of subsidiary		
Net assets deconsolidated	**(1)**	-
Fair value of interest retained	**-**	-
Consideration received upon deconsolidation	**-**	-
Loss on deconsolidation of subsidiary	**(1)**	-

The loss on deconsolidation of $1.1m arises due to the recognition of the perpetual capital bond issuance costs amortised to date by Kiwibank having been previously eliminated upon consolidation. The loss on deconsolidation is reflected within operating expenses. As a consequence of the deconsolidation, the Banking Group also derecognised a deferred tax liability on fair value losses of $1.4m as disclosed in note 7.

Notes to the financial statements continued

33. 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 providing oversight on risk appetites, 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 a 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.

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 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; iii) the Disclosure Committee, which is focused on continuous disclosure requirements; and iv) the Enterprise Portfolio Management Group, 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 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 2017.

Notes to the financial statements continued

33. Risk management continued

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 directly to the Chair of the Board Finance, Audit and Disclosures Committee with matrix reporting 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.

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 policy statements – 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 Board Finance, Audit and Disclosures Committee. In the event of large, unexpected losses, the Banking Group is committed to restoring its capital position. Management have developed plans accordingly.

33. Risk management continued

- **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).

The Banking Group's high level "risk structure" recognises five 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.
- **Business and strategic 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.
- **Systemic risk** – the risk the global and domestic economic environment changes materially so the Banking Group is unable to achieve its business goals and strategies. This includes changes in financial markets impacting credit and liquidity flows.

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.

  An independent credit management function staffed by credit risk specialists exists to; i) provide independent credit decisions; ii) support front-line lending staff in the application of sound credit practices; iii) provide centralised remedial management of troublesome and impaired accounts; and iv) review 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 is 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.

33. Risk management continued

- **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 (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.

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 function 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.

Notes to the financial statements continued

33. Risk management continued

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.

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 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 re-priced. A separate independent Market Risk Management Unit is responsible for the daily measurement and monitoring of market risk exposures.

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 tables below 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

	30/06/17						
Dollars in millions	Total	Non-interest bearing	Up to 3 months	3 to 6 months	6 months to 1 year	Between 1 & 2 years	Over 2 years
Financial assets							
Cash and cash equivalents	464	33	431	-	-	-	-
Due from other financial institutions	228	-	208	20	-	-	-
Available-for-sale assets	1,474	-	374	209	122	460	309
Loans and advances	17,815	(21)	5,570	1,648	3,989	4,657	1,972
Derivative financial instruments	370	370	-	-	-	-	-
Due from related parties	80	5	45	-	-	30	-
Other financial assets	18	18	-	-	-	-	-
Total financial assets	20,449	405	6,628	1,877	4,111	5,147	2,281
Financial liabilities							
Due to other financial institutions	(59)	(7)	(52)	-	-	-	-
Deposits and other borrowings	(15,983)	(1,772)	(8,551)	(2,958)	(2,331)	(192)	(179)
Derivative financial instruments	(416)	(416)	-	-	-	-	-
Debt securities issued	(2,258)	-	(1,404)	(61)	-	(271)	(522)
Subordinated debt	(405)	-	-	(150)	-	-	(255)
Due to related parties	(12)	(12)	-	-	-	-	-
Other financial liabilities	(67)	(67)	-	-	-	-	-
Total financial liabilities	(19,200)	(2,274)	(10,007)	(3,169)	(2,331)	(463)	(956)
On-balance sheet gap	1,249	(1,869)	(3,379)	(1,292)	1,780	4,684	1,325
Net derivative notional principals	(9)	-	4,233	1,132	(1,565)	(3,791)	(18)
Net effective interest rate gap	1,240	(1,869)	854	(160)	215	893	1,307

Notes to the financial statements continued

33. Risk management continued

Interest rate repricing schedule continued

	30/06/16						
Dollars in millions	Total	Non-interest bearing	Up to 3 months	3 to 6 months	6 months to 1 year	Between 1 & 2 years	Over 2 years
Financial assets							
Cash and cash equivalents	509	31	478	-	-	-	-
Due from other financial institutions	247	42	205	-	-	-	-
Available-for-sale assets	955	-	89	-	26	294	546
Loans and advances	16,689	(31)	5,313	1,559	3,185	5,304	1,359
Derivative financial instruments	658	658	-	-	-	-	-
Due from related parties	77	1	45	-	31	-	-
Other financial assets	10	10	-	-	-	-	-
Total financial assets	19,145	711	6,130	1,559	3,242	5,598	1,905
Financial liabilities							
Due to other financial institutions	(135)	(4)	(131)	-	-	-	-
Deposits and other borrowings	(14,782)	(1,506)	(9,463)	(1,809)	(1,563)	(245)	(196)
Derivative financial instruments	(725)	(725)	-	-	-	-	-
Debt securities issued	(2,207)	-	(977)	(159)	(160)	(98)	(813)
Subordinated debt	(258)	-	-	-	-	(150)	(108)
Due to related parties	(4)	(4)	-	-	-	-	-
Other financial liabilities	(77)	(77)	-	-	-	-	-
Total financial liabilities	(18,188)	(2,316)	(10,571)	(1,968)	(1,723)	(493)	(1,117)
On-balance sheet gap	957	(1,605)	(4,441)	(409)	1,519	5,105	788
Net derivative notional principals	20	-	4,706	(170)	(981)	(4,026)	491
Net effective interest rate gap	977	(1,605)	265	(579)	538	1,079	1,279

Notes to the financial statements continued

33. 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.

	30/06/17							
Dollars in millions	NZD	CHF	AUD	USD	GBP	EUR	Other	Total
Assets								
Cash and cash equivalents	385	-	9	37	19	12	2	464
Due from other financial institutions	228	-	-	-	-	-	-	228
Available-for-sale assets	1,474	-	-	-	-	-	-	1,474
Loans and advances	17,810	-	1	3	-	1	-	17,815
Derivative financial instruments	(54)	487	(25)	(60)	-	(1)	23	370
Due from related parties	80	-	-	-	-	-	-	80
Other financial assets	18	-	-	-	-	-	-	18
Total financial assets	19,941	487	(15)	(20)	19	12	25	20,449
Liabilities								
Due to other financial institutions	(33)	-	-	(26)	-	-	-	(59)
Deposits and other borrowings	(15,879)	-	(20)	(49)	(21)	(11)	(3)	(15,983)
Derivative financial instruments	(1,382)	-	280	606	3	(2)	79	(416)
Debt securities issued	(944)	(478)	(239)	(495)	-	-	(102)	(2,258)
Subordinated debt	(405)	-	-	-	-	-	-	(405)
Due to related parties	(12)	-	-	-	-	-	-	(12)
Other financial liabilities	(67)	-	-	-	-	-	-	(67)
Total financial liabilities	(18,722)	(478)	21	36	(18)	(13)	(26)	(19,200)
Net on-balance sheet financial positon	1,219	9	6	16	1	(1)	(1)	1,249

