# AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED

ABN 11 005 357 522

**THE COMPANY**

**2018 Financial Report**

**30 September 2018**

**FINANCIAL STATEMENTS**



**NOTES TO THE FINANCIAL STATEMENTS**

# FINANCIAL REPORT

## INCOME STATEMENT

| For the year ended 30 September | Note | 2018 $m | 2017 $m |
|---|---|---|---|
| Interest income | | 27,020 | 25,613 |
| Interest expense | | (16,574) | (15,017) |
| Net interest income | 2 | 10,446 | 10,596 |
| Other operating income | 2 | 8,645 | 5,987 |
| Net funds management and commission income | 2 | (8) | 158 |
| Share of associates' (loss)/profit | 2 | (1) | 60 |
| Operating income | | 19,082 | 16,801 |
| Operating expenses | 3 | (8,121) | (7,623) |
| Profit before credit impairment and income tax | | 10,961 | 9,178 |
| Credit impairment charge | 12 | (629) | (881) |
| **Profit before income tax** | | 10,332 | 8,297 |
| Income tax expense | 4 | (1,808) | (2,063) |
| **Profit for the year** | | 8,524 | 6,234 |

The notes appearing on pages 8 to 70 form an integral part of these financial statements.

# FINANCIAL REPORT (continued)

## STATEMENT OF COMPREHENSIVE INCOME

| For the year ended 30 September | 2018 $m | 2017 $m |
|---|---|---|
| Profit for the year | 8,524 | 6,234 |
| Other comprehensive income | | |
| Items that will not be reclassified subsequently to profit or loss | 27 | 2 |
| Items that may be reclassified subsequently to profit or loss | | |
| Foreign currency translation reserve | (154) | (57) |
| Other reserve movements | 177 | (272) |
| Income tax attributable to the above items | (124) | 8 |
| Other comprehensive income after tax | (74) | (319) |
| Total comprehensive income for the year | 8,450 | 5,915 |

The notes appearing on pages 8 to 70 form an integral part of the financial statements.

# BALANCE SHEET

| As at 30 September | Note | 2018 $m | 2017 $m |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents[1] | 7 | 80,227 | 63,399 |
| Settlement balances owed to ANZ | | 1,666 | 5,006 |
| Collateral paid | | 9,184 | 7,685 |
| Trading securities | 8 | 29,519 | 35,606 |
| Derivative financial instruments | 9 | 64,448 | 57,036 |
| Available-for-sale assets | 10 | 64,728 | 58,506 |
| Net loans and advances | 11 | 475,419 | 452,424 |
| Regulatory deposits | | 264 | 495 |
| Assets held for sale | 25 | - | 1,748 |
| Due from controlled entities | | 90,170 | 91,208 |
| Shares in controlled entities | 23 | 18,852 | 18,084 |
| Investments in associates | | 18 | 20 |
| Current tax assets | | 266 | 23 |
| Deferred tax assets | | 1,071 | 932 |
| Goodwill and other intangible assets | 19 | 1,446 | 1,852 |
| Premises and equipment | | 898 | 928 |
| Other assets | | 2,571 | 2,427 |
| **Total assets** | | 840,747 | 797,379 |
| | | | |
| **Liabilities** | | | |
| Settlement balances owed by ANZ | | 9,867 | 8,219 |
| Collateral received | | 6,002 | 5,238 |
| Deposits and other borrowings | 13 | 511,992 | 494,235 |
| Derivative financial instruments | 9 | 65,638 | 56,830 |
| Due to controlled entities | | 88,383 | 88,882 |
| Current tax liabilities | | 85 | 94 |
| Deferred tax liabilities | | 39 | 71 |
| Payables and other liabilities | | 5,002 | 5,683 |
| Employee entitlements | | 421 | 394 |
| Other provisions | 20 | 838 | 390 |
| Debt issuances | 14 | 98,626 | 85,495 |
| **Total liabilities** | | 786,893 | 745,531 |
| **Net assets** | | 53,854 | 51,848 |
| | | | |
| **Shareholders' equity** | | | |
| Ordinary share capital | 21 | 27,533 | 29,416 |
| Reserves | 21 | (56) | 36 |
| Retained earnings | 21 | 26,377 | 22,396 |
| **Total shareholders' equity** | 21 | 53,854 | 51,848 |

1. Includes settlement balances owed to ANZ that meet the definition of cash and cash equivalents.

The notes appearing on pages 8 to 70 form an integral part of the financial statements.

# FINANCIAL REPORT (continued)

## CASH FLOW STATEMENT

| For the year ended 30 September | 2018 $m | 2017 $m |
|---|---|---|
| Profit after income tax | 8,524 | 6,234 |
| Adjustments to reconcile to net cash provided by/(used in) operating activities: | | |
| Provision for credit impairment | 629 | 881 |
| Depreciation and amortisation | 1,023 | 775 |
| Net derivatives/foreign exchange adjustment | 5,764 | (2,099) |
| Impairment of investment in Wealth Australia | 597 | - |
| (Gain)/Loss on sale from divestments | (246) | 219 |
| Reclassification of businesses to held for sale | - | 231 |
| Other non-cash movements | (2) | (39) |
| *Net(increase)/decrease in operating assets:* | | |
| Collateral paid | (1,083) | 3,045 |
| Trading securities | 8,913 | (1,696) |
| Net loans and advances | (20,187) | (13,772) |
| Net intra-group loans and advances | (1,796) | 938 |
| Other assets | (525) | (270) |
| *Net increase/(decrease) in operating liabilities:* | | |
| Deposits and other borrowings | 7,432 | 29,131 |
| Settlement balances owed by ANZ | 1,604 | (837) |
| Collateral received | 341 | (505) |
| Other liabilities | 84 | 686 |
| Total adjustments | 2,548 | 16,688 |
| Net cash provided by operating activities[1] | 11,072 | 22,922 |
| Cash flows from investing activities | | |
| Available-for-sale assets: | | |
| Purchases | (18,853) | (15,151) |
| Proceeds from sale or maturity | 15,282 | 11,512 |
| Proceeds from divestments | 1,786 | (5,472) |
| Net return of capital | 989 | 173 |
| Other assets | (301) | (353) |
| Net cash (used in) investing activities | (1,097) | (9,291) |
| Cash flows from financing activities | | |
| Debt issuances[2]: | | |
| Issue proceeds | 21,962 | 16,210 |
| Redemptions | (11,921) | (21,462) |
| Dividends paid | (4,585) | (4,411) |
| On market purchase of treasury shares | (114) | (75) |
| Share buy-back | (1,880) | - |
| Net cash provided by/(used in) financing activities | 3,462 | (9,738) |
| Net increase in cash and cash equivalents | 13,437 | 3,893 |
| Cash and cash equivalents at beginning of year | 63,399 | 61,994 |
| Effects of exchange rate changes on cash and cash equivalents | 3,391 | (2,488) |
| Cash and cash equivalents at end of year | 80,227 | 63,399 |

1. Net cash provided by operating activities includes income taxes paid of $2,648 million (2017: $2,155 million).
2. Non-cash changes in debt issuances includes fair value hedging gains of $1,168 million (2017: $1,149 million) and foreign exchange losses of $4,487 million (2017: foreign exchange gains $413 million).

The notes appearing on pages 8 to 70 form an integral part of the financial statements.

## STATEMENT OF CHANGES IN EQUITY

| | Ordinary share capital $m | Reserves[1] $m | Retained earnings $m | Total shareholders' equity $m |
|---|---|---|---|---|
| As at 1 October 2016 | 29,162 | 344 | 20,753 | 50,259 |
| Profit for the year | - | - | 6,234 | 6,234 |
| Other comprehensive income for the year | - | (316) | (3) | (319) |
| Total comprehensive income for the year | - | (316) | 6,231 | 5,915 |
| Transactions with equity holders in their capacity as equity holders: | | | | - |
| Dividends paid | - | - | (4,609) | (4,609) |
| Dividend reinvestment plan[2] | 198 | - | - | 198 |
| Other equity movements: | | | | |
| Group employee share acquisition scheme | 56 | - | - | 56 |
| Other items | - | 8 | 21 | 29 |
| As at 30 September 2017 | 29,416 | 36 | 22,396 | 51,848 |
| Profit for the year | - | - | 8,524 | 8,524 |
| Other comprehensive income for the year | - | (95) | 21 | (74) |
| Total comprehensive income for the year | - | (95) | 8,545 | 8,450 |
| Transactions with equity holders in their capacity as equity holders: | | | | |
| Dividends paid | - | - | (4,585) | (4,585) |
| Dividend reinvestment plan[2] | - | - | - | - |
| Group share buy-back[3] | (1,880) | - | - | (1,880) |
| Other equity movements: | | | | |
| Group employee share acquisition scheme | (3) | - | - | (3) |
| Other items | - | 3 | 21 | 24 |
| As at 30 September 2018 | 27,533 | (56) | 26,377 | 53,854 |

1. Further information on individual reserves is disclosed in Note 21 Shareholders' Equity.
2. No new shares were issued under the Dividend Reinvestment Plan (DRP) for the 2018 interim dividend (nil shares for the 2017 final dividend; nil shares for the 2017 interim dividend; 7.1 million shares for the 2016 final dividend) as the shares were purchased on-market and provided directly to the shareholders participating in the DRP. On-market share purchases for the DRP in the September 2018 financial year were $392 million (Sept 17 full year: $176 million).
3. As announced on 18 December 2017, 22 June 2018 and 19 October 2018, there is currently an on-market buy-back in relation to ANZ's ordinary shares of $3.0 billion. The Company bought back $1,880 million worth of shares during the 2018 financial year resulting in 66.7 million shares being cancelled during the year.

The notes appearing on pages 8 to 70 form an integral part of the financial statements.

# NOTES TO THE FINANCIAL STATEMENTS

## 1. ABOUT THE FINANCIAL STATEMENTS

These are the financial statements for Australia and New Zealand Banking Group Limited (the Company or ANZ) for the year ended 30 September 2018. The Company is incorporated and domiciled in Australia. The address of the Company's registered office and its principal place of business is ANZ Centre, 833 Collins Street, Docklands, Victoria, Australia 3008.

On 30 October 2018, the Directors resolved to authorise the issue of these financial statements.

Information in the financial statements is included only to the extent we consider it material and relevant to the understanding of the financial statements. A disclosure is considered material and relevant if, for example:

- the dollar amount is significant in size (quantitative factor);
- the dollar amount is significant by nature (qualitative factor);
- the user cannot understand the Company's results without the specific disclosure (qualitative factor);
- the information is critical to a user's understanding of the impact of significant changes in the Company's business during the period, for example: business acquisitions or disposals (qualitative factor); and
- the information relates to an aspect of the Company's operations that is important to its future performance (qualitative factor).

.This section of the financial statements:

- outlines the basis upon which the Company's financial statements have been prepared; and
- discusses any new accounting standards or regulations that directly impact the financial statements.

### BASIS OF PREPARATION

This financial report is a general purpose (Tier 1) financial report (as defined under the Corporations law) prepared by a 'for profit' entity, in accordance with Australian Accounting Standards (AASs) and other authoritative pronouncements of the Australian Accounting Standards Board (AASB) the *Corporations Act 2001*, and the International Financial Reporting Standards (IFRS) and interpretations published by the International Accounting Standards Board (IASB).

The Company is a reporting entity under the *Corporations Act 2001*, and is not exempt from preparing consolidated financial statements. The financial statements for the Company have been prepared for the purpose of the Company fulfilling its financial reporting obligations under part 7.8 of the *Corporations Act 2001*, as required for Australian Financial Services Licensees.

The Company is the ultimate parent entity of the ANZ Group. The Company consists of the following operations undertaken in Australia and in its overseas branches:

- Retail and Business & Private Banking operations,
- Institutional operations, and
- Technology Services & Operations and Group Centre operations

The consolidated financial statements of the Group can be found as part of the 2018 Annual Report at https//shareholder.anz.com/annual-report-shareholder-review and copies are available from the Company's registered office and principal place of business.

We present these financial statements in Australian dollars, which is the Company's functional and presentation currency. We have rounded values to the nearest million dollars ($m), unless otherwise stated, as allowed under the Australian Securities and Investments Commission (ASIC) Corporations (Rounding in Financial/Directors Report) Instrument 2016/191.

### BASIS OF MEASUREMENT

We have prepared the financial information in accordance with the historical cost basis - except the following assets and liabilities which we have stated at their fair value:

- derivative financial instruments and in the case of fair value hedging, a fair value adjustment is made on the underlying hedging exposure;
- available-for-sale financial assets;
- financial instruments held for trading;
- other financial assets and liabilities designated at fair value through profit and loss; and
- other assets held for sale where the fair value less cost of disposal is less than their carrying value.

In accordance with AASB 119 *Employee Benefits* defined benefit obligations are measured using the Projected Unit Credit Method.

# 1. ABOUT THE FINANCIAL STATEMENTS (continued)

## FOREIGN CURRENCY TRANSLATION

### TRANSACTIONS AND BALANCES

Foreign currency transactions are translated into the relevant functional currency at the exchange rate prevailing at the date of the transaction. At the reporting date, monetary assets and liabilities denominated in foreign currencies are translated into Australian dollars, being the functional currency, at the relevant spot rate. Any foreign currency translation gains or losses are included in profit or loss in the period they arise.

We measure translation differences on non-monetary items at fair value through profit or loss and report them as part of the fair value gain or loss on these items. We include any translation differences on non-monetary items classified as available-for-sale financial assets in the available-for-sale revaluation reserve in equity.

## KEY JUDGEMENTS AND ESTIMATES

When applying accounting policies, management has made a number of judgements and applied estimates and assumptions about past and future events. Further information on the key judgements and estimates that we consider material to the financial statements are contained within the relevant notes to the financial statements.

## ACCOUNTING STANDARDS NOT EARLY ADOPTED

A number of new standards, amendments to standards and interpretations have been published but are not mandatory for the financial statements for the year ended 30 September 2018, and have not been applied by the Company in preparing these financial statements.

We have identified three standards relevant to the Company and further details are set out below.

### AASB 9 FINANCIAL INSTRUMENTS (AASB 9)

In December 2014, the AASB issued the Australian Accounting Standard AASB 9 *Financial Instruments* which has replaced AASB 139 *Financial Instruments: Recognition and Measurement* (AASB 139). AASB 9 is effective for the Company from 1 October 2018.

AASB 9 stipulates new requirements for the impairment of financial assets, classification and measurement of financial assets and liabilities and general hedge accounting. Details of the key requirements and estimated impacts on the Company are outlined below.

#### Impairment

AASB 9 replaces the incurred loss impairment model under AASB 139 with an expected credit loss (ECL) model incorporating forward looking information and which does not require an actual loss event to have occurred for an impairment provision to be recognised.

The ECL model will be applied to all financial assets measured at amortised cost, debt instruments measured at fair value through other comprehensive income, lease receivables, certain loan commitments and financial guarantees not measured at fair value through profit or loss.

Under the ECL model, the following three-stage approach is applied to measuring expected credit losses based on credit migration between the stages since origination:

- Stage 1: At the origination of a financial asset, and where there has not been a significant increase in credit risk since origination, a provision equivalent to 12 months ECL is recognised.
- Stage 2: Where there has been a significant increase in credit risk since origination, a provision equivalent to lifetime ECL is recognised. If credit risk were to improve in a subsequent period such that the increase in credit risk since origination is no longer considered significant, the exposure returns to a Stage 1 classification and a 12 month ECL.
- Stage 3: Similar to the current AASB 139 requirements for individual impairment provisions, lifetime ECL is recognised for loans where there is objective evidence of impairment.

Expected credit losses are estimated at the facility level by using a probability of default reflecting a probability weighted range of possible future economic scenarios, and applying this to the estimated exposure of the Company at the point of default (exposure at default) after taking into account the value of any collateral held or other mitigants of loss (loss given default), while allowing for the impact of discounting for the time value of money.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ABOUT THE FINANCIAL STATEMENTS (continued)

Key judgements and estimates made by the Company include the following:

- *Significant increase in credit risk*

  Stage 2 assets are those that have experienced a significant increase in credit risk (SICR) since initial recognition. In determining what constitutes a SICR, the Company considers both qualitative and quantitative information. For the majority of portfolios, the primary indicator of a SICR is a significant deterioration in the internal credit rating grade of a facility since origination. The Company will also use secondary indicators, such as 30 days past due arrears, as backstops to these primary indicators.

  The determination of trigger points in relation to the deterioration of rating grades, combined with secondary risk indicators where used, requires judgement. In determining the Company's policy, alternative indicators have been considered and assessed, and these will be subject to regular review to ensure they remain appropriate.

- *Forward looking information*

  The measurement of expected credit losses reflects an unbiased probability-weighted range of possible future outcomes.

  In applying forward looking information in the Company's AASB 9 credit models, the Company uses four alternative economic scenarios in estimating ECL. A base case scenario reflects management's base case assumptions used for medium term planning purposes. Additional upside and downside scenarios are determined together with a severe downside scenario. The Company's Credit and Market Risk Committee (CMRC) will be responsible for reviewing and approving forecast economic scenarios and the associated probability weights applied to each scenario.

  Where applicable, adjustments may be made to account for situations where known or expected risks have not been adequately addressed in the modelling process. CMRC will be responsible for recommending such adjustments.

The overall level of expected credit losses and areas of significant management judgement will be reported to, and oversighted by, the Company's Board Risk Committee.

**Classification and measurement**

*Financial assets - general*

There are three measurement classifications for financial assets under AASB 9: Amortised Cost, Fair Value through Profit or Loss (FVTPL) and Fair Value through Other Comprehensive Income (FVOCI). Financial assets are classified into these measurement classifications on the basis of two criteria:

- the business model within which the financial asset is managed; and
- the contractual cash flow characteristics of the financial asset (specifically whether the contractual cash flows represent 'solely payments of principal and interest').

The resultant financial asset classifications are as follows:

- Amortised cost: financial assets with contractual cash flows that comprise the payment of principal and interest only and which are held in a business model whose objective is to collect their cash flows;
- Fair value through other comprehensive income: financial assets with contractual cash flows that comprise the payment of principal and interest only and which are held in a business model whose objective is to both collect their cash flows and to sell; and
- Fair value through profit or loss: Any other financial assets not falling into the categories above are measured at FVTPL.