Notes to the financial statements continued

33. Risk management continued

Currency risk management continued

	30/06/16							
Dollars in millions	NZD	CHF	AUD	USD	GBP	EUR	Other	Total
Assets								
Cash and cash equivalents	433	-	10	43	11	9	3	509
Due from other financial institutions	205	-	-	42	-	-	-	247
Available-for-sale assets	955	-	-	-	-	-	-	955
Loans and advances	16,687	-	-	1	-	1	-	16,689
Derivative financial instruments	248	512	(27)	(101)	(3)	(3)	32	658
Due from related parties	77	-	-	-	-	-	-	77
Other financial assets	10	-	-	-	-	-	-	10
Total financial assets	18,615	512	(17)	(15)	8	7	35	19,145
Liabilities								
Due to other financial institutions	(92)	-	-	(43)	-	-	-	(135)
Deposits and other borrowings	(14,689)	-	(18)	(47)	(13)	(12)	(3)	(14,782)
Derivative financial instruments	(1,339)	-	177	305	4	5	123	(725)
Debt securities issued	(1,231)	(495)	(136)	(190)	-	-	(155)	(2,207)
Subordinated debt	(258)	-	-	-	-	-	-	(258)
Due to related parties	(4)	-	-	-	-	-	-	(4)
Other financial liabilities	(77)	-	-	-	-	-	-	(77)
Total financial liabilities	(17,690)	(495)	23	25	(9)	(7)	(35)	(18,188)
Net on-balance sheet financial positon	925	17	6	10	(1)	-	-	957

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 function 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; i) 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 ii) by 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 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 are 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.

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.

Treasury (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.

Notes to the financial statements continued

33. Risk management continued

Liquidity risk management process

The Banking Group's liquidity management responsibilities include:

- Day-to-day liquidity requirements. RBNZ liquidity ratios are calculated and monitored daily to ensure that the Group:
  - is compliant with part 11 of the Conditions of Registration and the RBNZ "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

Non-derivative cash flows

The tables below 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

33. Risk management continued

Non-derivative cash flows by contractual maturity

	30/06/17						
Dollars in millions	On demand	Up to 3 months	3 to 12 months	Between 1 & 5 years	More than 5 years	Gross nominal inflow/outflow	Carrying amount
Non-derivative cash flows							
Liabilities							
Due to other financial institutions	(59)	-	-	-	-	(59)	(59)
Deposits and other borrowings	(5,756)	(4,563)	(5,391)	(414)	-	(16,124)	(15,983)
Debt securities issued	(199)	(528)	(290)	(1,329)	(33)	(2,379)	(2,258)
Subordinated debt	(3)	-	(12)	(61)	(421)	(497)	(405)
Due to related parties	(12)	-	-	-	-	(12)	(12)
Other financial liabilities	(67)	-	-	-	-	(67)	(67)
Total financial liabilities	(6,096)	(5,091)	(5,693)	(1,804)	(454)	(19,138)	(18,784)
Assets							
Cash and cash equivalents	464	-	-	-	-	464	464
Due from other financial institutions	148	60	20	-	-	228	228
Available-for-sale assets	65	224	379	857	-	1,525	1,474
Loans and advances	195	369	1,119	3,990	29,953	35,626	17,815
Due from related parties	5	1	1	78	-	85	80
Other financial assets	18	-	-	-	-	18	18
Total financial assets	895	654	1,519	4,925	29,953	37,946	20,079
Net non-derivative cash flows	(5,201)	(4,437)	(4,174)	3,121	29,499	18,808	
Derivative cash flows - net							
Interest rate derivatives	(8)	(9)	(26)	(8)	-	(51)	
Total	(8)	(9)	(26)	(8)	-	(51)	
Derivative cash flows - gross							
Foreign exchange derivatives							
Inflow	266	619	250	657	33	1,825	
Outflow	(276)	(651)	(253)	(602)	(39)	(1,821)	
Total	(10)	(32)	(3)	55	(6)	4	
Off-balance sheet cash flows							
Capital commitments	-	(8)	(1)	-	-	(9)	
Undrawn loan commitments	(2,857)	-	-	-	-	(2,857)	
Lease commitments	-	(2)	(6)	(27)	(47)	(82)	
Total	(2,857)	(10)	(7)	(27)	(47)	(2,948)	
Net cash flows	(8,076)	(4,488)	(4,210)	3,141	29,446	15,813	
Cumulative net cash flows	(8,076)	(12,564)	(16,774)	(13,633)	15,813	15,813	

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

33. Risk management continued

Non-derivative cash flows by contractual maturity continued

	30/06/16						
Dollars in millions	On demand	Up to 3 months	3 to 12 months	Between 1 & 5 years	More than 5 years	Gross nominal inflow/outflow	Carrying amount
Non-derivative cash flows							
Liabilities							
Due to other financial institutions	(135)	-	-	-	-	(135)	(135)
Deposits and other borrowings	(5,605)	(5,398)	(3,411)	(489)	-	(14,903)	(14,782)
Debt securities issued	(147)	(249)	(459)	(1,467)	(35)	(2,357)	(2,207)
Subordinated debt	(3)	-	(12)	(61)	(286)	(362)	(258)
Due to related parties	(4)	-	-	-	-	(4)	(4)
Other financial liabilities	(77)	-	-	-	-	(77)	(77)
Total financial liabilities	(5,971)	(5,647)	(3,882)	(2,017)	(321)	(17,838)	(17,463)
Assets							
Cash and cash equivalents	509	-	-	-	-	509	509
Due from other financial institutions	247	-	-	-	-	247	247
Available-for-sale assets	8	11	72	925	-	1,016	955
Loans and advances	174	357	1,088	3,823	28,626	34,068	16,689
Due from related parties	-	2	31	45	-	78	77
Other financial assets	10	-	-	-	-	10	10
Total financial assets	948	370	1,191	4,793	28,626	35,928	18,487
Net non-derivative cash flows	(5,023)	(5,277)	(2,691)	2,776	28,305	18,090	
Derivative cash flows - net							
Interest rate derivatives	(18)	(11)	(55)	(34)	(2)	(120)	
Total	(18)	(11)	(55)	(34)	(2)	(120)	
Derivative cash flows - gross							
Foreign exchange derivatives							
Inflow	437	170	377	747	35	1,766	
Outflow	(443)	(174)	(390)	(678)	(40)	(1,725)	
Total	(6)	(4)	(13)	69	(5)	41	
Off-balance sheet cash flows							
Capital commitments	-	(5)	(1)	-	-	(6)	
Undrawn loan commitments	(2,650)	-	-	-	-	(2,650)	
Lease commitments	-	(1)	(4)	(13)	-	(18)	
Total	(2,650)	(6)	(5)	(13)	-	(2,674)	
Net cash flows	(7,697)	(5,298)	(2,764)	2,798	28,298	15,337	
Cumulative net cash flows	(7,697)	(12,995)	(15,759)	(12,961)	15,337	15,337	

Equity risk

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

Notes to the financial statements continued

33. Risk management continued

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 and 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 & workplace safety
- Clients, products & business practices (NB: This category includes a large proportion of Kiwibank's compliance risks.)
- Damage to physical assets
- Business disruption and system failures
- 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 are 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 Disclosures Committee and to the Board Risk, Credit and Compliance Committee.

Business and strategic 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.

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.
- Building capability within the Banking Group to enable both the pursuit of opportunities and mitigation of vulnerabilities.

Notes to the financial statements continued

33. Risk management continued

Risk Governance

Risk Governance encompasses roles and responsibilities of the Board, CRO and the risk management function, and independent assessment of the Risk Governance Framework.

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

Key elements of the Risk Governance function are:

- **Risk Appetite & supporting policy frameworks** – The Risk appetite and culture framework includes a definition of risk culture, an effective risk appetite statement, and clearly defined risk limits. It also defines roles and responsibilities for the Board of Directors and senior management in establishing the approved risk appetite statement.

  This requires clearly defined frameworks, including specific policy, for the development and maintenance of Credit Origination, Portfolio Management and Policies/Sector Policies and Delegated Lending Authorities. These frameworks are regularly reviewed and refined for continuous improvement and to support Business needs.

  The Banking Group's Executive Risk Committee (comprising of executive management) is tasked with producing robust credit policies, credit management processes and asset writing strategies; examining portfolio standards, concentrations of lending, asset impairment; and monitoring compliance with policy.

- **Quality Assurance of credit activities** – This provides assurance that Credit Policy, processes and systems are being used as designed, by both individual staff and systematically across the Banking Group.

  The Risk governance function includes reviewing material credit change initiatives ensuring they are working as designed and producing intended outcomes.

- **Model Assurance** – to provide assurance that models are fit for purpose and working as intended, the function is tasked with developing model validation standards with the primary focus on models used for rating credit exposure.

Notes to the financial statements continued

34. 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 (for example, financial assets held for trading) or equity (for example, available for sale assets 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 upon financial assets and liabilities that have re-priced 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			
30 June 2017		-1%	+1%	-1%	+1%
Dollars in millions	Carrying amounts	Net profit	Net profit	Equity	Equity
Financial assets					
Cash and cash equivalents	464	-	-	-	-
Due from other financial institutions	228	-	-	-	-
Available-for-sale assets	1,474	-	-	18	(18)
Loans and advances	17,815	5	(5)	5	(5)
Derivative financial instruments	370	205	(196)	204	(195)
Due from related parties	80	-	-	-	-
Other financial assets	18	-	-	-	-
Total financial assets	**20,449**	**210**	**(201)**	**227**	**(218)**
Financial liabilities					
Due to other financial institutions	(59)	-	-	-	-
Deposits and other borrowings	(15,983)	-	-	-	-
Derivative financial instruments	(416)	(186)	177	(258)	248
Debt securities issued	(2,258)	(19)	18	(19)	18
Subordinated debt	(405)	(2)	2	(2)	2
Due to related parties	(12)	-	-	-	-
Other financial liabilities	(67)	-	-	-	-
Total financial liabilities	**(19,200)**	**(207)**	**197**	**(279)**	**268**

Notes to the financial statements continued

34. Sensitivity analysis continued

		Interest rate risk – Fair value			
30 June 2016		-1%	+1%	-1%	+1%
Dollars in millions	Carrying amounts	Net profit	Net profit	Equity	Equity
Financial assets					
Cash and cash equivalents	509	-	-	-	-
Due from other financial institutions	247	-	-	-	-
Available-for-sale assets	955	-	-	23	(22)
Loans and advances	16,689	8	(8)	8	(8)
Derivative financial instruments	658	348	(332)	365	(348)
Due from related parties	77	-	-	-	-
Other financial assets	10	-	-	-	-
Total financial assets	19,145	356	(340)	396	(378)
Financial liabilities					
Due to other financial institutions	(135)	-	-	-	-
Deposits and other borrowings	(14,782)	-	-	-	-
Derivative financial instruments	(725)	(325)	309	(403)	386
Debt securities issued	(2,207)	(26)	25	(26)	25
Subordinated debt	(258)	(2)	2	(2)	2
Due to related parties	(4)	-	-	-	-
Other financial liabilities	(77)	-	-	-	-
Total financial liabilities	(18,188)	(353)	336	(431)	413

34. Sensitivity analysis continued

		Interest rate risk – Earnings			
30 June 2017		**-1%**	**+1%**	**-1%**	**+1%**
Dollars in millions	**Carrying amounts**	**Net profit**	**Net profit**	**Equity**	**Equity**
Financial assets					
Cash and cash equivalents	**464**	**(4)**	**4**	**(4)**	**4**
Due from other financial institutions	**228**	**(2)**	**2**	**(2)**	**2**
Available-for-sale assets	**1,474**	**(10)**	**10**	**(10)**	**10**
Loans and advances	**17,815**	**(122)**	**122**	**(122)**	**122**
Derivative financial instruments	**370**	**117**	**(117)**	**117**	**(117)**
Due from related parties	**80**	**(1)**	**1**	**(1)**	**1**
Other financial assets	**18**	**-**	**-**	**-**	**-**
Total financial assets	**20,449**	**(22)**	**22**	**(22)**	**22**
Financial liabilities					
Due to other financial institutions	**(59)**	**1**	**(1)**	**1**	**(1)**
Deposits and other borrowings	**(15,983)**	**138**	**(138)**	**138**	**(138)**
Derivative financial instruments	**(416)**	**(151)**	**151**	**(151)**	**151**
Debt securities issued	**(2,258)**	**14**	**(14)**	**14**	**(14)**
Subordinated debt	**(405)**	**-**	**-**	**-**	**-**
Due to related parties	**(12)**	**-**	**-**	**-**	**-**
Other financial liabilities	**(67)**	**-**	**-**	**-**	**-**
Total financial liabilities	**(19,200)**	**2**	**(2)**	**2**	**(2)**