In December 2017, the AASB issued AASB 2017-6 Amendments to Australian Accounting Standards - Prepayment Features with Negative Compensation which amends the requirements of AASB 9 so that certain prepayment features meet the solely payments of principal and interest test. The Company intends to early adopt this amendment so that it applies from the date of initial application of AASB 9.

AASB 9 allows the Company to irrevocably elect to designate a financial asset as measured at FVTPL on initial recognition if doing so eliminates or significantly reduces an accounting mismatch.

*Financial assets - equity instruments*

AASB 9 also permits non-traded equity investments to be designated at FVOCI on an instrument by instrument basis. If this election is made under AASB 9, gains or losses are not reclassified from other comprehensive income to profit or loss on disposal of the investment. However, gains or losses may be reclassified within equity.

*Financial liabilities*

The classification and measurement requirements for financial liabilities under AASB 9 are largely consistent with AASB 139 with the exception that for financial liabilities designated as measured at fair value, gains or losses relating to changes in the entity's own credit risk are included in other comprehensive income except where doing so would create or enlarge an accounting mismatch in profit or loss. This part of the standard was early adopted by the Company on 1 October 2013.

## 1. ABOUT THE FINANCIAL STATEMENTS (continued)

**General hedge accounting**

AASB 9 introduces new hedge accounting requirements which more closely align accounting with risk management activities undertaken when hedging financial and non-financial risks.

AASB 9 provides the Company with an accounting policy choice to continue to apply the AASB 139 hedge accounting requirements until the International Accounting Standards Board's ongoing project on macro hedge accounting is completed. The Company's current expectation is that it will continue to apply the hedge accounting requirements of AASB 139.

**Transition to AASB 9**

Other than as noted above under classification and measurement of financial liabilities, AASB 9 has a date of initial application for the Company of 1 October 2018.

The classification and measurement, and impairment requirements, will be applied retrospectively by adjusting opening retained earnings at 1 October 2018. The Company does not intend to restate comparatives.

**Impact**

The estimated impact of AASB 9 relates to the Impairment and the Classification and Measurement provisions. These estimates are based on accounting policies, assumptions and judgements and estimation techniques that remain subject to change until the Company finalises its financial statements for the year ending 30 September 2019.

- *Impairment*

  For the financial statements of the Company, the adoption of AASB 9 is expected to reduce net assets at 1 October 2018 by approximately $729 million offset by deferred tax of approximately $208 million.

- *Classification and measurement of financial assets*

  While some classification changes will occur as a result of the application of the business model and contractual cash flow characteristics tests, these are not expected to be significant from a Company perspective.

  The adoption of the Classification and Measurement requirements of the standard will result in measurement differences compared to those under AASB 139. Financial assets with a current carrying value of approximately $4.8 billion, predominantly bonds and debt instruments, will be reclassified between amortised cost, FVTPL and FVOCI. The net re-measurement from these reclassifications is not material. There are no other material changes in the measurement categories.

- *Classification and measurement of financial liabilities*

  The Company has issued certain financial liabilities (bonds included within the Debt issuances caption) with an amortised cost carrying amount at 30 September 2018 of approximately $2.6 billion. The Company will elect to designate these liabilities as measured at fair value through profit or loss effective from initial application of AASB 9 to reduce an accounting mismatch that currently exists. The impact on net assets and retained earnings is not material.

**AASB 15 REVENUE FROM CONTRACTS WITH CUSTOMERS**

AASB 15 is effective for the Company from 1 October 2018 and replaces existing guidance on the recognition of revenue from contracts with customers. The standard requires identification of distinct performance obligations within a contract, and allocation of the transaction price of the contract to those performance obligations. Revenue is then recognised as each performance obligation is satisfied. The standard also provides guidance on whether an entity is acting as a principal or an agent which impacts the presentation of revenue on a gross or net basis.

The Company has assessed all revenue streams existing at the date of transition to the new standard and determined that the impact of AASB 15 is immaterial, given a majority of Company revenues are outside the scope of the standard. The Company will adopt AASB 15 retrospectively including restatement of prior period comparatives.

Certain revenues for the credit cards business will be impacted as follows:

- Certain loyalty costs will be presented as operating expenses rather than presented as a net reduction of other operating income where the Company is assessed to be acting as a principal (rather than an agent) under the new standard. In addition, certain incentives received from card scheme providers related to card marketing and migration activities will be presented as operating income and no longer netted against operating expenses.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ABOUT THE FINANCIAL STATEMENTS (continued)

**AASB 16 LEASES**

The final version of AASB 16 was issued in February 2016 and is not effective for the Company until 1 October 2019. AASB 16 requires a lessee to recognise its:

- right to use the underlying leased asset, as a right-of-use asset; and
- obligation to make lease payments as a lease liability.

AASB 16 substantially carries forward the lessor accounting requirements in AASB 117 *Leases*.

The Company is in the process of the assessing the impact of application of AASB 16 and is not yet able to reasonably estimate the impact on its financial statements.

## 2. OPERATING INCOME

| | 2018 $m | 2017 $m |
|---|---|---|
| **Net interest income** | | |
| **Interest income by type of financial asset** | | |
| Available-for-sale assets | 1,232 | 985 |
| Financial assets at amortised cost | 21,520 | 20,546 |
| Trading securities | 881 | 739 |
| Interest income - external | 23,633 | 22,270 |
| Interest income - controlled entities | 3,387 | 3,343 |
| Interest income | 27,020 | 25,613 |
| **Interest expense by type of financial liability** | | |
| Financial liabilities at amortised cost | (12,148) | (10,961) |
| Securities sold short | (239) | (111) |
| Financial liabilities designated at fair value through profit or loss | (69) | (78) |
| Interest expense - external | (12,456) | (11,150) |
| Interest expense - controlled entities | (3,763) | (3,781) |
| Interest expense | (16,219) | (14,931) |
| Major bank levy | (355) | (86) |
| **Net interest income** | 10,446 | 10,596 |
| **Other operating income** | | |
| **i) Fee and commission income** | | |
| Lending fees[1] | 599 | 652 |
| Non-lending fees and commissions | 2,152 | 2,211 |
| Fee and commission income - external | 2,751 | 2,863 |
| Fee and commission income - controlled entities | 1,279 | 1,197 |
| Fee and commission income | 4,030 | 4,060 |
| Fee and commission expense | (994) | (1,019) |
| Net fee and commission income | 3,036 | 3,041 |
| **ii) Other income** | | |
| Net foreign exchange earnings and other financial instruments income[2] | 1,178 | 1,053 |
| Dividends received from controlled entities[3] | 4,773 | 2,299 |
| Sale of Asia Retail and Wealth businesses | 13 | (219) |
| Sale of Shanghai Rural Commercial Bank (SRCB) | 233 | (231) |
| Write down of investment in Wealth Australia (AWA)[3] | (597) | - |
| Other | 9 | 44 |
| Other income[4] | 5,609 | 2,946 |
| **Other operating income** | 8,645 | 5,987 |
| **Net funds management and commission income** | | |
| Funds management income | (80) | 74 |
| Commission income[5] | 72 | 84 |
| **Net funds management and commission income** | (8) | 158 |
| **Share of associates' profit** | (1) | 60 |
| **Operating income[6]** | 19,082 | 16,801 |

1. Lending fees exclude fees treated as part of the effective yield calculation in interest income.
2. Includes fair value movements (excluding realised and accrued interest) on derivatives not designated as accounting hedges entered into to manage interest rate and foreign exchange risk on funding instruments, ineffective portions of cash flow hedges, and fair value movements in financial assets and liabilities designated at fair value through profit and loss.
3. During 2018 the Company received a dividend of $582 million from AWA and wrote the investment in AWA down by an equivalent amount. The impact of this has been presented net in the income statements.
4. Total other income includes external dividend income from Bank of Tianjin of $27 million (2017: $26 million).
5. Commission income includes insurance commissions which were previously reported separately.
6. Includes customer remediation of $310 million for the September 2018 year (2017: $52 million).

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 2. OPERATING INCOME (continued)

### RECOGNITION AND MEASUREMENT

**NET INTEREST INCOME**

#### Interest Income and Expense

We recognise interest income and expense for all financial instruments, including those classified as held for trading, available-for-sale (AFS) assets or designated at fair value, through profit or loss in net interest income. For assets held at amortised cost the Company use the effective interest rate method to calculate its amortised cost. The effective interest rate is the rate that discounts the stream of estimated future cash receipts or payments over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or liability. For assets subject to prepayment, we determine their expected life on the basis of historical behaviour of the particular asset portfolio - taking into account contractual obligations and prepayment experience.

We recognise fees and costs, which form an integral part of the financial instrument (for example loan origination fees and costs), using the effective interest method. This is presented as part of interest income or expense depending on whether the underlying financial instrument is a financial asset or financial liability.

#### Major Bank Levy

The Major Bank Levy Act 2017 ('Levy' or 'Major bank levy') became effective from 1 July 2017 and applies a rate of 0.06% to certain liabilities of the Company. The Company has determined that the levy represents a finance cost for the Company and is presented in interest expense in the Income Statement.

**OTHER OPERATING INCOME**

#### Fee and Commission Income

We recognise fees or commissions:

- that relate to the execution of a significant act (for example, advisory or arrangement services, placement fees and underwriting fees) when the significant act has been completed; and
- charged for providing ongoing services (for example, maintaining and administering existing facilities) as income over the period the service is provided.

#### Net Foreign Exchange Earnings and Other Financial Instruments Income

We recognise the following as net foreign exchange earnings and other financial instruments income:

- exchange rate differences arising on the settlement of monetary items and translation differences on monetary items translated at rates different to those at which they were initially recognised or included in a previous financial report;
- fair value movements (excluding realised and accrued interest) on derivatives that we use to manage interest rate and foreign exchange risk on funding instruments not designated as accounting hedges;
- the ineffective portions of fair value hedges, cash flow hedges and net investment hedges;
- fair value movements on financial assets and financial liabilities designated at fair value through profit or loss or held for trading;
- amounts released from the Available-for-sale (AFS) revaluation reserve in equity when an AFS asset is sold, and
- immediately upon sale or repayment of a hedged item, the unamortised fair value adjustments in items designated as fair value hedges and amounts accumulated in equity related to designated cash flow hedges.

#### Dividends Received from Controlled Entities

Dividends are recognised as revenue when the right to receive payment is established.

#### Gain or Loss on Disposal of Non-Financial Assets

The gain or loss on the disposal of assets is the difference between the carrying value of the asset and the proceeds of disposal net of costs. This is recognised in other income in the year in which the significant risks and rewards transfer to the buyer.

## 2. OPERATING INCOME (continued)

### RECOGNITION AND MEASUREMENT

**NET FUNDS MANAGEMENT AND COMMISSION INCOME**

#### Funds Management Income

We recognise the fees we charge to customers in connection with financial advice and the management of investment products when we have provided the service.

#### Commission Income

We recognise commissions received for distributing products to customers in the period when we become entitled to the commission.

**SHARE OF ASSOCIATES' PROFIT**

The equity method is applied to accounting for associates in the financial statements. Under the equity method the Company's share of the after tax results of associates is included in the Income Statement and the Statement of Comprehensive Income.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 3. OPERATING EXPENSES

| | 2018 $m | 2017 $m |
|---|---|---|
| **Personnel** | | |
| Salaries and related costs | 3,233 | 3,288 |
| Superannuation costs | 258 | 266 |
| Other | 163 | 227 |
| **Personnel expenses** | 3,654 | 3,781 |
| **Premises** | | |
| Rent | 395 | 409 |
| Other | 264 | 275 |
| **Premises expenses** | 659 | 684 |
| **Technology** | | |
| Depreciation and amortisation | 682 | 662 |
| Licences and outsourced services | 457 | 413 |
| Accelerated amortisation[2] | 240 | - |
| Other | 204 | 216 |
| **Technology expenses** | 1,583 | 1,291 |
| **Restructuring** | 210 | 55 |
| **Other** | | |
| Advertising and public relations | 160 | 192 |
| Professional fees | 497 | 397 |
| Freight, stationery, postage and communication | 179 | 204 |
| Royal Commission legal costs | 55 | - |
| Other | 1,124 | 1,019 |
| **Other expenses** | 2,015 | 1,812 |
| **Operating expenses**[1] | 8,121 | 7,623 |

1. Includes customers remediation of $255 million for the September 2018 year (2017: $79million).
2. Accelerated software amortisation charge relates to certain software assets in the Institutional and Australia divisions following the reassessment of useful lives.

### RECOGNITION AND MEASUREMENT

**OPERATING EXPENSES**

Operating expenses are recognised as services are provided to the Company over the period in which an asset is consumed or once a liability is created.

**SALARIES AND RELATED COSTS - ANNUAL LEAVE, LONG SERVICE LEAVE AND OTHER EMPLOYEE BENEFITS**

Wages and salaries, annual leave, and other employee entitlements expected to be paid or settled within twelve months of employees rendering service are measured at their nominal amounts using remuneration rates that the Company expects to pay when the liabilities are settled.

We accrue employee entitlements relating to long service leave using an actuarial calculation. It includes assumptions regarding staff departures, leave utilisation and future salary increases. The result is then discounted using market yields at the reporting date. The market yields are determined from a blended rate of high quality corporate bonds with terms to maturity that closely match the estimated future cash outflows.

If we expect to pay short term cash bonuses, then a liability is recognised when the Company has a present legal or constructive obligation to pay this amount (as a result of past service provided by the employee) and the obligation can be reliably measured.

## 3. OPERATING EXPENSES (continued)

### RECOGNITION AND MEASUREMENT

Personnel expenses also include share-based payments which may be cash or equity settled. We calculate the fair value of equity settled remuneration at grant date, which is then amortised over the vesting period, with a corresponding increase in share capital or the share option reserve as applicable. When we estimate the fair value, we take into account market vesting conditions, such as share price performance conditions. We take non-market vesting conditions, such as service conditions, into account by adjusting the number of equity instruments included in the expense.

After the grant of an equity-based award, the amount we recognise as an expense is reversed when non-market vesting conditions are not met, for example an employee fails to satisfy the minimum service period specified in the award on resignation, termination or notice of dismissal for serious misconduct. However, we do not reverse the expense if the award does not vest due to the failure to meet a market-based performance condition.

Further information on share-based payment schemes operated by the Company during the current and prior year is included in Note 27 Employee Share and Option Plans.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 4. INCOME TAX

### INCOME TAX EXPENSE

Reconciliation of the prima facie income tax expense on pre-tax profit with the income tax expense recognised in profit or loss:

| | 2018 $m | 2017 $m |
|---|---|---|
| **Profit before income tax** | 10,332 | 8,297 |
| Prima facie income tax expense at 30% | 3,100 | 2,489 |
| Tax effect of permanent differences: | | |
| Share of associates' profit | - | (18) |
| Sale of Shanghai Rural Commercial Bank (SRCB) | (84) | 172 |
| Tax provisions no longer required | (39) | - |
| Interest on convertible instruments | 67 | 69 |
| Overseas tax rate differential | (6) | 27 |
| Rebatable and non-assessable dividends | (1,606) | (690) |
| Provision for foreign tax on dividend repatriation | 28 | 8 |
| Write down of investment in Wealth Australia | 354 | - |
| Other | 13 | 24 |
| **Subtotal** | 1,827 | 2,081 |
| Income tax over provided in previous years | (19) | (18) |
| **Income tax expense** | 1,808 | 2,063 |
| Current tax expense | 2,037 | 1,997 |
| Adjustments recognised in the current year in relation to the current tax of prior years | (19) | (18) |
| Deferred tax expense/(income) relating to the origination and reversal of temporary differences | (210) | 84 |
| **Income tax expense** | 1,808 | 2,063 |
| Australia | 1,695 | 1,975 |
| Overseas | 113 | 88 |
| **Income tax expense** | 1,808 | 2,063 |
| **Effective tax rate** | 17.5% | 24.9% |

## 4. INCOME TAX (continued)

### TAX CONSOLIDATION

The Company and all its wholly owned Australian resident entities are part of a tax-consolidated group under Australian taxation law. The Company is the head entity in the tax-consolidated group. We recognise each of the following in the separate financial statements of members of the tax consolidated group on a 'group allocation' basis: tax expense/income, and deferred tax liabilities/assets, that arise from temporary differences of the members of the tax-consolidated group. The Company (as head entity in the tax-consolidated group) recognises current tax liabilities and assets of the tax-consolidated group.

Under a tax funding arrangement between the entities in the tax consolidated group, amounts are recognised as payable to or receivable by the Company and each member of the tax-consolidated group in relation to the tax contribution amounts paid or payable between the Company and the other members of the tax-consolidated group.

Members of the tax-consolidated group have also entered into a tax sharing agreement that provides for the allocation of income tax liabilities between the entities were the head entity to default on its income tax payment obligations.

### UNRECOGNISED DEFERRED TAX ASSETS AND LIABILITIES

Unrecognised deferred tax assets related to unused realised tax losses (on revenue account) total $nil (2017: $nil). Unrecognised deferred tax liabilities related to additional potential foreign tax costs (assuming all retained earnings in offshore branches are repatriated) total $42 million (2017: $38 million).

### RECOGNITION AND MEASUREMENT

#### INCOME TAX EXPENSE

Income tax expense comprises both current and deferred taxes and is based on the accounting profit adjusted for differences in the accounting and tax treatments of income and expenses (that is, taxable income). We recognise tax expense in profit or loss except to the extent to which it relates to items recognised directly in equity and other comprehensive income, in which case we recognise it directly in equity or other comprehensive income respectively.

#### CURRENT TAX EXPENSE

Current tax is the tax we expect to pay on taxable income for the year, based on tax rates (and tax laws) which are enacted at the reporting date. We recognise current tax as a liability (or asset) to the extent that it is unpaid (or refundable).

#### DEFERRED TAX ASSETS AND LIABILITIES

We account for deferred tax using the balance sheet method. Deferred tax arises because accounting income is not always the same as the taxable income. This creates temporary differences, which usually reverse over time. Until they reverse, we recognise a deferred tax asset, or liability, on the balance sheet. We measure deferred taxes at the tax rates that we expect will apply to the period(s) when the asset is realised, or the liability settled, based on tax rates (and tax laws) that have been enacted or substantially enacted at the reporting date.

We offset current and deferred tax assets and liabilities only to the extent that:

- they relate to income taxes imposed by the same taxation authority;
- there is a legal right and intention to settle on a net basis; and
- it is allowed under the tax law of the relevant jurisdiction.

### KEY JUDGEMENTS AND ESTIMATES

Judgement is required in determining provisions held in respect of uncertain tax positions. The Company estimates its tax liabilities based on its understanding of the relevant law in each of the countries in which it operates and seeks independent advice where appropriate.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 5. DIVIDENDS

### ORDINARY SHARE DIVIDENDS

Dividends are provided for in the financial statements once determined, accordingly, the final dividend announced for the current financial year is provided for and paid in the following financial year.

| Dividends | % of total | Amount per share | Total dividend $m |
|---|---|---|---|
| Financial Year 2017 | | | |
| 2016 final dividend paid | | 80.0 cents | 2,342 |
| 2017 interim dividend paid | | 80.0 cents | 2,349 |
| Bonus option plan adjustment | | | (82) |
| Dividends paid during the year ended 30 September 2017 | | | 4,609 |
| Cash | 91.9% | | 4,235 |
| Dividend reinvestment plan | 8.1% | | 374 |
| Dividends paid during the year ended 30 September 2017 | | | 4,609 |
| Financial Year 2018 | | | |
| 2017 final dividend paid | | 80.0 cents | 2,350 |
| 2018 interim dividend paid | | 80.0 cents | 2,317 |
| Bonus option plan adjustment | | | (82) |
| Dividends paid during the year ended 30 September 2018 | | | 4,585 |
| Cash | 91.5% | | 4,193 |
| Dividend reinvestment plan | 8.5% | | 392 |
| Dividends paid during the year ended 30 September 2018 | | | 4,585 |

| Dividends announced and to be paid after year-end | Payment date | Amount per share | Total dividend $m |
|---|---|---|---|
| 2018 final dividend (fully franked at 30%, New Zealand imputation credit NZD 10 cents per share) | 18 December 2018 | 80.0 cents | 2,296 |

### DIVIDEND REINVESTMENT PLAN AND BONUS OPTION PLAN

Eligible shareholders can elect to reinvest their dividend entitlement into ANZ ordinary shares under the Company's Dividend Reinvestment Plan (DRP). Eligible shareholders can elect to forgo their dividend entitlement and instead receive ANZ ordinary shares under the Company's Bonus Option Plan (BOP). For the 2018 final dividend, DRP participation will be satisfied by an on-market purchase of shares and BOP participation will be satisfied by an issue of ANZ ordinary shares. There will be no discount applied to the DRP and BOP price.

See Note 21 Shareholders' Equity for details of shares the Company issued or purchased in respect of the DRP and BOP.

### DIVIDEND FRANKING ACCOUNT

| | Currency | 2018 $m | 2017 $m |
|---|---|---|---|
| Australian franking credits available at 30% (2017: 30%) tax rate | AUD | 97 | 171 |
| New Zealand imputation credits available (which can be attached to our Australian dividends but may only be used by New Zealand resident shareholders) | NZD | 3,868 | 3,680 |

The above amounts represent the balances of the franking accounts as at the end of the financial year, adjusted for:

- franking credits that will arise from the payment of income tax payable as at the end of the financial year; and
- franking credits/debits from the receipt/payment of dividends that have been recognised as tax receivables/payables as at the end of the financial year.

## 5. DIVIDENDS (continued)

The proposed final 2018 dividend will utilise the entire balance of $97 million franking credits available at 30 September 2018. Instalment tax payments on account of the 2019 financial year which will be made after 30 September 2018 will generate sufficient franking credits to enable the final 2018 dividend to be fully franked. The extent to which future dividends will be franked will depend on a number of factors, including the level of profits generated by the Company that will be subject to tax in Australia.

### RESTRICTIONS ON THE PAYMENT OF DIVIDENDS

APRA's written approval is required before paying dividends on ANZ ordinary shares:

- if the aggregate dividends exceed the Company's after tax earnings (in calculating those after tax earnings, we take into account any payments we made on senior capital instruments) in the financial year to which they relate; or
- if the Group's Common Equity Tier 1 capital ratio falls within capital range buffers specified by APRA.

If the Company fails to pay a dividend or distribution on its ANZ Capital Notes or ANZ Capital Securities on the scheduled payment date, it may (subject to a number of exceptions) be restricted from resolving to pay or paying any dividend on the ANZ ordinary shares.

## 6. SEGMENT REPORTING

No operating segment disclosures have been presented in these Company financial statements. Disaggregated information for the Company's segments is not information which is regularly provided to the Chief Executive Officer, who is the Chief Operating Decision Maker (CODM) of the Company.

Full details of the operating segments of the Group are provided in Note 7 Segment Reporting in the ANZ 2018 Group Annual Report located at https://shareholder.anz.com/annual-report-shareholder-review.

## 7. CASH AND CASH EQUIVALENTS

| | 2018 $m | 2017 $m |
|---|---|---|
| Coins, notes and cash at bank | 912 | 1,096 |
| Securities purchased under agreements to resell in less than 3 months | 27,631 | 20,818 |
| Balances with central banks | 32,009 | 22,389 |
| Settlement balances owed to ANZ within 3 months | 19,675 | 19,096 |
| **Cash and cash equivalents** | 80,227 | 63,399 |

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 8. TRADING SECURITIES

| | 2018 $m | 2017 $m |
|---|---|---|
| Government securities | 21,545 | 25,647 |
| Corporate and financial institution securities | 4,302 | 5,060 |
| Equity and other securities | 3,672 | 4,899 |
| Trading securities | 29,519 | 35,606 |

### RECOGNITION AND MEASUREMENT

Trading securities are financial instruments we either:

- acquire principally for the purpose of selling in the short-term; or
- hold as part of a portfolio we manage for short-term profit making.

We recognise purchases and sales of trading securities on trade date:

- initially, we measure them at fair value through the profit and loss; and
- subsequently, we measure them in the balance sheet at their fair value with any revaluation recognised in the profit or loss.

### KEY JUDGEMENTS AND ESTIMATES

Judgement is required when applying the valuation techniques used to measure the fair value of trading securities not valued using quoted market prices. Refer to Note 16 Fair Value of Financial Assets and Financial Liabilities for further details.

# 9. DERIVATIVE FINANCIAL INSTRUMENTS

| Fair Value | Assets 2018 $m | Liabilities 2018 $m | Assets 2017 $m | Liabilities 2017 $m |
|---|---|---|---|---|
| Derivative financial instruments - held for trading | 62,813 | (63,177) | 55,261 | (54,937) |
| Derivative financial instruments - designated in hedging relationships | 1,635 | (2,461) | 1,775 | (1,893) |
| Derivative financial instruments | 64,448 | (65,638) | 57,036 | (56,830) |

## FEATURES

Derivative financial instruments are contracts:

- whose value is derived from an underlying price index (or other variable) defined in the contract – sometimes the value is derived from more than one variable;
- that require little or no initial net investment; and
- that are settled at a future date.

Movements in the price of the underlying variables, which cause the value of the contract to fluctuate, are reflected in the fair value of the derivative.

## PURPOSE

The Company's derivative financial instruments have been categorised as following:

| | |
|---|---|
| Trading | Derivatives held in order to:<br>• Meet customer needs for managing their own risks.<br>• Manage risk in the Company's positions that are not in a designated hedge accounting relationship.<br>• Undertake market making and positioning activities to generate profits from short-term fluctuations in prices or margins. |
| Designated in Hedging Relationships | Derivatives designated into hedge accounting relationships in order to minimise profit or loss volatility by matching movements to underlying positions relating to:<br>• Hedges of the Company's exposures to interest rate risk and currency risk.<br>• Hedges of other exposures relating to non-trading positions. |

## TYPES

The Company offers and uses four different types of derivative financial instruments:

| | |
|---|---|
| Forwards | A contract documenting the rate of interest, or the currency exchange rate, to be paid or received on a notional principal obligation at a future date. |
| Futures | An exchange traded contract in which the parties agree to buy and sell an asset in the future for a price agreed on the transaction date, with a net settlement in cash paid on the future date without physical delivery of the asset. |
| Swaps | A contract in which two parties exchanges one series of cash flows for another. |
| Options | A contract in which the buyer of the contract has the right - but not the obligation - to buy (known as a "call option") or to sell (known as a "put option") an asset or instrument at a set price on a future date. The seller has the corresponding obligation to fulfil the transaction to sell or buy the asset or instrument if the buyer exercises the option. |

## RISKS MANAGED

The Company offers and uses the instruments described above to manage fluctuations in the following market factors:

| | |
|---|---|
| Foreign Exchange | Currencies at current or determined rates of exchange. |
| Interest Rate | Fixed or variable interest rates applying to money lent, deposited or borrowed. |
| Commodity | Soft commodities (that is, agricultural products such as wheat, coffee, cocoa and sugar) and hard commodities (that is, mined products such as gold, oil and gas). |
| Credit | Counterparty risk in the event of default. |

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 9. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

### DERIVATIVE FINANCIAL INSTRUMENTS – HELD FOR TRADING

The majority of the Company's derivative financial instruments are held for trading. The fair value of derivative financial instruments held for trading are:

| Fair Value | Assets 2018 $m | Liabilities 2018 $m | Assets 2017 $m | Liabilities 2017 $m |
|---|---|---|---|---|
| Interest rate contracts | | | | |
| Forward rate agreements | 6 | (7) | 2 | (1) |
| Futures contracts | 48 | (31) | 97 | (34) |
| Swap agreements | 32,873 | (33,510) | 27,584 | (27,720) |
| Options purchased | 780 | - | 742 | - |
| Options sold | - | (1,408) | - | (1,365) |
| Total | 33,707 | (34,956) | 28,425 | (29,120) |
| Foreign exchange contracts | | | | |
| Spot and forward contracts | 14,057 | (13,221) | 14,132 | (13,731) |
| Swap agreements | 12,276 | (11,609) | 10,070 | (10,073) |
| Options purchased | 461 | - | 475 | - |
| Options sold | - | (649) | - | (439) |
| Total | 26,794 | (25,479) | 24,677 | (24,243) |
| Commodity contracts | 2,258 | (2,684) | 1,991 | (1,398) |
| Credit default swaps | | | | |
| Structured credit derivative purchased | 22 | - | 52 | - |
| Other credit derivatives purchased | 8 | (29) | 13 | (110) |
| Credit derivatives purchased | 30 | (29) | 65 | (110) |
| Structured credit derivatives sold | - | (26) | - | (58) |
| Other credit derivatives sold | 24 | (3) | 103 | (8) |
| Credit derivatives sold | 24 | (29) | 103 | (66) |
| Total | 54 | (58) | 168 | (176) |
| Derivative financial instruments - held for trading | 62,813 | (63,177) | 55,261 | (54,937) |

## 9. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

### DERIVATIVE FINANCIAL INSTRUMENTS – DESIGNATED IN HEDGING RELATIONSHIPS

There are three types of hedge accounting relationships the Company utilises:

| | Fair value hedge | Cash flow hedge | Net investment hedge |
|---|---|---|---|
| Objective of this hedging arrangement | To hedge our exposure to changes to the fair value of a recognised asset or liability or unrecognised firm commitment caused by interest rate or foreign currency movements. | To hedge our exposure to variability in cash flows of a recognised asset or liability, a foreign exchange component of a firm commitment or a highly probable forecast transaction caused by interest rate, foreign currency and other price movements. | To hedge our exposure to exchange rate differences arising from the translation of our foreign operations from their functional currency to Australian dollars. |
| Recognition of effective hedge portion | The following are recognised in profit or loss at the same time:<br>• all changes in the fair value of the underlying item relating to the hedged risk; and<br>• the change in the fair value of derivatives. | We recognise the effective portion of changes in the fair value of derivatives designated as a cash flow hedge in the cash flow hedge reserve. | We recognise the effective portion of changes in the fair value of the hedging instrument in the foreign currency translation reserve. |
| Recognition of ineffective hedge portion | Recognised immediately in other operating income. | | |
| If a hedging instrument expires, or is sold, terminated, or exercised; or no longer qualifies for hedge accounting | When we recognise the hedged item in profit or loss, we recognise the related unamortised fair value adjustment in profit or loss. This may occur over time if the hedged item is amortised to profit or loss as part of the effective yield over the period to maturity. | Only when we recognise the hedged item in profit or loss is the amount previously deferred in the cash flow hedge reserve transferred to profit or loss. | The amount we defer in the foreign currency translation reserve remains in equity and is transferred to profit or loss only when we dispose of, or partially dispose of, the foreign operation. |
| Hedged item sold or repaid | We recognise the unamortised fair value adjustment immediately in profit or loss. | Amounts accumulated in equity are transferred immediately to profit or loss. | The gain or loss, or applicable proportion, we recognise in equity is transferred to profit or loss on disposal or partial disposal of a foreign operation. |

The fair value of derivative financial instruments designated in hedging relationships are::

| Fair Value | Hedge accounting type | Assets 2018 $m | Liabilities 2018 $m | Assets 2017 $m | Liabilities 2017 $m |
|---|---|---|---|---|---|
| Foreign exchange swap agreements | Fair value | 1 | - | 1 | - |
| Foreign exchange spot and forward contracts | Fair value | 1 | - | - | - |
| Interest rate swap agreements | Fair value | 1,211 | (2,251) | 1,287 | (1,555) |
| Interest rate futures contracts | Fair value | 47 | (1) | 80 | - |
| Interest rate swap agreements | Cash flow | 330 | (148) | 361 | (278) |
| Foreign exchange swap agreements | Cash flow | 44 | (52) | 35 | (49) |
| Foreign exchange spot and forward contracts | Cash flow | 1 | - | - | (5) |
| Foreign exchange spot and forward contracts | Net investment | - | (9) | 11 | (6) |
| Derivative financial instruments - designated in hedging relationships | | 1,635 | (2,461) | 1,775 | (1,893) |

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 9. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The impact recognised in profit or loss arising from derivative financial instruments designated in hedge accounting relationships, is as follows:

| | Hedge accounting type | 2018 $m | 2017 $m |
|---|---|---|---|
| **Gain/(loss) recognised in other operating income** | | | |
| Hedged item | Fair value | 934 | (43) |
| Hedging instrument | Fair value | (949) | 38 |
| Ineffective portion of hedged instrument | Cash flow | 13 | (20) |

### RECOGNITION AND MEASUREMENT

| | |
|---|---|
| Recognition | Initially and at each reporting date, we recognise all derivatives at fair value. If the fair value of a derivative is positive, then we carry it as an asset, but if its value is negative, then we carry it as a liability.<br>Valuation adjustments are integral in determining the fair value of derivatives. This includes:<br>• a derivative credit valuation adjustment (CVA) to reflect the counterparty risk and/or event of default; and<br>• a funding valuation adjustment (FVA) to account for funding costs and benefits in the derivatives portfolio. |
| Derecognition of assets and liabilities | We remove derivative assets from our balance sheet when the contracts expire or we have transferred substantially all the risks and rewards of ownership. We remove derivative liabilities from our balance sheet when the Company's contractual obligations are discharged, cancelled or expired. |
| Impact on the Income Statement | How we recognise gains or losses on derivative financial instruments depends on whether the derivative is held for trading or is designated into a hedging relationship. For derivative financial instruments held for trading, gains or losses from changes in the fair value are recognised in profit or loss.<br>For an instrument designated into a hedging relationship the recognition of gains or losses depends on the nature of the item being hedged. Refer to the table on page 25 for profit or loss treatment depending on the hedge type. |
| Hedge effectiveness | To qualify for hedge accounting a hedge is expected to be highly effective. A hedge is highly effective only if the following conditions are met:<br>• the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated (prospective effectiveness); and<br>• the actual results of the hedge are within the range of 80-125% (retrospective effectiveness).<br>The Company monitors hedge effectiveness on a regular basis but at a minimum at least at each reporting date. |

### KEY JUDGEMENTS AND ESTIMATES

Judgement is required when we select the valuation techniques used to measure the fair value of derivatives, particularly the selection of valuation inputs that are not readily observable, and the application of valuation adjustments to certain derivatives. Refer to Note 16 Fair Value of Financial Assets and Financial Liabilities for further details.

## 10. AVAILABLE-FOR-SALE ASSETS

| Period | Security type | 2018 Government securities $m | 2018 Corporate and financial institution securities $m | 2018 Equity and other securities $m | 2018 Total $m | 2017 Government securities $m | 2017 Corporate and financial institution securities $m | 2017 Equity and other securities $m | 2017 Total $m |
|---|---|---|---|---|---|---|---|---|---|
| Less than 3 months | | 5,725 | 850 | - | 6,575 | 5,424 | 768 | - | 6,192 |
| Between 3 and 12 months | | 6,729 | 2,221 | - | 8,950 | 4,168 | 2,163 | - | 6,331 |
| Between 1 and 5 years | | 24,455 | 10,364 | 159 | 34,978 | 15,656 | 10,726 | 403 | 26,785 |
| Greater than 5 years | | 11,569 | - | 1,572 | 13,141 | 16,079 | 260 | 2,134 | 18,473 |
| No maturity | | - | - | 1,084 | 1,084 | - | - | 725 | 725 |
| Available-for-sale assets | | 48,478 | 13,435 | 2,815 | 64,728 | 41,327 | 13,917 | 3,262 | 58,506 |

During the year, the Company recognized a net gain (before tax) in respect of available-for-sale (AFS) assets of $70 million (2017: $15 million) was recognised in other operating income.

The carrying value of AFS equity securities is $1,084 million (2017: $725 million). This includes the Company's $1,025 million (2017: $676 million) investment in the Bank of Tianjin (BoT) that ceased being classified as an associate in March 2016.

### RECOGNITION AND MEASUREMENT

AFS assets comprise non-derivative financial assets which we designate as AFS since we do not hold them principally for trading purposes. They include both equity and debt securities. AFS assets are initially recognised at fair value plus transaction costs and are revalued at least bi-annually. On revaluation, we include movements in fair value within the available-for-sale revaluation reserve in equity, except for certain items which are recognised directly in profit or loss, being interest on debt securities, dividends received, foreign exchange on debt securities and impairment charges.

When we sell the asset, any cumulative gain or loss from the available-for-sale revaluation reserve is recognised in profit or loss.

At each reporting date, we assess whether any AFS assets are impaired. We assess the impairment of any debt securities if an event has occurred which will have a negative impact on the asset's estimated cash flows. For equity securities, we assess if there is a significant or prolonged decline in their fair value below cost.