Notes to the financial statements continued

34. Sensitivity analysis continued

		Interest rate risk – Earnings			
30 June 2016		-1%	+1%	-1%	+1%
Dollars in millions	Carrying amounts	Net profit	Net profit	Equity	Equity
Financial assets					
Cash and cash equivalents	509	(5)	5	(5)	5
Due from other financial institutions	247	(2)	2	(2)	2
Available-for-sale assets	955	(5)	5	(5)	5
Loans and advances	16,689	(113)	113	(113)	113
Derivative financial instruments	658	128	(128)	128	(128)
Due from related parties	77	-	-	-	-
Other financial assets	10	-	-	-	-
Total financial assets	19,145	3	(3)	3	(3)
Financial liabilities					
Due to other financial institutions	(135)	1	(1)	1	(1)
Deposits and other borrowings	(14,782)	130	(130)	130	(130)
Derivative financial instruments	(725)	(177)	177	(177)	177
Debt securities issued	(2,207)	12	(12)	12	(12)
Subordinated debt	(258)	-	-	-	-
Due to related parties	(4)	-	-	-	-
Other financial liabilities	(77)	-	-	-	-
Total financial liabilities	(18,188)	(34)	34	(34)	34

Notes to the financial statements continued

34. Sensitivity analysis continued

		Currency risk			
30 June 2017		**-10%**	**+10%**	**-10%**	**+10%**
Dollars in millions	**Carrying amounts**	**Net profit**	**Net profit**	**Equity**	**Equity**
Financial assets					
Cash and cash equivalents	**464**	**8**	**(7)**	**8**	**(7)**
Due from other financial institutions	**228**	**-**	**-**	**-**	**-**
Available-for-sale assets	**1,474**	**-**	**-**	**-**	**-**
Loans and advances	**17,815**	**-**	**-**	**-**	**-**
Derivative financial instruments	**370**	**43**	**(38)**	**43**	**(38)**
Due from related parties	**80**	**-**	**-**	**-**	**-**
Other financial assets	**18**	**-**	**-**	**-**	**-**
Total financial assets	**20,449**	**51**	**(45)**	**51**	**(45)**
Financial liabilities					
Due to other financial institutions	**(59)**	**(3)**	**2**	**(3)**	**2**
Deposits and other borrowings	**(15,983)**	**(12)**	**11**	**(12)**	**11**
Derivative financial instruments	**(416)**	**96**	**(88)**	**96**	**(88)**
Debt securities issued	**(2,258)**	**(132)**	**120**	**(132)**	**120**
Subordinated debt	**(405)**	**-**	**-**	**-**	**-**
Due to related parties	**(12)**	**-**	**-**	**-**	**-**
Other financial liabilities	**(67)**	**-**	**-**	**-**	**-**
Total financial liabilities	**(19,200)**	**(51)**	**45**	**(51)**	**45**

Notes to the financial statements continued

34. Sensitivity analysis continued

		Currency risk			
30 June 2016		-10%	+10%	-10%	+10%
Dollars in millions	Carrying amounts	Net profit	Net profit	Equity	Equity
Financial assets					
Cash and cash equivalents	509	8	(7)	8	(7)
Due from other financial institutions	247	-	-	-	-
Available-for-sale assets	955	-	-	-	-
Loans and advances	16,689	-	-	-	-
Derivative financial instruments	658	41	(37)	41	(37)
Due from related parties	77	-	-	-	-
Other financial assets	10	-	-	-	-
Total financial assets	19,145	49	(44)	49	(44)
Financial liabilities					
Due to other financial institutions	(135)	(4)	4	(4)	4
Deposits and other borrowings	(14,782)	(11)	9	(11)	9
Derivative financial instruments	(725)	61	(56)	61	(56)
Debt securities issued	(2,207)	(93)	85	(93)	84
Subordinated debt	(258)	-	-	-	-
Due to related parties	(4)	-	-	-	-
Other financial liabilities	(77)	-	-	-	-
Total financial liabilities	(18,188)	(47)	42	(47)	41

35. Auditor's remuneration

Dollars in thousands	**Year ended 30/06/17**	Year ended 30/06/16
Auditor's remuneration		
Audit and review of financial statements	**763**	744
Other Services:		
Other assurance services ❶	**57**	13
Tax compliance services ❷	**198**	25
Other services ❸	**277**	29

❶ Other assurance services relate to a registry audit, trustee reporting and a controls assurance report (2016: registry audits and trustee reporting).

❷ Tax compliance services relate to the review of tax returns and GST apportionment methodology (2016: review of tax returns).

❸ Other services include off-quarter disclosure statements and other agreed upon procedures, accounting opinions relating to the treatment of the Banking Group's capital instruments, IT support services and workshop facilitation services (2016: off-quarter Disclosure Statements and other agreed upon procedures).

Notes to the financial statements continued

36. 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	**30/06/17**	30/06/16
Less than one year	**8**	5
Between one and two years	**7**	5
Between two and five years	**20**	8
Greater than five years	**47**	-
Total lease commitments	**82**	18

37. Capital expenditure commitments

Capital expenditure commitments contracted for as at 30 June 2017, but not provided for in these financial statements, total $9.1m; (30 June 2016: $6.3m) and are analysed in note 33.

38. Contingent liabilities and loan 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.

There are no material contingent liabilities as at 30 June 2017 (30 June 2016: nil).

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

Dollars in millions	**30/06/17**	30/06/16
Loan commitments	**2,857**	2,650

39. Contingent assets

The Banking Group held insurance policies at the date of the 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 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.

40. Events subsequent to the reporting date

On 10 August 2017, the RBNZ re-issued notices of non-objection to the treatment of Kiwibank's Tier 2 convertible subordinated bond ("Kiwibank Bonds") and Additional Tier 1 perpetual capital bond issued to KCFL as capital instruments as at that date. The re-recognition of these capital instruments increases the Banking Group's regulatory capital by $247m but has no impact on the Banking Group's balance sheet.

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

Capital adequacy

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	
	30/06/17	30/06/16
Capital adequacy ratios		
Common Equity Tier 1 capital ratio	**12.3%**	9.1%
Tier 1 capital ratio	**12.3%**	10.7%
Total capital ratio	**13.4%**	12.9%
RBNZ 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	**5.4%**	4.6%
Buffer ratio requirement	**2.5%**	2.5%

	Kiwibank Limited	
	30/06/17	30/06/16
Capital adequacy ratios		
Common Equity Tier 1 capital ratio	**11.9%**	8.6%
Tier 1 capital ratio	**11.9%**	10.1%
Total capital ratio	**12.9%**	12.3%

Capital adequacy 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

Following the RBNZ's determination that they did not comply with certain requirements in Document BS2A, Capital Adequacy Framework (Standardised Approach), the Perpetual Capital Bonds issued by the Bank to KCFL ceased to be included within AT1 capital from 29 May 2017.

The Perpetual capital bond issue, issued by the Bank on 27 May 2015, and which is fully paid, 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 5-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.