If an AFS asset is impaired, then we remove the cumulative loss related to that asset from the available-for-sale revaluation reserve. We then recognise it in profit or loss for:

- debt instruments, as a credit impairment expense; and
- equity instruments, as a negative impact in other operating income.

We recognise any later reversals of impairment on debt securities in the profit or loss through the credit impairment charge line. However, we do not make any reversals of impairment for equity securities. To the extent previously impaired equity securities recover in value, gains are recognised directly in equity.

### KEY JUDGEMENTS AND ESTIMATES

Judgement is required when we select valuation techniques used to measure the fair value of AFS assets not valued using quoted market prices, particularly the selection of valuation inputs that are not readily observable. Refer to Note 16 Fair Value of Financial Assets and Financial Liabilities for further details.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 11. NET LOANS AND ADVANCES

| | 2018 $m | 2017 $m |
|---|---|---|
| Overdrafts | 6,047 | 6,155 |
| Credit cards | 8,379 | 8,639 |
| Commercial bills[1] | 6,861 | 8,386 |
| Term loans – housing | 273,908 | 268,416 |
| Term loans – non-housing[1] | 180,965 | 161,610 |
| Other | 1,494 | 1,578 |
| **Subtotal** | 477,654 | 454,784 |
| Unearned income | (165) | (149) |
| Capitalised brokerage/mortgage origination fees | 710 | 751 |
| **Gross loans and advances (including assets classified as held for sale)** | 478,199 | 455,386 |
| Provision for credit impairment (refer to Note 12) | (2,780) | (2,962) |
| **Net loans and advances** | 475,419 | 452,424 |
| *Residual contractual maturity:* | | |
| Within one year | 76,744 | 67,609 |
| After more than one year | 398,675 | 384,815 |
| **Net loans and advances** | 475,419 | 452,424 |
| *Carried on Balance Sheet at:* | | |
| Amortised cost | 475,418 | 452,408 |
| Fair value through profit or loss (designated on initial recognition) | 1 | 16 |
| **Net loans and advances** | 475,419 | 452,424 |

1. Some of the loans previously shown in Commercial bills outstanding have been reclassified to Term Loans – non-housing. Restatement impact of $2,597 million for September 2017.

### RECOGNITION AND MEASUREMENT

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are facilities the Company provides directly to customers or through third party channels.

Loans and advances are initially recognised at fair value plus transaction costs directly attributable to the issue of the loan or advance, which are primarily brokerage/mortgage origination fees which we amortise over the estimated life of the loan. Subsequently, we then measure loans and advances at amortised cost using the effective interest rate method, net of any provision for credit impairment, or at fair value when they are specifically designated on initial recognition as fair value through profit or loss or when held for trading.

We classify contracts to lease assets and hire purchase agreements as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer or an unrelated third party. We include these facilities in 'Other' in the table above.

The Company enters into transactions in which it transfers financial assets that are recognised on its balance sheet. When the Company retains substantially all of the risks and rewards of the transferred assets then the transferred assets remain on the Company's balance sheet, however, if substantially all the risks and rewards are transferred then the Company derecognises the asset.

If the risks and rewards are partially retained and control over the asset is lost, then the Company derecognises the asset. If control over the asset is not lost, the Company continues to recognise the asset to the extent of its continuing involvement.

We separately recognise the rights and obligations retained, or created, in the transfer as assets and liabilities as appropriate.

# 12. PROVISION FOR CREDIT IMPAIRMENT

## PROVISION FOR CREDIT IMPAIRMENT - BALANCE SHEET

| | Net loans and advances | | Off-balance sheet credit related commitments | | Total | |
|---|---|---|---|---|---|---|
| Provision for credit impairment | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m |
| Individual provision | | | | | | |
| Balance at start of year | 887 | 942 | 16 | 15 | 903 | 957 |
| New and increased provisions | 1,175 | 1,467 | 12 | 1 | 1,187 | 1,468 |
| Write-backs | (337) | (348) | - | - | (337) | (348) |
| Bad debts written off (excluding recoveries) | (1,031) | (1,138) | - | - | (1,031) | (1,138) |
| Other[1] | 1 | (36) | (10) | - | (9) | (36) |
| Total individual provision | 695 | 887 | 18 | 16 | 713 | 903 |
| Collective provision | | | | | | |
| Balance at start of year | 1,625 | 1,678 | 434 | 493 | 2,059 | 2,171 |
| Charge/(release) to profit or loss | 14 | (24) | (27) | (42) | (13) | (66) |
| Other[2] | 14 | (29) | 7 | (17) | 21 | (46) |
| Total collective provision | 1,653 | 1,625 | 414 | 434 | 2,067 | 2,059 |
| Total provision for credit impairment | 2,348 | 2,512 | 432 | 450 | 2,780 | 2,962 |

1. Other individual provision includes an adjustment for exchange rate fluctuations and the impact of discount unwind on individual provisions.
2. Other collective provision includes the Asia Retail and Wealth business divestment and an adjustment for exchange rate fluctuations.

## CREDIT IMPAIRMENT CHARGE - INCOME STATEMENT

| Credit impairment charge | 2018 $m | 2017 $m |
|---|---|---|
| New and increased provisions | 1,187 | 1,468 |
| Write-backs | (337) | (348) |
| Recoveries of amounts previously written-off | (208) | (173) |
| Individual credit impairment charge | 642 | 947 |
| Collective credit impairment release | (13) | (66) |
| Total credit impairment charge | 629 | 881 |

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 12. PROVISION FOR CREDIT IMPAIRMENT (continued)

### RECOGNITION AND MEASUREMENT

The Company recognises two types of impairment provisions for its loans and advances:

- Individual provisions for significant assets that are assessed to be impaired; and
- Collective provisions for portfolios of similar assets that are assessed collectively for impairment.

The accounting treatment for each of them is detailed below:

| | Individually | Collectively |
|---|---|---|
| Assessment | If any impaired loans and advances exceed specified thresholds and an impairment event has been identified, then we assess the need for a provision individually. | To allow for any small value loans and advances where losses may have been incurred but not yet identified, and individually significant loans and advances that we do not assess as impaired, we assess them collectively in pools of assets with similar risk characteristics. |
| Impairment | Loans and advances are assessed as impaired if we have objective evidence that we may not recover principal or interest payments (that is, a loss event has been incurred). | We estimate the provision on the basis of historical loss experience for assets with similar credit risk characteristics to others in the respective collective pool. We adjust the historical loss experience based on current observable data – such as: changing economic conditions, the impact of the inherent risk of large concentrated losses within the portfolio and an assessment of the economic cycle. |
| Measurement | We measure impairment loss as the difference between the asset's carrying amount and estimated future cash flows discounted to their present value at the asset's original effective interest rate. We record the result as an expense in profit or loss in the period we identify the impairment and recognise a corresponding reduction in the carrying amount of loans and advances through an offsetting provision. | |
| Uncollectable amounts | If a loan or advance is uncollectable (whether partially or in full), then we write off the balance (and also any related provision for credit impairment).<br>We write off unsecured retail facilities at the earlier of the facility becoming 180 days past due, or the customer's bankruptcy or similar legal release from the obligation to repay the loan or advance. For secured facilities, write offs occur net of the proceeds determined to be recoverable from the realisation of collateral. | |
| Recoveries | If we recover any cash flows from loans and advances we have previously written off, then we recognise the recovery in profit or loss in the period the cash flows are received. | |
| Off-balance sheet amounts | Any off-balance sheet items, such as loan commitments, are considered for impairment both on an individual and collective basis. | |

### KEY JUDGEMENTS AND ESTIMATES

When we measure impairment of loans and advances, we use management's judgement of the extent of losses at reporting date.

| | Individually | Collectively |
|---|---|---|
| Key Judgements | • Estimated future cash flows<br>• Business prospects for the customer<br>• Realisable value of any collateral<br>• Company's position relative to other claimants<br>• Reliability of customer information<br>• Likely cost and duration of recovering loans | • Estimated future cash flows<br>• Historical loss experience of assets with similar risk characteristics<br>• Impact of large concentrated losses inherent in the portfolio<br>• Assessment of the economic cycle |

We regularly review our key judgements and update them to reflect actual loss experience.

## 13. DEPOSITS AND OTHER BORROWINGS

The table below shows our total deposits and other borrowings by type:

| | 2018 $m | 2017 $m |
|---|---|---|
| Certificates of deposit | 41,867 | 53,597 |
| Term deposits | 164,182 | 146,445 |
| On demand and short term deposits | 206,415 | 209,260 |
| Deposits not bearing interest | 13,794 | 12,389 |
| Deposits from banks and securities sold under repurchase agreements | 70,992 | 57,945 |
| Commercial paper | 14,742 | 14,599 |
| Deposits and other borrowings | 511,992 | 494,235 |
| *Residual contractual maturity:* | | |
| - to be settled within 1 year | 504,182 | 479,809 |
| - to be settled after 1 year | 7,810 | 14,426 |
| Deposits and other borrowings | 511,992 | 494,235 |
| *Carried on Balance Sheet at:* | | |
| Amortised cost | 511,937 | 494,162 |
| Fair value through profit or loss (designated on initial recognition) | 55 | 73 |
| Deposits and other borrowings | 511,992 | 494,235 |

### RECOGNITION AND MEASUREMENT

For deposits and other borrowings that are:

- not designated at fair value through profit or loss on initial recognition, we measure them at amortised cost and recognise their interest expense using the effective interest rate method; and
- managed on a fair value basis, reduce or eliminate an accounting mismatch or contain an embedded derivative, we designate them as fair value through profit or loss.

Refer to Note 16 Fair Value of Financial Assets and Financial Liabilities for details of the split between amortised cost and fair value.

For deposits and other borrowings designated at fair value we recognise the amount of fair value gain or loss attributable to changes in the Company's own credit risk in other comprehensive income in retained earnings. Any remaining amount of fair value gain or loss we recognise directly in profit or loss. Once we have recognised an amount in other comprehensive income, we do not later reclassify it to profit or loss.

Securities sold under repurchase agreements represent a liability to repurchase the financial assets that remain on our balance sheet since the risks and rewards of ownership remain with the Company. Over the life of the repurchase agreement, we recognise the difference between the sale price and the repurchase price and charge it to interest expense in the Income Statement.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 14. DEBT ISSUANCES

The Company uses a variety of funding programmes to issue senior debt (including covered bonds) and subordinated debt. The difference between senior debt and subordinated debt is that holders of senior debt take priority over holders of subordinated debt owed by the relevant issuer and subordinated debt will be repaid by the relevant issuer only after the repayment of claims of depositors, other creditors and the senior debt holders.

| | 2018 $m | 2017 $m |
|---|---|---|
| Senior debt | 68,951 | 54,046 |
| Covered bonds | 14,221 | 14,959 |
| **Total unsubordinated debt** | 83,172 | 69,005 |
| Subordinated debt | | |
| - Additional Tier 1 capital | 7,461 | 7,995 |
| - Tier 2 capital | 7,993 | 8,495 |
| **Total subordinated debt** | 15,454 | 16,490 |
| **Total debt issued** | 98,626 | 85,495 |

For further information relating to debt issuances, refer to the ANZ 2018 Group Annual Report (Note 15 Debt Issuances) available at https://shareholder.anz.com/annual-report-shareholder-review.

## 15. FINANCIAL RISK MANAGEMENT

### RISK MANAGEMENT FRAMEWORK AND MODEL

**INTRODUCTION**

The use of financial instruments is fundamental to the Company's businesses of providing banking and other financial services to our customers. The associated financial risks (primarily credit, market, and liquidity risks) are a significant portion of the Company's principal risks.

We disclose details of all principal risks impacting the Company, and further information on the Company's risk management activities, in the Our Approach to Risk Management section of the Directors' Report in the ANZ 2018 Group Annual Report available at https//shareholder.anz.com/annual-report-shareholder-review.

This note details the Company's financial risk management policies, processes and quantitative disclosures in relation to the key financial risks:

| Principal financial risks | Key sections applicable to this risk |
|---|---|
| **Overview** | • An overview of our Risk Management Framework |
| **Credit risk**<br>Credit risk is the risk of financial loss from a customer, or counterparty, failing to meet their financial obligations – including the whole and timely payment of principal, interest, and other receivables. | • Credit risk overview, management and control responsibilities<br>• Maximum exposure to credit risk<br>• Credit quality<br>• Concentrations of credit risk<br>• Collateral management |
| **Market risk**<br>Market risk is the risk of loss arising from potential adverse changes in the value of the Company's assets and liabilities and other trading positions from fluctuations in market variables. These variables include, but are not limited to interest rates, foreign exchange, equity prices, commodity prices, credit spreads, implied volatilities, and asset correlations. | • Market risk overview, management and control responsibilities<br>• Measurement of market risk<br>• Traded and non-traded market risk<br>• Equity securities classified as available-for-sale<br>• Foreign currency risk – structural exposure |
| **Liquidity and funding risk**<br>Liquidity risk is the risk that the Company is unable to meet its payment obligations when they fall due; or does not have the appropriate amount, tenor and composition of funding and liquidity to fund increases in its assets. | • Liquidity risk overview, management and control responsibilities<br>• Key areas of measurement for liquidity risk<br>• Funding position<br>• Residual contractual maturity analysis of the Company's liabilities |

# 15. FINANCIAL RISK MANAGEMENT (continued)

## OVERVIEW

### AN OVERVIEW OF OUR RISK MANAGEMENT FRAMEWORK

This overview is provided to aid the users of the financial statements to understand the context of the financial disclosures required under AASB 7 *Financial Instruments: Disclosures*. It should be read in conjunction with the Our Approach to Risk Management section of the Directors' Report in the ANZ 2018 Group Annual Report available at https//shareholder.anz.com/annual-report-shareholder-review.

The Board is responsible for establishing and overseeing the Company's Risk Management Framework (RMF). The Board has delegated authority to the Board Risk Committee (BRC) to develop and monitor compliance with the Company's risk management policies. The BRC reports regularly to the Board on its activities.

The Board approves the strategic objectives of the Company including:

- the Risk Appetite Statement (RAS), sets out the Board's expectations regarding the degree of risk that the Company is prepared to accept in pursuit of its strategic objectives and business plan; and
- the Risk Management Strategy (RMS), which describes the Company's strategy for managing risks and the key elements of the RMF that gives effect to this strategy. This includes a description of each material risk, and an overview of how the RMF addresses each risk, with reference to the relevant policies, standards and procedures. It also includes information on how the Company identifies measures, evaluates, monitors, reports and controls or mitigates material risks.

The Company, through its training and management standards and procedures, aims to maintain a disciplined and robust control environment in which all employees understand their roles and obligations. At the Company, risk is everyone's responsibility.

The Company has an independent risk management function, headed by the Chief Risk Officer who:

- is responsible for overseeing the risk profile and the risk management framework;
- can effectively challenge activities and decisions that materially affect the Company's risk profile; and
- has an independent reporting line to the BRC to enable the appropriate escalation of issues of concern.

The Internal Audit Function reports directly to the Board Audit Committee (BAC). Internal Audit provides:

- an independent evaluation of the Company's RMF annually and undertakes a comprehensive review every three years;
- assurance on the appropriateness, effectiveness and adequacy of the risk management framework, which includes assurance the framework is operating effectively; and
- recommendations to improve the framework and/or work practices to strengthen the effectiveness of day to day operations.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 15. FINANCIAL RISK MANAGEMENT (continued)

### CREDIT RISK

**CREDIT RISK OVERVIEW, MANAGEMENT AND CONTROL RESPONSIBILITIES**

Granting credit facilities to customers is one of the Company's major sources of income. As this activity is also a principal risk, the Company dedicates considerable resources to its management. The Company assumes credit risk in a wide range of lending and other activities in diverse markets and in many jurisdictions. Credit risks arise from traditional lending to customers as well as from inter-bank, treasury, trade finance and capital markets activities around the world.

Our credit risk management framework ensures we apply a consistent approach across the Company when we measure, monitor and manage the credit risk appetite set by the Board. The Board is assisted and advised by the BRC in discharging its duty to oversee credit risk. The BRC:

- sets the credit risk appetite and credit strategies; and
- approves credit transactions beyond the discretion of executive management.

We quantify credit risk through an internal credit rating system (masterscales) to ensure consistency across exposure types and to provide a consistent framework for reporting and analysis. The system uses models and other tools to measure the following for customer exposures:

| | |
|---|---|
| Probability of Default (PD) | Expressed by a Customer Credit Rating (CCR), reflecting the Company's assessment of a customer's ability to service and repay debt. |
| Exposure at Default (EAD) | The expected amount of loan outstanding at the time of default. |
| Loss Given Default (LGD) | Expressed by a Security Indicator (SI) ranging from A to G. The SI is calculated by reference to the percentage of loan covered by security which the Company can realise if a customer defaults. The A-G scale is supplemented by a range of other SIs which cover factors such as cash cover and sovereign backing. For retail and some small business customers, we group exposures into large homogenous pools – and the LGD is assigned at the pool level. |

Our specialist credit risk teams develop and validate the Company's PD and LGD rating models. The outputs from these models drive our day-to-day credit risk management decisions including origination, pricing, approval levels, regulatory capital adequacy, economic capital allocation, and credit provisioning.

All customers with whom the Company has a credit relationship are assigned a CCR at origination via either of the following assessment approaches:

| Large and more complex lending | Retail and some small business lending |
|---|---|
| Rating models provide a consistent and structured assessment, with judgement required around the use of out-of-model factors. We handle credit approval on a dual approval basis, jointly with the business writer and an independent credit officer. | Automated assessment of credit applications using a combination of scoring (application and behavioural), policy rules and external credit reporting information. If the application does not meet the automated assessment criteria, then it is referred out for manual assessment. |

We use the Company's internal CCRs to manage the credit quality of financial assets neither past due nor impaired. To enable wider comparisons, the Company's CCRs are mapped to external rating agency scales as follows:

| Internal Rating | ANZ Customer Requirements | Moody's Rating | Standard & Poor's Rating |
|---|---|---|---|
| Strong credit profile | Demonstrated superior stability in their operating and financial performance over the long-term, and whose earnings capacity is not significantly vulnerable to foreseeable events. | Aaa – Baa3 | AAA – BBB- |
| Satisfactory risk | Demonstrated sound operational and financial stability over the medium to long-term — even though some may be susceptible to cyclical trends or variability in earnings. | Ba1 – B1 | BB+ – B+ |
| Sub-standard but not past due nor impaired | Demonstrated some operational and financial instability, with variability and uncertainty in profitability and liquidity projected to continue over the short and possibly medium term. | B2 - Caa | B - CCC |

## 15. FINANCIAL RISK MANAGEMENT (continued)

### CREDIT RISK (continued)

#### MAXIMUM EXPOSURE TO CREDIT RISK

For financial assets recognised on the balance sheet, the maximum exposure to credit risk is the carrying amount. In certain circumstances there may be differences between the carrying amounts reported on the balance sheet and the amounts reported in the tables below. Principally, these differences arise in respect of financial assets that are subject to risks other than credit risk, such as equity instruments which are primarily subject to market risk, or bank notes and coins.