Subordinated bonds

The subordinated debt issue, issued by the Bank on 10 December 2012 and which is fully paid, is included within Tier 2 capital. The issue is subordinate to all other general liabilities of the Banking Group and is denominated in New Zealand dollars. The material terms and conditions are:

Subordinated debt issued 10 December 2012:

a) the Subordinated Bonds constitute direct, unsecured, subordinated debt obligations of Kiwibank;

b) the Subordinated Bonds pay interest at the Coupon Rate of 5.8% pa;

c) interest will be paid in arrears in equal semi-annual instalments. Payments of interest are subject to Kiwibank and the Banking Group being able to satisfy the Solvency Test immediately following payment;

d) the maturity date of the Subordinated Bonds is 15 December 2022. Kiwibank may redeem the Subordinated Bonds on the First Call Date (15 December 2017) and on any Interest Payment Date thereafter subject to Kiwibank and the Banking Group being able to satisfy the Solvency Test immediately following the payment; Kiwibank may also redeem the Subordinated Bonds at any time (including before the First Call Date) if a Regulatory Event or a Tax Event occurs; and

e) the Subordinated 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.

Under the RBNZ's Basel III rules the $150m subordinated debt is subject to a loss absorbency haircut.

Capital adequacy continued

Convertible subordinated bonds ("Kiwibank Bonds")

Following the RBNZ's determination that they did not comply with certain requirements in Document BS2A, Capital Adequacy Framework (Standardised Approach), the convertible subordinated bonds issued by the Bank to KCFL ceased to be included within Tier 2 capital from 29 May 2017.

The convertible subordinated bond issue, issued by the Bank on 6 June 2014 and which is fully paid, is subordinate to all other general liabilities of the Banking Group and is denominated in New Zealand dollars. The material terms and conditions are:

a) the convertible subordinated bonds constitute direct, unsecured, subordinated debt obligations of Kiwibank;

b) interest on the convertible subordinated bonds is payable semi-annually at an initial rate of 6.61% p.a. subject to the condition that Kiwibank and the Banking Group is solvent after each payment;

c) the convertible subordinated 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;

d) the convertible subordinated bonds have a maturity date of 15 July 2024, however, Kiwibank may elect to make early repayment on 15 July 2019 or any semi-annual interest payment date thereafter; and

e) the convertible subordinated 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.

Risk 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: i) selected balance sheet assets; ii) off balance-sheet exposures and market contracts; and iii) business unit net income.

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 RBNZ 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 RBNZ 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 set out on pages 83 to 88 summarise the composition of regulatory capital and capital adequacy ratios for the year ended 30 June 2017. Throughout the period Kiwibank and the Banking Group complied with both regulatory and internal capital adequacy requirements.

Capital adequacy continued

Regulatory capital

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

	The Banking Group	
Dollars in millions	**30/06/17**	30/06/16
Common Equity Tier 1 capital		
Issued and fully paid up share capital	**737**	400
Retained earnings (net of appropriations)	**651**	616
Accumulated other comprehensive income and other disclosed reserves ❶❷	**(8)**	(34)
Less deductions from Common Equity Tier 1 capital		
Intangible assets	**(97)**	(158)
Cash flow hedge reserve	**13**	45
Deferred tax assets	**(34)**	(8)
Receivables from affiliated insurance group	**(1)**	-
Total Common Equity Tier 1 capital	**1,261**	861
Additional Tier 1 capital		
Perpetual capital bonds ❸	**-**	147
Total Additional Tier 1 capital	**-**	147
Total Tier 1 capital	**1,261**	1,008
Tier 2 capital		
Subordinated bonds and capital notes	**108**	208
Total Tier 2 capital	**108**	208
Total capital	**1,369**	1,216

❶ Includes Available for Sale Reserve of $5m. The available-for-sale reserve includes the cumulative net change in the fair value of available-for-sale securities until the investment is derecognised or impaired.

❷ Includes cash flow hedge reserve of ($13m). 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).

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

Capital adequacy continued

On-balance sheet exposures

	The Banking Group			
	30/06/17			
Dollars in millions	Total exposure	Risk weighting	Risk weighted exposure	Minimum Pillar I capital requirement
On-balance sheet exposures				
Cash and gold bullion	**33**	**0%**	**-**	**-**
Sovereigns and central banks	**879**	**0%**	**-**	**-**
Multilateral development banks and other international organisations	**335**	**0%**	**-**	**-**
Public sector entities	**121**	**20%**	**24**	**2**
	4	**100%**	**4**	**-**
Banks	**655**	**20%**	**131**	**10**
	127	**50%**	**64**	**5**
Corporate	**92**	**50%**	**46**	**4**
	705	**100%**	**705**	**56**
Residential mortgages not past due	**10,175**	**35%**	**3,561**	**285**
	5,001	**40%**	**2,000**	**160**
	782	**50%**	**391**	**31**
	210	**70%**	**147**	**12**
	53	**75%**	**40**	**3**
	49	**90%**	**44**	**4**
	251	**100%**	**251**	**20**
Impaired assets	**7**	**100%**	**7**	**1**
Past due residential mortgages > 90 days	**1**	**35%**	**-**	**-**
	3	**100%**	**3**	**-**
Other past due assets	**1**	**150%**	**2**	**-**
Non risk weighted assets	**501**	**0%**	**-**	**-**
Other assets	**631**	**100%**	**631**	**50**
Total on-balance sheet exposures	**20,616**		**8,051**	**643**

Capital adequacy continued

Off-balance sheet exposures and market related contracts

	The Banking Group					
	30/06/17					
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	**7**	**100%**	**7**	**100%**	**7**	**1**
Asset sale with recourse	**-**	**100%**	**-**	**-**	**-**	**-**
Forward asset purchase	**-**	**100%**	**-**	**-**	**-**	**-**
Commitment with certain drawdown	**106**	**100%**	**106**	**100%**	**106**	**8**
Note issuance facility	**-**	**50%**	**-**	**-**	**-**	**-**
Revolving underwriting facility	**356**	**50%**	**178**	**40%**	**71**	**6**
Revolving underwriting facility	**1,154**	**20%**	**231**	**38%**	**88**	**7**
Revolving underwriting facility	**123**	**0%**	**-**	**-**	**-**	**-**
Performance-related contingency	**6**	**50%**	**3**	**100%**	**3**	**-**
Other commitments where original maturity is greater than one year	**289**	**50%**	**145**	**52%**	**75**	**6**
Other commitments where original maturity is less than or equal to one year	**5**	**20%**	**1**	**100%**	**1**	**-**
Other commitments where original maturity is less than or equal to one year	**-**	**20%**	**-**	**20%**	**-**	**-**
Other commitments that cancel automatically when the creditworthiness of the counterparty deteriorates or that can be cancelled unconditionally at any time without prior notice	**818**	**0%**	**-**	**0%**	**-**	**-**
Market related contracts: ❶						
(a) Foreign exchange contracts	**1,726**	**n/a**	**101**	**50%**	**51**	**4**
(b) Interest rate contracts	**41,864**	**n/a**	**432**	**36%**	**156**	**12**
(c) CVA					**109**	**9**
Total off-balance sheet exposures	**46,454**		**1,204**		**667**	**53**

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

Residential mortgages by loan-to-value ratio

	The Banking Group		
	30/06/17		
Dollars in millions	On-balance sheet	Off-balance sheet	Total
LVR 0% - 80%	**14,747**	**474**	**15,221**
LVR >80% - 90%	**1,345**	**40**	**1,385**
LVR 90% +	**439**	**24**	**463**
Total	**16,531**	**538**	**17,069**

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

At 30 June 2017, of the loans with an LVR greater than 80%, $419m relates to “Welcome Home” loans, whose credit risk is mitigated by the New Zealand Crown.

Capital adequacy continued

Residential mortgages by loan-to-value ratio continued

The Bank has restated the ratios as at 30 June 2016 below as it has identified that in previous periods the LVR disclosure had been incorrectly calculated as exposures with missing LVRs were not included in the LVR 90%+ category but distributed across the respective LVR bands in line with the average portfolio LVR distribution. Further adjustments have been made to reflect off-balance sheet mortgage exposures and calculations without the benefit of any credit risk mitigation.

	The Banking Group		
	Reported 30/06/16		
Dollars in millions	**On-balance sheet**	**Off-balance sheet**	**Total**
LVR 0% - 80%	13,887	345	14,232
LVR >80% - 90%	1,322	14	1,336
LVR 90% +	245	11	256
Total	15,454	370	15,824

	The Banking Group		
	Restated 30/06/16		
Dollars in millions	**On-balance sheet**	**Off-balance sheet**	**Total**
LVR 0% - 80%	13,238	465	13,703
LVR >80% - 90%	1,638	42	1,680
LVR 90% +	578	37	615
Total	15,454	544	15,998

Reconciliation of mortgage-related amounts

	The Banking Group
Dollars in millions	**30/06/17**
Residential mortgages total on-balance sheet exposures	**16,531**
Collective allowance for impairment	**19**
Deferred arrangement fees	**96**
Gross residential mortgage loans per asset quality (note 10)	**16,646**
Other term lending residentially secured	**(917)**
Gross term loans - housing per loans and advances (note 8)	**15,729**

Credit risk mitigation

	The Banking Group			
	30/06/17			
Dollars in millions	**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**
Sovereign or central bank	-	-	-	-
Multilateral development bank	-	-	-	-
Public sector entities	-	-	-	-
Bank	**(42,509)**	-	**(240)**	**(19)**
Corporate	-	-	-	-
Residential mortgage	-	-	-	-
Other	-	-	-	-
	(42,509)	-	**(240)**	**(19)**

Capital adequacy continued

Operational risk

	The Banking Group	
	30/06/17	
Dollars in millions	Implied risk weighted exposure	Total operational risk capital requirement
Operational risk	1,215	97

Market Risk

	The Banking Group			
	30/06/17			
	Implied risk weighted exposure		Aggregate capital charge	
Dollars in millions	End of period	Peak end-of-day	End of period	Peak end-of-day
Interest rate risk	513	625	41	50
- of which relates to trading book	40	47	3	4
Foreign currency risk	16	18	1	1
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

	The Banking Group		
	30/06/17		
Dollars in millions	Total exposure after credit risk mitigation	Risk weighted exposure or implied risk weighted exposure	Total capital requirement
Total credit risk plus equity	24,561	8,478	677
Operational risk	n/a	1,215	97
Market risk	n/a	529	42
Total Pillar I risk	24,561	10,222	816

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 changes to external ratings, delays to the core banking system replacement, and cyber risks.

The Bank has made an internal capital allocation of $47m (30 June 2016: $44m).

Capital adequacy continued

Subsequent events

On 10 August 2017, the RBNZ re-issued notices of non-objection to the treatment of Kiwibank's Tier 2 convertible subordinated bond ("Kiwibank Bonds") and Additional Tier 1 perpetual capital bond issued to KCFL as capital instruments as at that date. As a result, Management will undertake a further review of future capital requirements given the capital instruments had been excluded from the Banking Group's 30 June 2017 capital position after the RBNZ's initial revocation of the letters of non-objection. The impact of the re-recognition of these capital instruments on the Banking Group's capital position is shown below:

	The Banking Group		
	Regulatory minima	As at 30/06/17	Restated as at 30/06/17 including capital instruments
Capital adequacy ratios			
Common Equity Tier 1 capital ratio	**4.50%**	**12.3%**	**12.3%**
Tier 1 capital ratio	**6.00%**	**12.3%**	**13.8%**
Total capital ratio	**8.00%**	**13.4%**	**15.8%**
Buffer ratios			
Buffer ratio	**2.50%**	**5.4%**	**7.8%**

Conditions of registration

The conditions of registration imposed on Kiwibank Limited by the Reserve Bank of New Zealand pursuant to section 74 of the Reserve Bank of New Zealand Act 1989, which were applicable as at 30 June 2017, are as follows:

Conditions of registration as from 1 October 2016 – Kiwibank Limited

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 $30 million;
    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 Reserve Bank; and
    f) the Bank meets the requirements of Part 3 of the Reserve Bank of New Zealand document "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,-

the Total capital ratio, the Tier 1 capital ratio, the Common Equity Tier 1 capital ratio and Total capital must be calculated in accordance with 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 Reserve Bank of New Zealand document "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 Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

1A. That -
    a) the Bank has an internal capital adequacy assessment process ("ICAAP") that accords with the requirements set out in the document "Guidelines on a bank's internal capital adequacy assessment process ('ICAAP')" (BS12) dated December 2007;
    b) under its ICAAP, the Bank identifies and measures its "other material risks" defined as all material risks of the Banking Group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015; and
    c) 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:

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 Reserve Bank for restoring the buffer ratio; and
    c) have the capital plan approved by the Reserve Bank

For the purpose of this condition of registration,-

"buffer ratio", "distributions", and "earnings" have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: "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 generally accepted accounting practice.

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

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

   a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the Banking Group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and

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

   In determining the total amount of the Banking Group's insurance business -

   a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and

   b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

   For the purposes of this condition of registration, -

   "insurance business" means the undertaking or assumption of liability as an insurer under a contract of insurance:

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

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 ❶	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

❶ This table uses the rating scales of S&P, Fitch and Moody's (Fitch's scale is identical to Standard & Poor's.)

   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 Reserve Bank of New Zealand 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.

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 Reserve Bank of New Zealand 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 Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
   b) the Reserve Bank has advised that it has no objection to that appointment.
8. That a person must not be appointed as chairperson of the board of the Bank unless:
   a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
   b) the Reserve Bank has advised that it has no objection to that appointment.
9. That the Bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:
   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 Reserve Bank of New Zealand 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 on 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.

    For the purposes of this condition of registration, the term "legal and practical ability to control and execute" is explained in the Reserve Bank of New Zealand document entitled "Outsourcing Policy" (BS11) dated January 2006.
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.