For undrawn facilities, this maximum exposure to credit risk is the full amount of the committed facilities. For contingent exposures, the maximum exposure to credit risk is the maximum amount the Company would have to pay if the instrument is called upon.

The table below shows our maximum exposure to credit risk of on-balance sheet and off-balance sheet positions before taking account of any collateral held or other credit enhancements:

| | Reported | | Excluded[1]/Other[2] | | Maximum exposure to credit risk | |
|---|---|---|---|---|---|---|
| | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m |
| On-balance sheet positions | | | | | | |
| Net loans and advances[2] | 475,419 | 452,424 | (432) | (450) | 475,851 | 452,874 |
| Other financial assets: | | | | | | |
| Cash and cash equivalents | 80,227 | 63,399 | 912 | 1,096 | 79,315 | 62,303 |
| Settlement balances owed to ANZ[3] | 1,666 | 5,006 | 1,666 | 5,006 | - | - |
| Collateral paid | 9,184 | 7,685 | - | - | 9,184 | 7,685 |
| Trading securities | 29,519 | 35,606 | 3,486 | 4,653 | 26,033 | 30,953 |
| Derivative financial instruments | 64,448 | 57,036 | - | - | 64,448 | 57,036 |
| Available-for-sale assets | 64,728 | 58,506 | 1,084 | 725 | 63,644 | 57,781 |
| Regulatory deposits | 264 | 495 | - | - | 264 | 495 |
| Due from controlled entities | 90,170 | 91,208 | - | - | 90,170 | 91,208 |
| Other financial assets[4] | 2,177 | 2,040 | - | - | 2,177 | 2,040 |
| Total other financial assets | 342,383 | 320,981 | 7,148 | 11,480 | 335,235 | 309,501 |
| Subtotal | 817,802 | 773,405 | 6,716 | 11,030 | 811,086 | 762,375 |
| Off-balance sheet positions | | | | | | |
| Undrawn and contingent facilities[2,5] | 203,483 | 187,291 | 432 | 450 | 203,051 | 186,841 |
| Total | 1,021,285 | 960,696 | 7,148 | 11,480 | 1,014,137 | 949,216 |

1. Excluded comprises bank notes and coins and cash at bank within cash and cash equivalents, and equity securities within available-for-sale financial assets. Equity securities and precious metal exposures recognised as trading securities have been excluded as they do not have credit exposure.
2. Other relates to the transfer of individual and collective provisions for credit impairment, related to off-balance sheet facilities held in net loans and advances. The provisions are transferred for the purposes of showing the maximum exposure to credit risk by relevant facility type in this and the following tables.
3. Settlement balances owed to ANZ relating to trade dated assets which do not carry credit risk and thus are excluded.
4. Other financial assets mainly comprise accrued interest and acceptances.
5. Undrawn facilities and contingent facilities includes guarantees, letters of credit and performance related contingencies.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 15. FINANCIAL RISK MANAGEMENT (continued)

### CREDIT RISK (continued)

#### CREDIT QUALITY

The table below provides an analysis of the credit quality of the maximum exposure to credit risk split by:

- neither past due nor impaired financial assets by credit quality;
- past due but not impaired assets by ageing; and
- restructured and impaired assets presented as gross amounts and net of individual provisions.

| | Loans and advances | | Other financial assets | | Off-balance sheet credit related commitments | | Total | |
|---|---|---|---|---|---|---|---|---|
| | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m |
| Neither past due nor impaired | | | | | | | | |
| Strong credit profile[1] | 350,031 | 323,613 | 333,962 | 308,116 | 173,688 | 154,941 | 857,681 | 786,670 |
| Satisfactory risk[2] | 98,222 | 101,510 | 1,185 | 1,285 | 27,996 | 30,361 | 127,403 | 133,156 |
| Sub-standard but not past due or impaired[3] | 13,348 | 14,160 | 88 | 100 | 1,337 | 1,471 | 14,773 | 15,731 |
| Sub-total | 461,601 | 439,283 | 335,235 | 309,501 | 203,021 | 186,773 | 999,857 | 935,557 |
| Past due but not impaired | | | | | | | | |
| ≥ 1 < 30 days | 7,456 | 7,231 | - | - | - | - | 7,456 | 7,231 |
| ≥ 30 < 60 days | 2,067 | 1,841 | - | - | - | - | 2,067 | 1,841 |
| ≥ 60 < 90 days | 1,138 | 1,005 | - | - | - | - | 1,138 | 1,005 |
| ≥ 90 days | 2,780 | 2,706 | - | - | - | - | 2,780 | 2,706 |
| Sub-total | 13,441 | 12,783 | - | - | - | - | 13,441 | 12,783 |
| Restructured and impaired | | | | | | | | |
| Impaired loans | 1,256 | 1,624 | - | - | - | - | 1,256 | 1,624 |
| Restructured items[4] | 248 | 71 | - | - | - | - | 248 | 71 |
| Non-performing commitments and contingencies | - | - | - | - | 48 | 84 | 48 | 84 |
| Gross impaired financial assets | 1,504 | 1,695 | - | - | 48 | 84 | 1,552 | 1,779 |
| Individual provisions | (695) | (887) | - | - | (18) | (16) | (713) | (903) |
| Sub-total restructured and net impaired | 809 | 808 | - | - | 30 | 68 | 839 | 876 |
| Total | 475,851 | 452,874 | 335,235 | 309,501 | 203,051 | 186,841 | 1,014,137 | 949,216 |

1. In 2018, collective provisions against Satisfactory and Sub-standard risk, which previously had been allocated against Strong credit profile are now reallocated to Satisfactory and Sub-standard risk. Comparatives have been restated accordingly.
2. In 2018, collective provisions against Satisfactory and Sub-standard risk, which previously had been allocated against Strong credit profile are now reallocated to Satisfactory and Sub-standard risk. Comparatives have been restated accordingly (Sep 17: Net loans and advances $438 million, Credit related commitments $139 million).
3. In 2018, collective provisions against Satisfactory and Sub-standard risk, which previously had been allocated against Strong credit profile are now reallocated to Satisfactory and Sub-standard risk. Comparatives have been restated accordingly (Sep 17: Net loans and advances $438 million, Credit related commitments $61 million).
4. Restructured items are facilities in which the original contractual terms have been modified for reasons related to the financial difficulties of the customer. Restructuring may consist of reduction of interest, principal or other payments legally due, or an extension in maturity materially beyond those typically offered for new facilities with similar risk.

## 15. FINANCIAL RISK MANAGEMENT (continued)

### CREDIT RISK (continued)

#### CONCENTRATIONS OF CREDIT RISK

Credit risk becomes concentrated when a number of customers are engaged in similar activities, have similar economic characteristics, or have similar activities within the same geographic region – therefore, they may be similarly affected by changes in economic or other conditions. The Company monitors its credit portfolio to manage risk concentration and rebalance the portfolio. The Company also applies single customer counterparty limits to protect against unacceptably large exposures to one single customer.

Composition of financial instruments that give rise to credit risk by industry group are presented below:

| | Loans and advances | | Other financial assets | | Off-balance sheet credit related commitments | | Total | |
|---|---|---|---|---|---|---|---|---|
| | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m |
| Agriculture, forestry, fishing and mining | 19,658 | 17,346 | 538 | 528 | 15,317 | 13,450 | 35,513 | 31,324 |
| Business services | 7,158 | 7,044 | 82 | 137 | 5,989 | 6,319 | 13,229 | 13,500 |
| Construction | 5,101 | 5,273 | 32 | 37 | 5,379 | 5,209 | 10,512 | 10,519 |
| Electricity, gas and water supply | 4,916 | 4,800 | 534 | 752 | 4,508 | 4,537 | 9,958 | 10,089 |
| Entertainment, leisure and tourism | 10,652 | 10,679 | 305 | 317 | 3,118 | 3,151 | 14,075 | 14,147 |
| Financial, investment and insurance | 43,245 | 34,256 | 262,203 | 236,975 | 35,326 | 27,690 | 340,774 | 298,921 |
| Government and official institutions | 748 | 846 | 63,225 | 61,440 | 2,043 | 2,016 | 66,016 | 64,302 |
| Manufacturing | 16,926 | 14,838 | 1,815 | 1,902 | 33,298 | 29,926 | 52,039 | 46,666 |
| Personal lending | 288,127 | 282,823 | 1,070 | 1,038 | 42,982 | 45,856 | 332,179 | 329,717 |
| Property services | 33,576 | 30,595 | 484 | 559 | 13,584 | 11,065 | 47,644 | 42,219 |
| Retail trade | 10,959 | 11,150 | 105 | 187 | 5,458 | 4,974 | 16,522 | 16,311 |
| Transport and storage | 10,204 | 9,805 | 459 | 959 | 6,606 | 5,598 | 17,269 | 16,362 |
| Wholesale trade | 11,946 | 11,013 | 2,644 | 2,225 | 17,725 | 16,542 | 32,315 | 29,780 |
| Other | 14,438 | 14,316 | 1,739 | 2,445 | 12,150 | 10,958 | 28,327 | 27,719 |
| Gross total | 477,654 | 454,784 | 335,235 | 309,501 | 203,483 | 187,291 | 1,016,372 | 951,576 |
| Provision for credit impairment | (2,348) | (2,512) | - | - | (432) | (450) | (2,780) | (2,962) |
| Subtotal | 475,306 | 452,272 | 335,235 | 309,501 | 203,051 | 186,841 | 1,013,592 | 948,614 |
| Unearned income | (165) | (149) | - | - | - | - | (165) | (149) |
| Capitalised brokerage/mortgage origination fees | 710 | 751 | - | - | - | - | 710 | 751 |
| Maximum exposure to credit risk | 475,851 | 452,874 | 335,235 | 309,501 | 203,051 | 186,841 | 1,014,137 | 949,216 |

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 15. FINANCIAL RISK MANAGEMENT (continued)

### CREDIT RISK (continued)

#### COLLATERAL MANAGEMENT

We use collateral for on and off-balance sheet exposures to mitigate credit risk if a counterparty cannot meet its repayment obligations from its expected cashflows. For some products, the collateral provided by customers is fundamental to the product's structuring, so it is not strictly the secondary source of repayment - for example, lending secured by trade receivables is typically repaid by the collection of those receivables.

The nature of collateral or security held for the relevant classes of financial assets is as follows:

| Net loans and advances | |
|---|---|
| Loans – housing and personal | Housing loans are secured by mortgage(s) over property and additional security may take the form of guarantees and deposits.<br>Personal lending (including credit cards and overdrafts) is predominantly unsecured. If we take security, then it is restricted to eligible vehicles, motor homes and other assets. |
| Loans – business | Business loans may be secured, partially secured or unsecured. Typically, we take security by way of a mortgage over property and/or a charge over the business or other assets.<br>If appropriate, we may take other security to mitigate the credit risk, for example: guarantees, standby letters of credit or derivative protection. |
| **Other financial assets** | |
| Trading securities, Available-for-sale assets, Derivatives and Other financial assets | For trading securities, we do not seek collateral directly from the issuer or counterparty. However, the collateral may be implicit in the terms of the instrument (for example, with an asset-backed security). The terms of debt securities may include collateralisation.<br>For derivatives, we typically terminate all contracts with the counterparty and settle on a net basis at market levels current at the time of a counterparty default under International Swaps and Derivatives Association (ISDA) Master Agreements.<br>Our preferred practice is to use a Credit Support Annex (CSA) to the ISDA so that open derivative positions with the counterparty are aggregated and cash collateral (or other forms of eligible collateral) is exchanged daily. The collateral is provided by the counterparty when their position is out of the money (or provided to the counterparty by the Company when our position is out of the money). |
| **Off-balance sheet positions** | |
| Undrawn and contingent liabilities. | Collateral for off balance sheet positions is mainly held against undrawn facilities, and they are typically performance bonds or guarantees. Undrawn facilities that are secured include housing loans secured by mortgages over residential property and business lending secured by commercial real estate and/or charges over business assets. |

The table below shows the estimated value of collateral we hold and the net unsecured portion of credit exposures:

| | Credit exposure | | Total value of collateral | | Unsecured portion of credit exposure | |
|---|---|---|---|---|---|---|
| | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m |
| Net loans and advances | 475,851 | 452,874 | 372,996 | 364,745 | 102,855 | 88,129 |
| Other financial assets | 335,235 | 309,501 | 30,166 | 22,705 | 305,069 | 286,796 |
| Off-balance sheet positions | 203,051 | 186,841 | 34,072 | 31,696 | 168,979 | 155,145 |
| **Total** | 1,014,137 | 949,216 | 437,234 | 419,146 | 576,903 | 530,070 |

# 15. FINANCIAL RISK MANAGEMENT (continued)

## MARKET RISK

### MARKET RISK OVERVIEW, MANAGEMENT AND CONTROL RESPONSIBILITIES

Market risk stems from the Company's trading and balance sheet management activities, the impact of changes and correlation between interest rates, foreign exchange rates, credit spreads and volatility in bond, commodity or equity prices.

The BRC delegates responsibility for day-to-day management of both market risks and compliance with market risk policies to the Credit & Market Risk Committee (CMRC) and the Group Asset & Liability Committee (GALCO).

Within overall strategies and policies established by the BRC, business units and risk management have joint responsibility for the control of market risk at the Company level. The Market Risk team (a specialist risk management unit independent of the business) allocates market risk limits at various levels and monitors and reports on them daily. This detailed framework allocates individual limits to manage and control exposures using risk factors and profit and loss limits.

Management, measurement and reporting of market risk, the management of market risk is undertaken in two broad categories:

| Traded Market Risk | Non-Traded Market Risk |
|---|---|
| Risk of loss from changes in the value of financial instruments due to movements in price factors for both physical and derivative trading positions. Principal risk categories monitored are:<br>1. Currency risk – potential loss arising from changes in foreign exchange rates or their implied volatilities.<br>2. Interest rate risk – potential loss from changes in market interest rates or their implied volatilities.<br>3. Credit spread risk – potential loss arising from a movement in margin or spread relative to a benchmark.<br>4. Commodity risk – potential loss arising from changes in commodity prices or their implied volatilities.<br>5. Equity risk – potential loss arising from changes in equity prices. | Risk of loss associated with the management of non-traded interest rate risk, liquidity risk and foreign exchange exposures. This includes interest rate risk in the banking book. This risk of loss arises from adverse changes in the overall and relative level of interest rates for different tenors, differences in the actual versus expected net interest margin, and the potential valuation risk associated with embedded options in financial instruments and bank products. |

### MEASUREMENT OF MARKET RISK

We primarily manage and control market risk using Value at Risk (VaR), sensitivity analysis and stress testing.

VaR gauges the Company's possible daily loss based on historical market movements.

The Company's VaR approach for both traded and non-traded risk is historical simulation. We use historical changes in market rates, prices and volatilities over:

- the previous 500 business days, to calculate standard VaR; and
- a 1-year stressed period, to calculate stressed VaR.

We calculate traded and non-traded VaR using one-day and ten-day holding periods. For stressed VaR, we use a ten-day period. Back testing is used to ensure our VaR models remain accurate.

The Company measures VaR at a 99% confidence interval which means there is a 99% chance that a loss will not exceed the VaR for the relevant holding period.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 15. FINANCIAL RISK MANAGEMENT (continued)

### MARKET RISK (continued)

**TRADED AND NON-TRADED MARKET RISK**

**Traded market risk**

The table below shows the traded market risk VaR on a diversified basis by risk categories:

| | 30 September 2018 | | | | 30 September 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | As at $m | High for year $m | Low for year $m | Average for year $m | As at $m | High for year $m | Low for year $m | Average for year $m |
| Traded value at risk 99% confidence | | | | | | | | |
| Foreign exchange | 2.9 | 9.8 | 1.7 | 4.0 | 4.3 | 10.0 | 2.6 | 5.1 |
| Interest rate | 8.2 | 14.9 | 4.8 | 7.4 | 5.6 | 18.9 | 4.7 | 7.2 |
| Credit | 2.0 | 6.2 | 2.0 | 3.7 | 4.1 | 5.1 | 1.6 | 3.2 |
| Commodity | 3.5 | 4.4 | 1.1 | 2.9 | 2.2 | 3.8 | 1.4 | 2.1 |
| Equity | - | - | - | - | - | 0.5 | - | 0.2 |
| Diversification benefit[1] | (9.1) | n/a | n/a | (7.8) | (6.1) | n/a | n/a | (7.6) |
| Total VaR | 7.5 | 16.9 | 5.8 | 10.2 | 10.1 | 20.8 | 6.3 | 10.2 |

1. The diversification benefit reflects risks that offset across categories. The high and low VaR figures reported for each factor did not necessarily occur on the same day as the high and low VaR reported for the Company as a whole. Consequently, a diversification benefit for high and low would not be meaningful and is therefore omitted from the table.

**Non-traded market risk**

**Balance sheet risk management**

The principal objectives of balance sheet risk management are to maintain acceptable levels of interest rate and liquidity risk to mitigate the negative impact of movements in interest rates on the earnings and market value of the Company's banking book, while ensuring the Company maintains sufficient liquidity to meet its obligations as they fall due.