Conditions of registration continued

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

    For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled "Liquidity Policy" (BS13) dated July 2014 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated December 2011.
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 a SPV.

    For the purposes of this condition, -

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

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

    "covered bond" means a debt security issued by any member of the Banking Group, for which repayment to holders is guaranteed by a SPV, and investors retain an unsecured claim on the issuer.
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 Reserve Bank in writing of the intended acquisition or business combination and at least 10 working days have passed; and
        (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the Bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011; and
    b) no member of the Banking Group may give effect to a qualifying acquisition or business combination that meets the non-objection threshold unless:
        (i) the Bank has notified the Reserve Bank in writing of the intended acquisition or business combination;
        (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the Bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011; and
        (iii) the Reserve Bank has given the Bank a notice of non-objection to the significant acquisition or business combination.

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

Conditions of registration continued

17. That the Bank is pre-positioned for Open Bank Resolution and in accordance with a direction from the Reserve Bank, the Bank can -
    a) close promptly at any time of the day and on any day of the week and that effective upon 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 Reserve Bank of New Zealand 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 Reserve Bank document: "Open Bank Resolution Pre-positioning Requirements Policy" (BS17) dated September 2013.

    For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the Reserve Bank of New Zealand 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 Reserve Bank; and
    c) if the Reserve Bank's agreement is conditional, meets the Reserve Bank'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 Reserve Bank of New Zealand 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 Reserve Bank of New Zealand 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 amount in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 60%, 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 amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 10% of the total of the qualifying new mortgage lending amount 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 registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

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.

Conditions of registration continued

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 Reserve Bank of New Zealand document entitled “Framework for Restrictions on High-LVR Residential Mortgage Lending” (BS19) dated October 2016:

“loan-to-valuation measurement period” means—

a) the three calendar month period ending on the last day of December 2016; 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 January 2017.

Amendments to conditions of registration

The RBNZ issued revised Conditions of Registration effective 1 October 2016. These reflect changes to the loan-to-value ratios applicable to property and non-property investment residential mortgage lending. These also refer to the revised version of Framework for Restrictions of High-LVR Residential Mortgage Lending (BS19).

As at 30 June 2017, there have been no other changes to the Conditions of Registration.

Independent auditor's report

To the readers of Kiwibank Limited and Banking Group's Disclosure Statement

This report includes:

- our audit opinion on the consolidated financial statements on pages 10 to 79 of the Disclosure Statement prepared in accordance with clause 24 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the 'Order'), New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS'). The consolidated financial statements comprise:
  - the balance sheet as at 30 June 2017;
  - 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; and
  - the notes to the financial statements, which include the basis of preparation and general accounting policies.
- our audit opinion on the supplementary information (excluding capital adequacy) for the year ended 30 June 2017 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 opinion on the supplementary information relating to Capital Adequacy for the year ended 30 June 2017 on pages 80 to 88 that is required to be prepared in accordance with the Bank's conditions of registration and disclosed in accordance with Schedule 9 of the Order.

The Auditor-General is the auditor of Kiwibank Limited (the 'Bank') and the Banking Group (the 'Banking Group') comprising the Bank and its New Zealand domiciled subsidiaries and other controlled entities. The Auditor-General has appointed me, Chris Barber, using the staff and resources of PricewaterhouseCoopers, to carry out the audit of the consolidated financial statements of the Banking Group on his behalf.

PricewaterhouseCoopers, 113-119 The Terrace, PO Box 243,Wellington 6140, New Zealand
T: +64 (4)462 7000, F: +64 (4)462 7001, www.pwc.com/nz

pwc

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

Our audit opinion

In our opinion:

- the consolidated financial statements of the Banking Group, on pages 10 to 79 (excluding the supplementary information included in the balance sheet and notes 10, 11, 22, 30, 33 and 34):
  - (i) give a true and fair view, in all material respects of:
    - its financial position as at 30 June 2017; and
    - its financial performance and cash flows for the year then ended; and
  - (ii) comply with generally accepted accounting practice in New Zealand in accordance with NZ IFRS and IFRS.
- the supplementary information included in the balance sheet and notes 10, 11, 22, 30, 33 and 34 prescribed by Schedules 4, 7, 13, 14, 15, and 17 of the Order:
  - (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 our audit opinion

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

We have fulfilled our responsibilities in accordance with the Auditor-General's Auditing Standards.

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.

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

Our firm carries out assignments for the Banking Group in the areas of other assurance, non-assurance services, tax compliance and other services. IT related support services have also been provided by a business acquired by PricewaterhouseCoopers during the year ended 30 June 2017. Appropriate safeguards were put in place to mitigate the threats to audit independence following the acquisition. 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.

Our audit approach

Overview

An audit is designed to obtain reasonable assurance as to whether the consolidated financial statements are free from quantitative and qualitative material misstatement.

Overall quantitative Banking Group materiality was $8.05 million, which represents 5% of profit before taxation and other impairment losses.

We chose profit before taxation and other impairment losses as the benchmark because, in our view, it is the benchmark against which the performance of the Banking Group is 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:

- Core banking system replacement
- Deconsolidation of Kiwi Capital Funding Limited from the Banking Group
- Allowance for impairment losses on loans and advances
- 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 consolidated 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 consolidated 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 consolidated financial statements as a whole.

Audit scope

We designed our audit by assessing the risks of material misstatement in the consolidated 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 consolidated financial statements as a whole, taking into account the structure of the Banking Group, the 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 consolidated financial statements of the current year. We have communicated the Key Audit Matters to the Directors of the Bank (the 'Directors'), but they are not a comprehensive reflection of all the matters that were identified by our audit and that were discussed with the Directors. In the table below we have described the Key Audit Matters and have included a summary of the principal audit procedures we performed to address those matters.

These matters were addressed in the context of our audit of the consolidated 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
Core banking system replacement As detailed in note 25 intangible assets, the Bank is reviewing its transformation strategy. As part of this, the Bank is reviewing the current project to replace its core banking system (the 'Project'). In accordance with Accounting Standards, the Bank has performed an assessment of whether the Project's work in progress costs	We discussed with management and the Directors the status of the Project and the transformation strategy review. Given management's and the Directors' view that it is highly unlikely that the Project will proceed without significant changes, we reviewed management's assessment of the recoverable amount of the Project's work in progress costs. This included considering and challenging the assumptions underpinning the