**Interest rate risk management**

Non-traded interest rate risk relates to the potential adverse impact of changes in market interest rates on the Company's future net interest income. This risk arises from two principal sources, namely mismatches between the repricing dates of interest bearing assets and liabilities; and the investment of capital and other non-interest bearing liabilities in interest bearing assets. Interest rate risk is reported using VaR and scenario analysis (based on the impact of a 1% rate shock). The table below shows VaR figures for non-traded interest rate risk for the combined Company as well as Australia, New Zealand and Asia Pacific, Europe and Americas (APEA) geographies which are calculated separately.

| | 30 September 2018 | | | | 30 September 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | As at $m | High for year $m | Low for year $m | Average for year $m | As at $m | High for year $m | Low for year $m | Average for year $m |
| Non-traded value at risk 99% confidence | | | | | | | | |
| Australia | 21.9 | 32.7 | 20.3 | 23.6 | 31.6 | 37.5 | 25.9 | 31.3 |
| New Zealand | - | 0.2 | - | - | - | 0.1 | - | 0.1 |
| APEA | 15.5 | 15.5 | 12.5 | 14.0 | 13.7 | 18.6 | 13.5 | 15.3 |
| Diversification benefit[1] | (11.8) | n/a | n/a | (9.6) | (13.3) | n/a | n/a | (9.3) |
| Total VaR | 25.6 | 35.2 | 22.3 | 28.0 | 32.0 | 43.7 | 31.3 | 37.4 |

1. The diversification benefit reflects the historical correlation between the regions. The high and low VaR figures reported for the region did not necessarily occur on the same day as the high and low VaR reported for the Company as a whole. Consequently, a diversification benefit for high and low would not be meaningful and is therefore omitted from the table.

## 15. FINANCIAL RISK MANAGEMENT (continued)

### MARKET RISK (continued)

We undertake scenario analysis to stress test the impact of extreme events on the Company's market risk exposures. We model a 1% overnight parallel positive shift in the yield curve to determine the potential impact on our net interest income over the next 12 months. This is a standard risk measure which assumes the parallel shift is reflected in all wholesale and customer rates.

The table below shows the outcome of this risk measure for the current and previous financial years, expressed as a percentage of reported net interest income. A positive number signifies that a rate increase is positive for net interest income over the next 12 months.

| | 2018 | 2017 |
|---|---|---|
| Impact of 1% rate shock | | |
| As at period end | 0.15% | 0.14% |
| Maximum exposure | 0.76% | 1.20% |
| Minimum exposure | 0.02% | 0.13% |
| Average exposure (in absolute terms) | 0.30% | 0.53% |

#### EQUITY SECURITIES CLASSIFIED AS AVAILABLE-FOR-SALE

Our available-for-sale financial assets contain equity investment holdings which predominantly comprise investments we hold for longer-term strategic reasons. The market risk impact on these equity investments is not captured by the Company's VaR processes for traded and non-traded market risks. Therefore, the Company regularly reviews the valuations of the investments within the portfolio and assesses whether the investments are impaired based on the recognition and measurement policies set out in Note 10 Available-for-sale Assets.

#### FOREIGN CURRENCY RISK – STRUCTURAL EXPOSURES

Our investment of capital in foreign operations — for example, branches, subsidiaries or associates with functional currencies other than the Australian Dollar — exposes the Company to the risk of changes in foreign exchange rates. Variations in the value of these foreign operations arising as a result of exchange differences are reflected in the foreign currency translation reserve in equity.

Where it is considered appropriate, the Company takes out economic hedges against larger foreign exchange denominated revenue streams (primarily New Zealand Dollar, US dollar and US dollar correlated). The primary objective of hedging is to ensure that, if practical, the consolidated capital ratios are neutral to the effect of changes in exchange rates.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 15. FINANCIAL RISK MANAGEMENT (continued)

### LIQUIDITY AND FUNDING RISK

**LIQUIDITY RISK AND FUNDING POSITION**

For information related to the liquidity risk and funding position refer to the ANZ 2018 Group Annual Report (Note 16 Financial Risk Management), available at https://shareholder.anz.com/annual-report-shareholder-review.

**RESIDUAL CONTRACTUAL MATURITY ANALYSIS OF THE COMPANY'S LIABILITIES**

The table below provides residual contractual maturity analysis of financial liabilities at 30 September within relevant maturity groupings. The table below excludes "Due to controlled entities" liabilities of $88.4 billion (2017: $88.9 billion) as the contractual maturity is linked to the repayment of underlying assets which are managed on a pool basis which is continuously reviewed. All outstanding Debt Issuance and Subordinated Debt is profiled on the earliest date on which the Company may be required to pay. All at-call liabilities are reported in the "Less than 3 month" category. Any other items without a specified maturity date are included in the "After 5 years" category. The amounts represent principal and interest cash flows - so they may differ from equivalent amounts reported on balance sheet. It should be noted that this is not how the Company manages its liquidity risk. The management of this risk is detailed in the ANZ 2018 Group Annual Report (Note 16 Financial Risk Management), available at https://shareholder.anz.com/annual-report-shareholder-review.

| 2018 | Less than 3 months $m | 3 to 12 months $m | 1 to 5 years $m | After 5 years $m | Total $m |
|---|---|---|---|---|---|
| Settlement balances owed by ANZ | 9,867 | - | - | - | 9,867 |
| Collateral received | 6,002 | - | - | - | 6,002 |
| Deposits and other borrowings | 440,725 | 65,446 | 7,918 | 116 | 514,205 |
| Liability for acceptances | 316 | - | - | - | 316 |
| Debt issuances[1] | 4,563 | 17,946 | 67,787 | 19,826 | 110,122 |
| Derivative liabilities (trading)[2] | 58,784 | - | - | - | 58,784 |
| Derivative assets and liabilities (balance sheet management) | | | | | |
| - Funding | | | | | |
| Receive leg | (13,221) | (26,116) | (66,671) | (30,071) | (136,079) |
| Pay leg | 13,193 | 25,122 | 64,316 | 30,005 | 132,636 |
| - Other balance sheet management | | | | | |
| Receive leg | (50,237) | (13,492) | (10,249) | (1,469) | (75,447) |
| Pay leg | 50,479 | 13,626 | 10,763 | 1,634 | 76,502 |

| 2017 | Less than 3 months $m | 3 to 12 months $m | 1 to 5 years $m | After 5 years $m | Total $m |
|---|---|---|---|---|---|
| Settlement balances owed by ANZ | 8,219 | - | - | - | 8,219 |
| Collateral received | 5,238 | - | - | - | 5,238 |
| Deposits and other borrowings | 410,672 | 70,910 | 14,819 | 145 | 496,546 |
| Liability for acceptances | 312 | - | - | - | 312 |
| Debt issuances[1] | 3,030 | 12,242 | 59,673 | 20,751 | 95,696 |
| Derivative liabilities (trading)[2] | 48,561 | - | - | - | 48,561 |
| Derivative assets and liabilities (balance sheet management) | | | | | |
| - Funding | | | | | |
| Receive leg | (12,433) | (14,536) | (66,440) | (24,247) | (117,656) |
| Pay leg | 12,174 | 14,254 | 66,670 | 24,579 | 117,677 |
| - Other balance sheet management | | | | | |
| Receive leg | (24,186) | (6,277) | (10,876) | (4,368) | (45,707) |
| Pay leg | 24,312 | 6,522 | 12,587 | 4,868 | 48,289 |

1. Any callable wholesale debt instruments have been included at their next call date. Balance includes subordinated debt instruments that may be settled in cash or in equity, at the option of the Company, and perpetual investments at next call date.
2. The full mark-to-market of derivative liabilities held for trading purposes is included in the 'less than 3 months' category.

At 30 September 2018 $164,944 million (2017: $150,339 million) of the Company's undrawn facilities and $38,539 million (2017: $36,952 million) of its issued guarantees mature in less than 1 year, based on the earliest date on which the Company may be required to pay.

## 16. FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Company carries a significant number of financial instruments on the balance sheet at fair value. The fair value is the best estimate of 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 measurement date.

### VALUATION

The Company has an established control framework, including appropriate segregation of duties, to ensure that fair values are accurately determined, reported and controlled. The framework includes the following features:

- products are approved for transacting with external customers and counterparties only where fair values can be appropriately determined;
- quoted market prices used to value financial instruments are independently verified with information from external pricing providers;
- fair value methodologies and inputs are evaluated and approved by a function independent of the party that undertakes the transaction;
- movements in fair values are independently monitored and explained by reference to underlying factors relevant to the fair value; and
- valuation adjustments (such as funding valuation adjustments, credit valuation adjustments and bid-offer adjustments) are independently validated and monitored.

If the Company holds offsetting risk positions, then the Company uses the portfolio exemption in AASB 13 *Fair Value Measurement* (AASB 13) to measure the fair value of such groups of financial assets and financial liabilities. We measure the portfolio based on the price that would be received to sell a net long position (an asset) for a particular risk exposure, or to transfer a net short position (a liability) for a particular risk exposure.

#### Fair value designation

We designate certain loans and advances and certain deposits and other borrowings and debt issuances as fair value through profit or loss:

- where they contain a separable embedded derivative which significantly modifies the instruments' cash flow; or
- in order to eliminate an accounting mismatch which would arise if the asset or liabilities were otherwise carried at amortised cost. This mismatch arises as we measure the derivative financial instruments (which we acquired to mitigate interest rate risk of the assets or liabilities) at fair value through profit or loss.

Our approach ensures that we recognise the fair value movements on the assets or liabilities in profit or loss in the same period as the movement on the associated derivatives.

We may also designate certain loans and advances and certain deposits and other borrowings and debt issuances as fair value through profit or loss where they are managed on a fair value basis to align the measurement with how the instruments are managed.

### FAIR VALUE APPROACH AND VALUATION TECHNIQUES

We use valuation techniques to estimate the fair value of assets and liabilities for recognition, measurement and disclosure purposes where no quoted price in an active market exists for that asset or liability. This includes the following:

| Asset or Liability | Fair Value Approach |
|---|---|
| Financial instruments classified as:<br>- Trading securities<br>- Securities sold short<br>- Derivative financial assets and liabilities<br>- Available-for-sale assets | Valuation techniques are used that incorporate observable market inputs for financial instruments with similar credit risk, maturity and yield characteristics. Equity instruments that are not traded in active markets may be measured using comparable company valuation multiples. |
| Financial instruments classified as:<br>- Net loans and advances<br>- Deposits and other borrowings<br>- Debt issuances | Discounted cash flow techniques are used whereby contractual future cash flows of the instruments are discounted using wholesale market interest rates, or market borrowing rates for debt with similar maturities or yield curve appropriate for the remaining term to maturity. |
| Assets held for sale | Valuation based on the expected sale price before transaction costs. |

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 16. FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (continued)

### CLASSIFICATION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The following tables set out the classification of financial asset and liability categories according to measurement bases together with their carrying amounts as reported on the balance sheet.

| | | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|---|
| | Note | At amortised cost $m | At fair value $m | Total $m | At amortised cost $m | At fair value $m | Total $m |
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | 7 | 80,227 | - | 80,227 | 63,399 | - | 63,399 |
| Settlement balances owed to ANZ | | 1,666 | - | 1,666 | 5,006 | - | 5,006 |
| Collateral paid | | 9,184 | - | 9,184 | 7,685 | - | 7,685 |
| Trading securities | 8 | - | 29,519 | 29,519 | - | 35,606 | 35,606 |
| Derivative financial instruments | 9 | - | 64,448 | 64,448 | - | 57,036 | 57,036 |
| Available-for-sale assets | 10 | - | 64,728 | 64,728 | - | 58,506 | 58,506 |
| Net loans and advances | 11 | 475,418 | 1 | 475,419 | 452,408 | 16 | 452,424 |
| Regulatory deposits | | 264 | - | 264 | 495 | - | 495 |
| Due from controlled entities | | 90,170 | - | 90,170 | 91,208 | - | 91,208 |
| Other financial assets | | 2,023 | - | 2,023 | 1,917 | - | 1,917 |
| Assets held for sale | | - | - | - | - | 1,748 | 1,748 |
| **Total** | | 658,952 | 158,696 | 817,648 | 622,118 | 152,912 | 775,030 |
| **Financial liabilities** | | | | | | | |
| Settlement balances owed by ANZ | | 9,867 | - | 9,867 | 8,219 | - | 8,219 |
| Collateral received | | 6,002 | - | 6,002 | 5,238 | - | 5,238 |
| Deposits and other borrowings | 13 | 511,937 | 55 | 511,992 | 494,162 | 73 | 494,235 |
| Derivative financial instruments | 9 | - | 65,638 | 65,638 | - | 56,830 | 56,830 |
| Due to controlled entities | | 88,383 | - | 88,383 | 88,882 | - | 88,882 |
| Payables and other liabilities | | 3,942 | 1,060 | 5,002 | 3,930 | 1,753 | 5,683 |
| Debt issuances | 14 | 97,184 | 1,442 | 98,626 | 83,743 | 1,752 | 85,495 |
| **Total** | | 717,315 | 68,195 | 785,510 | 684,174 | 60,408 | 744,582 |

### FAIR VALUE HIERARCHY

The Company categorises assets and liabilities carried at fair value into a fair value hierarchy as required by AASB 13 based on the observability of inputs used to measure the fair value:

- Level 1 – valuations based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – valuations using inputs other than quoted prices included within Level 1 that are observable for a similar asset or liability, either directly or indirectly; and
- Level 3 – valuations where significant unobservable inputs are used to measure the fair value of the asset or liability.

## 16. FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (continued)

The following table presents assets and liabilities carried at fair value in accordance with the fair value hierarchy:

| | Fair value measurements | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Quoted market price (Level 1) | | Using observable inputs (Level 2) | | Using unobservable inputs (Level 3) | | Total | |
| | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m |
| **Assets** | | | | | | | | |
| Trading securities[1] | **23,969** | 32,998 | **5,550** | 2,608 | **-** | - | **29,519** | 35,606 |
| Derivative financial instruments | **630** | 424 | **63,764** | 56,527 | **54** | 85 | **64,448** | 57,036 |
| Available-for-sale assets[1] | **61,655** | 53,958 | **1,996** | 4,504 | **1,077** | 44 | **64,728** | 58,506 |
| Net loans and advances (measured at fair value) | **-** | - | **1** | 16 | **-** | - | **1** | 16 |
| Assets held for sale | **-** | - | **-** | 1,748 | **-** | - | **-** | 1,748 |
| **Total** | **86,254** | 87,380 | **71,311** | 65,403 | **1,131** | 129 | **158,696** | 152,912 |
| **Liabilities** | | | | | | | | |
| Deposits and other borrowings (designated at fair value) | **-** | - | **55** | 73 | **-** | - | **55** | 73 |
| Derivative financial instruments | **1,666** | 250 | **63,929** | 56,504 | **43** | 76 | **65,638** | 56,830 |
| Payables and other liabilities[2] | **1,048** | 1,587 | **12** | 166 | **-** | - | **1,060** | 1,753 |
| Debt issuances (designated at fair value) | **-** | - | **1,442** | 1,752 | **-** | - | **1,442** | 1,752 |
| **Total** | **2,714** | 1,837 | **65,438** | 58,495 | **43** | 76 | **68,195** | 60,408 |

1. Of the assets and liabilities held at the end of 2018, during the year, we transferred:
   - $676 million (2017: nil) from Level 1 to Level 3 following a change in the valuation approach used to measure the investment in Bank of Tianjin;
   - $783 million (2017: nil) from Level 2 to Level 1 following increased trading activity to support the quoted prices;
   - There was no material transfer from Level 1 to Level 2 (2017: $408 million).

   Transfers into and out of levels are measured at the beginning of the reporting period in which the transfer occurred.
2. Payables and other liabilities relates to securities sold short, which we classify as held for trading and measured at fair value through profit or loss.

### FAIR VALUE MEASUREMENT INCORPORATING UNOBSERVABLE MARKET DATA

**Level 3 fair value measurements**

The net balance of Level 3 is an asset of $1,088 million (2017: $53 million). The assets and liabilities which incorporate significant unobservable inputs primarily include:

- equities for which there is no active market or traded prices cannot be observed;
- structured credit products for which credit spreads and default probabilities relating to the reference assets and derivative counterparties cannot be observed;
- other derivatives referencing market rates that cannot be observed primarily due to lack of market activity.

Movement in the Level 3 balance is due to transfer of our available-for-sale investment in Bank of Tianjin to Level 3 following a change in the valuation approach used to measure the asset.

There were no other material transfers in or out of Level 3 during the period.

*Bank of Tianjin (BoT)*

A revised valuation technique was applied to the investment in BoT as the Company considers that, in light of persistent illiquidity, the share price of BoT is not representative of fair value. The investment is valued based on comparative price-to-book (P/B) multiples (a P/B multiple is the ratio of the market value of equity to the book value of equity). The extent of judgement applied in determining the appropriate multiple and comparator group from which the multiple is derived are non-observable inputs which have resulted in the Level 3 classification. The application of this valuation approach resulted in a $349 million increase in the carrying value of the investment during the period to $1,025 million. The increase has been recognised as an unrealised gain in the available-for-sale revaluation reserve within shareholders' equity and accordingly, there is no impact from this revaluation on the Income Statement for the year ended 30 September 2018.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 16. FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (continued)

***Sensitivity to Level 3 data inputs***

When we make assumptions due to significant inputs not being directly observable in the market place (Level 3 inputs), then changing these assumptions changes the Company's estimate of the instrument's fair value. Favourable and unfavourable changes are determined by changing the primary unobservable parameter used to derive the valuation.

*Bank of Tianjin (BoT)*

The valuation of the BoT investment is sensitive to the selected unobservable input, being the P/B multiple. If the P/B multiple was increased or decreased by 10% it would result in a $102 million increase or decrease to the fair value of the investment, which would be recognised in shareholders' equity.

*Other*

The remaining Level 3 balance is immaterial and changes in the Level 3 inputs have a minimal impact on net profit and net assets of the Company.

**Deferred fair value gains and losses**

Where fair values are determined using unobservable inputs, the Company does not immediately recognise the difference between the transaction price and the amount we determine based on the valuation technique (day one gain or loss) in profit or loss. After initial recognition, we recognise the deferred amount in profit or loss on a straight line basis over the life of the transaction or until all inputs become observable.

The day one gains and losses deferred are not material.