Key Audit Matter	How our audit addressed the Key Audit Matter
are recoverable and has determined that an impairment of $90 million is necessary as a result of the Directors' judgement that it is considered highly unlikely that the Project will continue in its current form. The magnitude of the Project's work in progress balance and the management judgments involved increases the risk of material misstatement with respect to the carrying value of the Project's work in progress.	assessment, reviewing the advice of management's expert, testing the calculation of the impairment charge and the disclosures made in the financial statements. We have no material matters to report.
Deconsolidation of Kiwi Capital Funding Limited from the Banking Group Kiwi Capital Funding Limited (KCFL) was deconsolidated from the Banking Group during the year (refer to note 32 to the consolidated financial statements). The deconsolidation was as a result of management's proposal to institute governance changes in KCFL following a differing regulatory capital interpretation for capital instruments issued to KCFL. The basis of KCFL's deconsolidation involved a high level of complexity and judgement and increased the risk of management bias.	We discussed with management the governance changes made supporting the deconsolidation of KCFL and reviewed the relevant legal agreements to evaluate and assess the impact on the Banking Group's consolidated financial statements. We utilised our accounting technical specialists to make our own assessment of the factors resulting in the deconsolidation of KCFL from the Banking Group for financial reporting purposes. We used this as a basis to challenge the key judgements made by management, including the assessment of any potential management bias. We assessed whether the extent of the disclosures made, in relation to the deconsolidation were appropriate. We have no material matters to report.
Allowance for impairment losses on loans and advances The determination of impairment allowances is a highly subjective and judgemental area. As detailed in note 8, the Banking Group has loans and advances totalling $17,815 million. These are net of impairment allowances of $40 million which includes both allowances for individually impaired assets and collective allowances for impairment losses.	We understood and tested the design and operating effectiveness of key controls around identification of impairment triggers and categorisation of loans. For a sample of allowances for individually impaired assets, we: - Understood the latest developments of the borrowers and the basis of measuring the impairment allowances and considered whether key judgements were appropriate given the borrowers' circumstances. - Considered, in relation to testing of collateral valuations, whether valuations were up to date and

Key Audit Matter	How our audit addressed the Key Audit Matter
The audit was focused on impairment due to the materiality of the loan and advances balance and associated impairment allowances and the subjective nature of the impairment calculation. Impairment allowances represent management's best estimate of the losses incurred within loans and advances at the balance sheet date. They are calculated on a collective basis for portfolios of loans and advances of a similar nature and on an individual basis for significant loans and advances. The calculation of both individual and collective allowances for impairment is inherently judgemental. For allowances for individually impaired assets, judgement is required to determine when an impairment event has occurred and the value of collateral held relative to each loan. Collective allowances for impairment are calculated using models which approximate the impact of current economic and credit conditions on portfolios of loans. The inputs to these models are based on historical loss experience with judgement applied to determine the assumptions used to calculate impairment. Management also applies adjustments, or overlays, where they believe the data driven parameters and calculations are not appropriate, either due to emerging trends or models not fully capturing the risks in the loan portfolio. These overlays require significant judgement. See note 9 to the consolidated financial statements which explains the critical accounting estimates and assumptions in determining the impairment of loans and advances.	consistent with the strategy being followed in respect of the particular borrower. For the collective allowances for impairment, which reflect losses incurred but not yet identified and which are calculated using models, our work involved the following procedures: - We understood the governance over collective allowances for impairment and the models review process. - We understood the various models used including critically examining management's model monitoring process and, on a sample basis, conducting in-depth reviews of the models used to calculate the impairment allowances. - For key inputs and assumptions in the models, we obtained and tested the objective evidence that supported their appropriateness. - Where changes had been made in model parameters and assumptions, we understood the reasons why changes had taken place and used our industry knowledge and experience to evaluate the appropriateness of such changes. - We tested the completeness and accuracy of the underlying loan information used in the impairment models by agreeing details to the Banking Group's source systems as well as re-performing the calculation of the modelled provision. - For overlays to the modelled output, we challenged management to provide evidence that the overlays were appropriate. - We 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.

Key Audit Matter	How our audit addressed the Key Audit Matter
Operation of Information Technology (IT) systems and controls The Banking Group is heavily reliant on automated processes and controls performed by IT systems for the processing and recording of significant volumes of transactions including for its financial reporting processes. In considering the complexity of the Banking Group's processes and the design of the internal control environment, there are some 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 (ITGC) environment. 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.	For significant financial statement balances, we gained an understanding of the business processes, key controls and IT systems used to generate and support those 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 in-scope IT systems for the full financial reporting period. Where we identified design or operating effectiveness matters, we performed additional substantive audit procedures.

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

The Directors are responsible, on behalf of the Bank, for the other information 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 and is included on pages 1 to 9 and 89 to 94. Our opinion on the consolidated financial statements does not cover the other information included in the Disclosure Statement and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information above and, in doing so, consider whether the other information is materially inconsistent with the consolidated 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 consolidated financial statements and supplementary information

The Directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the consolidated financial statements in accordance with clause 24 of the Order, NZ IFRS and IFRS, that give a true and fair view of the matters to which they relate. The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. In addition, the Directors are also responsible for the preparation and fair presentation of supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 13, 14, 15, and 17 of the Order.

In preparing the consolidated 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 consolidated financial statements and supplementary information (excluding the supplementary information relating to capital adequacy)

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements, as a whole, and the supplementary information (excluding the supplementary information relating to capital adequacy disclosed on pages 80 to 88), 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 carried out in accordance with the Auditor-General 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 consolidated 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 assesses the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- 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 consolidated financial statements. We are responsible for the direction, supervision and performance of the Banking Group audit. We remain solely responsible for our opinion.
- 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.
- Provide the Directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Determine from the matters communicated with the Directors, those matters that were of most significance in the audit of the consolidated 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 supplementary information relating to capital adequacy)

We also report in accordance with clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the consolidated financial statements (excluding the supplementary information relating to capital adequacy disclosed on pages 80 to 88) for the year ended 30 June 2017:

(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

Our review opinion

Based on our review procedures, which are not an audit, nothing has come to our attention that causes us to believe that the supplementary information relating to Capital Adequacy disclosed on pages 80 to 88 is not, in all material respects, prepared in accordance with the Bank's conditions of registration and disclosed in accordance with Schedule 9 of the Order for the year ended 30 June 2017.

Basis for our review opinion

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)*.

Responsibilities of the Directors for the supplementary information relating to capital adequacy

The Directors are responsible, on behalf of the Bank, for the preparation of supplementary information relating to capital adequacy that is prepared in accordance with the Bank's conditions of registration and 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 supplementary information relating to capital adequacy that is free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for review of the supplementary information relating to capital adequacy

We are responsible for reviewing the supplementary information relating to capital adequacy disclosed on pages 80 to 88, to conclude whether anything has come to our attention that would cause us to believe that the supplementary information relating to capital adequacy disclosed on pages 80 to 88, is not, in all material respects:

(i) prepared in accordance with the Bank's conditions of registration; and
(ii) disclosed in accordance with Schedule 9 of the Order.

A review 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 disclosed on pages 80 to 88.

Chris Barber
On behalf of the Auditor-General
Wellington, New Zealand
8 September 2017

PricewaterhouseCoopers