### FINANCIAL ASSETS AND FINANCIAL LIABILITIES NOT MEASURED AT FAIR VALUE

The following table sets out the Company's basis of estimating fair values of financial instruments carried at amortised cost:

| Financial Asset and Liability | Fair Value Approach |
|---|---|
| Net loans and advances to banks | Discounted cash flows using prevailing market rates for loans with similar credit quality. |
| Net loans and advances to customers | Present value of future cash flows, discounted using a curve that incorporates changes in wholesale market rates, the Company's cost of wholesale funding and the customer margin, as appropriate. |
| Deposit liability without a specified maturity or at call | The amount payable on demand at the reporting date. We do not adjust the fair value for any value we expect the Company to derive from retaining the deposit for a future period. |
| Interest bearing fixed maturity deposits and other borrowings and acceptances with quoted market rates | Market borrowing rates of interest for debt with a similar maturity are used to discount contractual cash flows to derive the fair value. |
| Debt issuances | Calculated based on quoted market prices or observable inputs as applicable. If quoted market prices are not available, we use a discounted cash flow model using a yield curve appropriate for the remaining term to maturity of the debt instrument. The fair value reflects adjustments to credit spreads applicable to the Company for that instrument. |

## 16. FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (continued)

The financial assets and financial liabilities listed in the table below are carried at amortised cost on the Company's balance sheet. While this is the value at which we expect the assets will be realised and the liabilities settled, the Company provides an estimate of the fair value of the financial assets and financial liabilities at balance date in the table below.

| | At amortised cost | | Categorised into fair value hierarchy | | | | | | Fair value (total) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Quoted market price (Level 1) | | Using observable inputs (Level 2) | | With significant non-observable inputs (Level 3) | | | |
| | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m |
| Financial assets | | | | | | | | | | |
| Net loans and advances[1] | 475,418 | 452,408 | - | - | 28,352 | 25,172 | 447,259 | 427,282 | 475,611 | 452,454 |
| Due from controlled entities[2] | 90,170 | 91,208 | - | - | - | - | 90,170 | 91,208 | 90,170 | 91,208 |
| Total | 565,588 | 543,616 | - | - | 28,352 | 25,172 | 537,429 | 518,490 | 565,781 | 543,662 |
| Financial liabilities | | | | | | | | | | |
| Deposits and other borrowings | 511,937 | 494,162 | - | - | 512,049 | 494,291 | - | - | 512,049 | 494,291 |
| Debt issuances | 97,184 | 83,743 | 31,365 | 30,841 | 66,529 | 53,969 | - | - | 97,894 | 84,810 |
| Due to controlled entities[2] | 88,383 | 88,882 | - | - | - | - | 88,383 | 88,882 | 88,383 | 88,882 |
| Total | 697,504 | 666,787 | 31,365 | 30,841 | 578,578 | 548,260 | 88,383 | 88,882 | 698,326 | 667,983 |

1. We have reviewed the fair value of Net loans and advances previously presented as Level 2. In line with broader industry practice Net loans and advances other than Loans to Banks are now presented as Level 3
2. Carrying value assumed to approximate fair value for balances with controlled entities.

### KEY JUDGEMENTS AND ESTIMATES

The Company evaluates the material accuracy of the valuations incorporated in the financial statements as they can involve a high degree of judgement and estimation in determining the carrying values of financial assets and liabilities at the balance sheet date.

The majority of valuation models the Company uses employ only observable market data as inputs. However, for certain financial instruments, we may use data that is not readily observable in current markets. If we use unobservable market data, then we need to exercise more judgement to determine fair value depending on the significance of the unobservable input to the overall valuation. Generally, we derive unobservable inputs from other relevant market data and compare them to observed transaction prices where available.

When establishing the fair value of a financial instrument using a valuation technique, the Company considers valuation adjustments in determining the fair value. We may apply adjustments (such as bid/offer spreads, credit valuation adjustments and funding valuation adjustments – refer Note 9 Derivative Financial Instruments) to the techniques used to reflect the Company's assessment of factors that market participants would consider in setting fair value.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 17. ASSETS CHARGED AS SECURITY FOR LIABILITIES AND COLLATERAL ACCEPTED AS SECURITY FOR ASSETS

The following disclosure excludes the amounts presented as collateral paid and received in the Balance Sheet that relate to derivative liabilities and derivative assets respectively. The terms and conditions of those collateral agreements are included in the standard Credit Support Annex that forms part of the International Swaps and Derivatives Association Master Agreement.

### ASSETS CHARGED AS SECURITY FOR LIABILITIES

Assets charged as security for liabilities include the following types of instruments:

- Securities provided as collateral for repurchase transactions. These transactions are governed by standard industry agreements.
- Specified residential mortgages provided as security for notes and bonds issued to investors as part of the Company's covered bond programs.
- Collateral provided to central banks.
- Collateral provided to clearing houses.

The carrying amount of assets pledged as security are as follows:

| | 2018 $m | 2017 $m |
|---|---|---|
| Securities sold under arrangements to repurchase[1] | 39,332 | 35,454 |
| Residential mortgages provided as security for covered bonds | 19,612 | 19,604 |
| Other | 1,191 | 1,487 |

1. The amounts disclosed as securities sold under arrangements to repurchase include both:
   - assets pledged as security which continue to be recognised on the Company's balance sheet; and
   - assets repledged, which are included in the disclosure below.

### COLLATERAL ACCEPTED AS SECURITY FOR ASSETS

The Company has received collateral associated with various financial instruments. Under certain transactions the Company has the right to sell, or to repledge, the collateral received. These transactions are governed by standard industry agreements.

The fair value of collateral we have received and that which we have sold or repledged is as follows:

| | 2018 $m | 2017 $m |
|---|---|---|
| Fair value of assets which can be sold or repledged | 35,360 | 29,418 |
| Fair value of assets sold or repledged | 23,270 | 19,787 |

## 18. OFFSETTING

We offset financial assets and financial liabilities in the balance sheet (in accordance with AASB 132 *Financial Instruments: Presentation*) when there is:

- a current legally enforceable right to set off the recognised amounts in all circumstances; and
- an intention to settle the asset and liability on a net basis, or to realise the asset and settle the liability simultaneously.

If the above conditions are not met, the financial assets and liabilities are presented on a gross basis.

The Company does not have any arrangements that satisfy the conditions necessary to offset financial assets and financial liabilities within the balance sheet. The following table identifies financial assets and financial liabilities which have not been offset but are subject to enforceable master netting agreements (or similar arrangements) and the related amounts not offset in the balance sheet. We have not taken into account the effect of over-collateralisation.

| | | | Amount subject to master netting agreement or similar | | | |
|---|---|---|---|---|---|---|
| 2018 | Total amounts recognised in the Balance Sheet $m | Amounts not subject to master netting agreement or similar $m | Total $m | Financial instruments $m | Financial collateral (received)/ pledged $m | Net amount $m |
| Derivative assets | 64,448 | (2,423) | 62,025 | (52,723) | (5,042) | 4,260 |
| Reverse repurchase, securities borrowing and similar agreements[1] | 34,623 | (4,337) | 30,286 | (398) | (29,888) | - |
| **Total financial assets** | 99,071 | (6,760) | 92,311 | (53,121) | (34,930) | 4,260 |
| Derivative financial liabilities | (65,638) | 2,706 | (62,932) | 52,723 | 7,037 | (3,172) |
| Repurchase, securities borrowing and similar agreements[2] | (37,581) | 11,997 | (25,584) | 398 | 25,186 | - |
| **Total financial liabilities** | (103,219) | 14,703 | (88,516) | 53,121 | 32,223 | (3,172) |

| | | | Amount subject to master netting agreement or similar | | | |
|---|---|---|---|---|---|---|
| 2017 | Total amounts recognised in the Balance Sheet $m | Amounts not subject to master netting agreement or similar $m | Total $m | Financial instruments $m | Financial collateral (received)/ pledged $m | Net amount $m |
| Derivative assets | 57,036 | (2,138) | 54,898 | (46,268) | (4,598) | 4,032 |
| Reverse repurchase, securities borrowing and similar agreements[1] | 28,305 | (4,652) | 23,653 | (819) | (22,834) | - |
| **Total financial assets** | 85,341 | (6,790) | 78,551 | (47,087) | (27,432) | 4,032 |
| Derivative financial liabilities | (56,830) | 2,238 | (54,592) | 46,268 | 5,774 | (2,550) |
| Repurchase, securities borrowing and similar agreements[2] | (33,768) | 8,822 | (24,946) | 819 | 24,127 | - |
| **Total financial liabilities** | (90,598) | 11,060 | (79,538) | 47,087 | 29,901 | (2,550) |

1. Reverse repurchase agreements:
   - with less than 90 days to maturity are presented in the Balance Sheet within cash and cash and cash equivalents; or
   - with 90 days or more to maturity are presented in the Balance Sheet within net loans and advances.
2. Repurchase agreements are presented in the Balance Sheet within deposits and other borrowings.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 19. GOODWILL AND OTHER INTANGIBLE ASSETS

| | Goodwill[1] | | Software | | Other Intangibles | | Total | |
|---|---|---|---|---|---|---|---|---|
| | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m |
| Balance at start of year | 69 | 102 | 1,783 | 2,110 | - | 2 | 1,852 | 2,214 |
| Additions | - | - | 386 | 396 | - | - | 386 | 396 |
| Amortisation expense[2] | - | - | (787) | (541) | - | (2) | (787) | (543) |
| Impairment expense | - | - | (17) | (17) | - | - | (17) | (17) |
| Impairment on reclassification to held for sale[3] | - | (32) | - | (153) | - | - | - | (185) |
| Foreign currency exchange difference | 4 | (1) | 8 | (12) | - | - | 12 | (13) |
| Balance at end of year | 73 | 69 | 1,373 | 1,783 | - | - | 1,446 | 1,852 |
| Cost | 73 | 69 | 6,289 | 5,883 | 39 | 39 | 6,401 | 5,991 |
| Accumulated amortisation/impairment | n/a | n/a | (4,916) | (4,100) | (39) | (39) | (4,955) | (4,139) |
| Carrying amount | 73 | 69 | 1,373 | 1,783 | - | - | 1,446 | 1,852 |

1. Goodwill excludes notional goodwill in equity accounted investments.
2. ANZ has accelerated the amortisation of certain software assets predominately relating to its International business. This follows a recent review of the International business along with a number of divestments announced or completed this year. Accelerated amortisation expense of $240 million ($195 million post-tax) attributable to these assets has been recorded in the 2018 financial year.
3. In 2017 this relates to the sale of the Retail Asia business.

### RECOGNITION AND MEASUREMENT

The table below details how we recognise and measure different intangible assets:

| Intangible | Goodwill | Software |
|---|---|---|
| Definition | Excess amount the Company has paid in acquiring a business over the fair value less costs of disposal of the identifiable assets and liabilities acquired. | Purchases of “off the shelf” software assets are capitalised as assets.<br>Internal and external costs incurred in building software and computer systems costing greater than $20 million are capitalized as assets. Those less than $20 million are expensed in the year in which the costs are incurred. |
| Carrying value | Cost less any accumulated impairment losses.<br>Allocated to the cash generating unit to which the acquisition relates. | Initially, measured at cost.<br>Subsequently, carried at cost less accumulated amortisation and impairment losses.<br>Costs incurred in planning or evaluating software proposals or in maintaining systems after implementation are not capitalised. |
| Useful life | Indefinite.<br>Goodwill is reviewed for impairment at least annually or when there is an indication of impairment. | Except for major core infrastructure, amortised over periods between 3-5 years.<br>Major core infrastructure amortised over periods between 7 or 10 years. |
| Depreciation method | Not applicable. | Straight-line method. |

## 19. GOODWILL AND OTHER INTANGIBLE ASSETS (continued)

### KEY JUDGEMENTS AND ESTIMATES

Management judgement is used to assess the recoverable value of goodwill, and other intangible assets, and the useful economic life of an asset (or if an asset has an indefinite life). We reassess the recoverability of the carrying value at each reporting date.

At each balance date, software and other intangible assets, including those not ready for use, are assessed for indicators of impairment. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, the carrying value of the asset is written down immediately.

In addition, the expected useful economic life of intangible assets, including software assets, are assessed on an annual basis. The assessment requires management judgement, and in relation to our software assets, a number of factors can influence the expected economic useful lives. These factors include changes to business strategy, significant divestments and the underlying pace of technological change. In the current year, the assessment of useful economic life of software assets resulted in accelerated amortisation of certain software assets in the Institutional and Australia divisions of $240 million.

## 20. OTHER PROVISIONS

| | 2018 $m | 2017 $m |
|---|---|---|
| Customer remediation | 556 | 115 |
| Restructuring costs | 94 | 61 |
| Non-lending losses, frauds and forgeries | 75 | 73 |
| Other | 113 | 141 |
| Total other provisions | 838 | 390 |

| | Customer remediation $m | Restructuring costs $m | Non-lending losses, frauds and forgeries $m | Other $m | Total $m |
|---|---|---|---|---|---|
| Balance at start of year | 115 | 61 | 73 | 141 | 390 |
| New and increased provisions made during the year | 525 | 146 | 11 | 99 | 781 |
| Provisions used during the year | (60) | (98) | (8) | (65) | (231) |
| Unused amounts reversed during the year | (24) | (15) | (1) | (62) | (102) |
| Balance at end of year | 556 | 94 | 75 | 113 | 838 |

## 20. OTHER PROVISIONS (continued)

### Customer remediation

Customer remediation refers to the Company's activities in relation to compensating customers for past matters associated with products and services provided.

### Restructuring costs

Provisions for restructuring costs arise from activities related to material changes in the scope of business undertaken by the Company or the manner in which that business is undertaken and include employee termination benefits. Costs relating to on-going activities are not provided for and are expensed as incurred.

### Non-lending losses, frauds and forgeries

Non-lending losses include losses arising from specific legal actions not directly related to amounts of principal outstanding for loans and advances and losses arising from forgeries, frauds and the correction of operational issues. The amounts recognised are the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties that surround the events and circumstances that affect the provision.

### Other

Other provisions comprise various other provisions including loyalty programs, workers compensation, make-good provisions associated with leased premises and contingent liabilities recognised as part of a business combination.

### RECOGNITION AND MEASUREMENT

The Company recognises provisions when there is a present obligation, an outflow of economic resources is probable, and the amount of the provision can be measured reliably.

The amount recognised is the best estimate of the consideration required to settle the present obligation at reporting date, taking into account the risks and uncertainties surrounding the obligation.  Where a provision is measured using the estimated cash flows required to settle the present obligation, its carrying amount is the present value of those cash flows..

### KEY JUDGEMENTS AND ESTIMATES

The Company holds provisions for various obligations including customer remediation, restructuring costs and surplus lease space, non-lending losses, fraud and forgeries and litigation related claims.  These provisions involve judgements regarding the outcome of future events, including estimates of expenditure required to satisfy such obligations.  Where relevant, expert legal advice has been obtained and, in light of such advice, provisions and/or disclosures as deemed appropriate have been made.

In relation to customer remediation, determining the amount of the provisions, which represent management's best estimate of the cost of settling the identified matters, requires the exercise of significant judgement. It will often be necessary to form a view on a number of different assumptions, including, the number of impacted customers, the average refund per customer and the associated remediation costs. Consequently, the appropriateness of the underlying assumptions is reviewed on a regular basis against actual experience and other relevant evidence and adjustments are made to the provisions where appropriate.

# 21. SHAREHOLDERS' EQUITY

## SHAREHOLDERS' EQUITY

| | 2018 $m | 2017 $m |
|---|---|---|
| Ordinary share capital | 27,533 | 29,416 |
| Reserves: | | |
| Foreign currency translation reserve | (230) | (75) |
| Share option reserve | 92 | 87 |
| Available-for-sale revaluation reserve | (24) | (66) |
| Cash flow hedge reserve | 106 | 90 |
| Total reserves | (56) | 36 |
| Retained earnings | 26,377 | 22,396 |
| **Total shareholders' equity** | 53,854 | 51,848 |

## ORDINARY SHARE CAPITAL

The table below details the movement in ordinary shares for the period.

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Number of shares | $m | Number of shares | $m |
| Balance at start of the year | 2,937,415,327 | 29,416 | 2,927,476,660 | 29,162 |
| Bonus option plan[1] | 2,891,060 | - | 2,880,009 | - |
| Dividend reinvestment plan[2] | - | - | 7,058,658 | 198 |
| Group employee share acquisition scheme | - | (3) | - | 56 |
| Share buy-back[3] | (66,688,269) | (1,880) | - | - |
| **Balance at end of year** | 2,873,618,118 | 27,533 | 2,937,415,327 | 29,416 |

1. The Company issued 1.4 million shares under the Bonus Option Plan (BOP) for the 2018 interim dividend (1.5 million shares for the 2017 final dividend; 1.4 million shares for the 2017 interim dividend; 1.5 million shares for the 2016 final dividend).
2. No new shares were issued under the Dividend Reinvestment Plan (DRP) for the 2018 interim dividend (nil shares for the 2017 final dividend; nil shares for the 2017 interim dividend; 7.1 million shares for the 2016 final dividend) as the shares were purchased on-market and provided directly to the shareholders participating in the DRP. On-market purchases for the DRP in the September 2018 financial year were $392 million (September 17 full year: $176 million).
3. On 22 June 2018, the Company announced that it had increased its existing on-market buy-back of shares from $1.5 billion to $3.0 billion. The Company bought back $1,880 million worth of shares during the 2018 financial year resulting in 66.7 million shares being cancelled during the year.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 21. SHAREHOLDERS' EQUITY (continued)

### RECOGNITION AND MEASUREMENT

| | |
|---|---|
| **Ordinary shares** | Ordinary shares have no par value. They entitle holders to receive dividends, or proceeds available on winding up of the Company, in proportion to the number of fully paid ordinary shares held. They are recognised at the amount paid per ordinary share net of directly attributable costs. Every holder of fully paid ordinary shares present at a meeting in person, or by proxy, is entitled to:<br>• on a show of hands, one vote; and<br>• on a poll, one vote, for each share held. |
| **Treasury shares** | Treasury shares are shares in the Company which:<br>• the ANZ Employee Share Acquisition Plan purchases on market and have not yet distributed, or<br>• the Company issues to the ANZ Employee Share Acquisition Plan and have not yet been distributed.<br>Treasury shares are deducted from share capital and excluded from the weighted average number of ordinary shares used in the earnings per share calculations. |
| **Reserves:** | |
| Foreign currency translation reserve | Includes differences arising on translation of assets and liabilities into Australian dollars when the functional currency of a foreign operation (including subsidiaries and branches) is not Australian dollars. In this reserve, we reflect any offsetting gains or losses on hedging these exposures, together with any tax effect. |
| Cash flow hedge reserve | Includes fair value gains and losses associated with the effective portion of designated cash flow hedging instruments, net of deferred taxes to be realised when the position is settled. |
| Available-for-sale revaluation reserve | Includes the changes in fair value and exchange differences on our revaluation of available-for-sale financial assets, net of deferred taxes to be realised upon disposal of the asset. |
| Share option reserve | Includes amounts which arise on the recognition of share-based compensation expense. |

## 22. CAPITAL MANAGEMENT

### CAPITAL MANAGEMENT STRATEGY

ANZ's capital management strategy aims to protect the interests of depositors, creditors and shareholders. We achieve this through an Internal Capital Adequacy Assessment Process (ICAAP) whereby ANZ conducts detailed strategic and capital planning over a 3 year time horizon. The process involves:

- forecasting economic variables, financial performance of ANZ's divisions and the financial impact of new strategic initiatives to be implemented during the planning period;
- performing stress tests under different economic scenarios to determine the level of additional capital ('stress capital buffer') needed to absorb losses that may be experienced under an economic downturn;
- reviewing capital ratios and targets across various classes of capital against ANZ's risk profile; and
- developing a capital plan, taking into account capital ratio targets, current and future capital issuances requirements and options around capital products, timing and markets to execute the capital plan under differing market and economic conditions.

The capital plan is approved by the Board and updated as required. The Board and senior management are provided with regular updates of ANZ's capital position. Any material actions required to ensure ongoing prudent capital management are submitted to the Board for approval. Throughout the year, ANZ maintained compliance with all the regulatory requirements related to Capital Adequacy in the jurisdictions in which it operates.

### REGULATORY ENVIRONMENT

As ANZ is an Authorised Deposit-taking Institution (ADI) in Australia, it is regulated by APRA under the Banking Act 1959 (Cth). ANZ must comply with the minimum regulatory capital requirements, prudential capital ratios and specific reporting levels that APRA sets and which are consistent with the global Basel III capital framework. This is the common framework for determining the appropriate level of bank regulatory capital as set by the Basel Committee on Banking Supervision (BCBS).

For reporting purposes as part of the ANZ 2018 Annual Report, Capital Adequacy Ratios are presented for the Level 2 ADI and are not presented for the Company as a standalone entity. Refer to Note 23 Capital Management in the ANZ 2018 Group Annual Report for details of the Capital Adequacy Ratios, which can be found at https://shareholder.anz.com/annual-report-shareholders-review.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 23. SHARES IN CONTROLLED ENTITIES

| | Incorporated in | Nature of business | 2018 $m | 2017 $m |
|---|---|---|---|---|
| ANZ Bank (Lao) Ltd | Laos | Banking | 51 | 51 |
| ANZ Bank (Taiwan) Ltd | Taiwan | Banking | 849 | 849 |
| ANZ Bank (Vietnam) Ltd | Vietnam | Banking | 205 | 205 |
| ANZ Capel Court Ltd | Australia | Securitisation Manager | 18 | 18 |
| ANZ Capital Hedging Pty Ltd | Australia | In liquidation | 200 | 200 |
| ANZ Centre Chattels Trust | Australia | Property | 167 | 167 |
| ANZ Centre Trust | Australia | Property | 550 | 550 |
| ANZ Equities (Nominees) Pty Ltd | Australia | Custodial Services | 10 | 10 |
| ANZ Funds Pty Ltd | Australia | Holding Company | 12,053 | 9,698 |
| ANZ Guam, Inc | Guam | Banking | 17 | 17 |
| ANZ Lenders Mortgage Insurance Pty Ltd | Australia | Mortgage Insurance | 398 | 398 |
| ANZ Properties (Australia) Pty Ltd | Australia | Property | 6 | 6 |
| ANZ Rewards No.2 Pty Ltd | Australia | Credit Card Loyalty Program | 40 | 40 |
| ANZ Securities (Holdings) Pty Ltd | Australia | Holding Company | 36 | 36 |
| ANZ Support Services India Private Ltd | India | IT Services | 25 | 25 |
| ANZ Wealth Australia Ltd[1] | Australia | Holding Company | 2,563 | 4,034 |
| Australia and New Zealand Bank (China) Company Ltd | China | Banking | 1,121 | 1,121 |
| Australia and New Zealand Banking Group (PNG) Ltd | Papua New Guinea | Banking | 40 | 40 |
| Chongqing Liangping ANZ Rural Bank Company Ltd | China | Banking | 5 | 5 |
| Citizens Bancorp | Guam | Holding Company | 24 | 24 |
| E S & A Holdings Pty Ltd | Australia | Non-operating | 43 | 43 |
| Esanda Finance Corporation Ltd | Australia | Non-operating | 5 | 15 |
| Looking Together Pty Ltd | Australia | Non-operating | 6 | 5 |
| ACN 003 042 082 Ltd | Australia | Holding Company | 158 | 258 |
| PT Bank ANZ Indonesia (99% ownership) | Indonesia | Banking | 262 | 269 |
| Shares in controlled entities | | | 18,852 | 18,084 |

1. During the year ended 30 September 2018, the carrying amount was impaired by $597 million following the calculation of the fair value of ANZ Wealth Australia Ltd's subsidiaries being sold, and a net $874 million of capital was returned to the Company.

### RECOGNITION AND MEASUREMENT

The Company's subsidiaries are those entities it controls through being exposed to, or having rights to, variable returns from the entity and being able to affect those returns through its power over the entity. The Company assesses whether it has power over those entities by examining the Company's existing rights to direct the relevant activities of the entity. Investments in controlled entities are carried at cost less any accumulated impairment losses.

At least at each reporting date, the Company reviews investments in controlled entities for any indication of impairment. If an indication of impairment exists, then the Company determines the recoverable amount of the controlled entity using the higher of:

- the controlled entity's fair value less cost of disposal; and
- its value-in-use.

We use a discounted cash flow methodology, and other methodologies (such as capitalisation of earnings methodology), to determine the recoverable amount.

## 24. TRANSFERS OF FINANCIAL ASSETS

In the normal course of business the Company enters into transactions where it transfers financial assets directly to third parties or to Structured Entities (SEs). These transfers may give rise to the Company fully, or partially derecognising those financial assets depending on the Company's exposure to the risks and rewards or control over the transferred assets. If the Company retains substantially all of the risk and rewards of a transferred asset, the transfer does not qualify for derecognition and the asset remains on the Company's balance sheet in its entirety.

### SECURITISATIONS

Net loans and advances include residential mortgages securitised under the Company's securitisation programs which are assigned to bankruptcy remote SEs to provide security for obligations payable on the notes issued by the SEs. This includes mortgages that are held for potential repurchase agreements (Repos) with central banks. The holders of the issued notes have full recourse to the pool of residential mortgages which have been securitised and the Company cannot otherwise pledge or dispose of the transferred assets.

In some instances the Company is also the holder of the securitised notes. In addition, the Company is entitled to any residual income of the SEs and sometimes enters into derivatives with the SEs. The Company retains the majority of the risks and rewards of the residential mortgages and continues to recognise the mortgages as financial assets. The obligation to pay this amount to the SE is recognised as a financial liability of the Company.

The Company is exposed to variable returns from its involvement with these securitisation SEs and has the ability to affect those returns through its power over the SEs activities. The SEs are therefore consolidated by the Company when preparing consolidated Group financial statements.

### COVERED BONDS

The Company operates various global covered bond programs to raise funding in its primary markets. Net loans and advances include residential mortgages assigned to bankruptcy remote SEs associated with these covered bond programs. The mortgages provide security for the obligations payable on the issued covered bonds.

The covered bond holders have dual recourse to the issuer and the cover pool of assets. The issuer cannot otherwise pledge or dispose of the transferred assets, however, subject to legal arrangements it may repurchase and substitute assets as long as the required cover is maintained.

The Company is required to maintain the cover pool at a level sufficient to cover the bond obligations. In addition the Company is entitled to any residual income of the covered bond SEs and enters into derivatives with the SEs. The Company retains the majority of the risks and rewards of the residential mortgages and continues to recognise the mortgages as financial assets. The obligation to pay this amount to the SEs is recognised as a financial liability of the Company.

The Company is exposed to variable returns from its involvement with the covered bond SEs and has the ability to affect those returns through its power over the SEs activities. The SEs are therefore consolidated by the Company when preparing consolidated Group financial statements. The covered bonds issued externally are included within debt issuances.

### REPURCHASE AGREEMENTS

If the Company sells securities subject to repurchase agreements under which substantially all the risks and rewards of ownership remain with the Company, then those assets are considered to be transferred assets that do not qualify for derecognition. An associated liability is recognised for the consideration received from the counterparty.

The table below sets out the balance of assets transferred that do not qualify for derecognition, along with the associated liabilities:

| | Securitisations[1,2] | | Covered bonds | | Repurchase agreements | |
|---|---|---|---|---|---|---|
| | 2018 $m | 2017 $m | 2018 $m | 2017 $m | 2018 $m | 2017 $m |
| Current carrying amount of assets transferred | **64,765** | 65,030 | **19,612** | 19,604 | **39,332** | 35,454 |
| Carrying amount of associated liabilities | **64,765** | 65,030 | **19,612** | 19,604 | **37,581** | 33,768 |

1. The balances relate to transfers to internal structured entities.
2. The securitisation noteholders have recourse only to the pool of residential mortgages which have been securitised. The carrying value of securitised assets and the associated liabilities approximates their fair value.

## 25. ASSETS AND LIABILITIES HELD FOR SALE

At 30 September 2018, there were no assets or liabilities that have been reclassified to held for sale. The assets held for sale balance in 2017 comprised Investments in associates (SRCB) of $1,748 million. This sale was completed in the 2018 financial year.

- Shanghai Rural Commercial Bank (SRCB)

  On 3 January 2017, the Company announced that it had agreed to sell its 20% stake in Shanghai Rural Commercial Bank (SRCB). The sale was completed in the 2018 financial year.

- Asia Retail and Wealth Business

  ANZ Group announced that it had agreed to sell Retail and Wealth businesses in Singapore, Hong Kong, China, Taiwan and Indonesia to Singapore's DBS Bank on 31 October 2016. The Company is only impacted by branch operations which existed in Singapore and Hong Kong and the sale of these branches was completed prior to 30 September 2017.

### INCOME STATEMENT IMPACT RELATING TO ASSETS AND LIABILITIES HELD FOR SALE

During 2018, the Company recognised the following impacts in relation to assets and liabilities held for sale:

- $13 million gain relating to the completion of the sale related activities of the Asia Retail and Wealth business.
- $247 million net gain relating to SRCB comprising a $289 million gain on release of reserves, $56 million of foreign exchange losses and other costs, and a $14 million adjustment for tax.

During 2017, the Company recognised the following impacts in relation to assets and liabilities held for sale:

- $219 million loss relating to the reclassification of the Asia Retail and Wealth business to held for sale comprising of $185 million of software and goodwill impairment charges and $34 million of various other charges.
- $333 million loss relating to reclassification of SRCB to held for sale, comprising $219 million impairment to the investment, $12 million of foreign exchange losses, and $102 million of tax expenses.

The net result of these disposals is included in other income (refer to Note 2 Operating Income).

### KEY JUDGEMENTS AND ESTIMATES

A significant level of judgement is used by the Company to determine:

- whether an asset or group of assets is classified and presented as held for sale or as a discontinued operation; and
- the fair value of the assets and liabilities classified as being held for sale.

Management is required to exercise significant judgement when assessing the fair value less costs to sell for assets and liabilities held for sale. The judgemental factors include determining: costs to sell, allocation of goodwill, indemnities provided under the sale contract and consideration received - particularly where elements of consideration are contingent in nature. Any impairment we record is based on the best available evidence of fair value compared to the carrying value before the impairment. The final sale price may be different to the fair value we estimate when recording the impairment. Management regularly assess the appropriateness of the underlying assumptions against actual outcomes and other relevant evidence and adjustments are made to fair value where appropriate. We expect that the sales will complete within 12 months after balance date, subject to the relevant regulatory approvals and customary terms of sale for such assets..

## 26. SUPERANNUATION AND POST EMPLOYMENT BENEFIT OBLIGATIONS

Set out below is a summary of amounts recognised in the Balance Sheet in respect of the defined benefit superannuation schemes:

| | 2018 $m | 2017 $m |
|---|---|---|
| **Defined benefit obligation and scheme assets** | | |
| Present value of funded defined benefit obligation | (1,246) | (1,225) |
| Fair value of scheme assets | 1,385 | 1,328 |
| **Net defined benefit asset** | 139 | 103 |
| **As represented in the Balance Sheet** | | |
| Net liabilities arising from defined benefit obligations included in payables and other liabilities | (15) | (19) |
| Net assets arising from defined benefit obligations included in other assets | 154 | 122 |
| **Net defined benefit asset** | 139 | 103 |
| Weighted average duration of the benefit payments reflected in the defined benefit obligation (years) | 16.8 | 16.8 |

As at the most recent reporting dates of the schemes, the aggregate surplus of net market value of assets over the value of accrued benefits on a funding basis was $10 million (2017: deficit of $16 million). In 2018, the Company made defined benefit contributions totalling $2 million (2017: $1 million). It expects to make around $2 million next financial year.

### GOVERNANCE OF THE SCHEMES AND FUNDING OF THE DEFINED BENEFIT SECTIONS

The main defined benefit superannuation schemes in which the Company participates operate under trust law and are managed and administered on behalf of the members in accordance with the terms of the relevant trust deed and rules and all relevant legislation. These schemes have corporate trustees, which are wholly owned subsidiaries of the Company. The trustees are the legal owners of the assets, which are held separately from the assets of the Company and are responsible for setting investment policy and agreeing funding requirements with the employer through the triennial actuarial valuation process.

The defined benefit section of the ANZ Australian Staff Superannuation Scheme and ANZ UK Staff Pension Scheme are the two largest defined benefit plans and have been closed to new members since 1987 and 2004 respectively. These plans did not have a material deficit, or surplus, at the last funding valuations. The Company has no present liability under the schemes' trust deeds to fund a deficit (measured on a funding basis). A contingent liability of the Company may arise if any of these schemes were wound up.

### RECOGNITION AND MEASUREMENT

**Defined benefit superannuation schemes**

For the Company's defined benefit schemes, an independent actuary calculates the liability and expenses related to providing benefits to employees under each defined benefit scheme. They use the Projected Unit Credit Method to value the liabilities. The balance sheet includes:

- a defined benefit liability if the obligation is greater than the fair value of the schemes assets; and
- an asset (capped to its recoverable amount) if the fair value of the assets is greater than the obligation.

In each reporting period, the movements in the net defined benefit liability are recognised as follows:

- the net movement relating to the current period's service cost, net interest on the defined benefit liability, past service costs and other costs (such as the effects of any curtailments and settlements) as operating expenses;
- remeasurements of the net defined benefit liability (which comprise actuarial gains and losses and return on scheme assets, excluding interest income included in net interest) directly in retained earnings through other comprehensive income; and
- contributions of the Company directly against the net defined benefit position.

**Defined contribution superannuation schemes**

The Company operates a number of defined contribution schemes. It also contributes (according to local law, in the various countries in which it operates) to Government and other plans that have the characteristics of defined contribution plans. The Company's contributions to these schemes are recognised as personnel expenses when they are incurred.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 26. SUPERANNUATION AND POST EMPLOYMENT BENEFIT OBLIGATIONS (continued)

### KEY JUDGEMENTS AND ESTIMATES

The main assumptions we use in valuing defined benefit obligations are listed in the table below. A change to any assumptions, or applying different assumptions, could have a significant effect on the Statement of Other Comprehensive Income and Balance Sheet.

| Assumptions | 2018 | 2017 | Sensitivity analysis change in significant assumptions | Increase/(decrease) in defined benefit obligation 2018 $m | 2017 $m |
|---|---|---|---|---|---|
| Discount rate (% p.a.) | 2.65 - 3.7 | 2.5 - 3.8 | 0.5% increase | (131) | (104) |
| Future salary increases (% p.a.) | 3.75 | 3.7 | | | |
| Future pension indexation | | | | | |
| In payment (% p.a.)/In deferment (% p.a) | 2.0 - 3.0/ 2.25 | 2.0 - 3.0/ 2.2 | 0.5% increase | 109 | 86 |
| Life expectancy at age 60 for current pensioners | | | 1 year increase | 56 | 44 |
| – Males (years) | 25.5 - 29.0 | 25.4 - 28.9 | | | |
| – Females (years) | 28.7 - 31.0 | 28.6 - 30.9 | | | |

## 27. EMPLOYEE SHARE AND OPTION PLANS

The Company operates a number of employee share and option schemes under the ANZ Employee Share Acquisition Plan and the ANZ Share Option Plan.

### ANZ EMPLOYEE SHARE ACQUISITION PLAN

ANZ Employee Share Acquisition Plan schemes that operated during the 2017 and 2018 years were the Employee Share Offer and the Deferred Share Plan.

| Employee Share Offer | |
|---|---|
| Eligibility | Most permanent employees employed in either Australia or New Zealand with three years continuous service for the most recent financial year. |
| Grant | Up to AUD1,000 in Australia (and AUD800 in New Zealand) ANZ shares each financial year, subject to Board approval. |
| Allocation value | One week Volume Weighted Average Price (VWAP) of ANZ shares traded on the ASX in the week leading up to and including the date of grant. |
| Australia | ANZ ordinary shares are granted to eligible employees for nil consideration. The shares vest on grant and are held in trust for three years from grant date, after which time they may remain in trust, be transferred to the employee's name or sold. Dividends are automatically reinvested in the Dividend Reinvestment Plan. |
| New Zealand | Shares are granted to eligible employees on payment of NZD one cent per share. Shares vest subject to satisfaction of a three year service period, after which they may remain in trust, be transferred to the employee's name or sold. Unvested shares are forfeited if the employee resigns or is dismissed for serious misconduct. Dividends are either paid in cash or reinvested into the Dividend Reinvestment Plan. |
| Expensing value (fair value) | In Australia, the fair value of the shares is expensed in the year shares are granted, as they are not subject to forfeiture.<br><br>In New Zealand, the fair value is expensed on a straight-line basis over the three year vesting period.<br><br>The expense is recognised as a share-based compensation expense with a corresponding increase in share capital. |
| FY 2018 | 541,982 shares were granted on 1 December 2017 at an issue price of $28.67. |
| FY 2017 | Zero shares were granted in the 2017 financial year. |

## 27. EMPLOYEE SHARE AND OPTION PLANS (continued)

### Deferred Share Plan

| | |
|---|---|
| **i) Chief Executive Officer (CEO) and Group Executive Committee (ExCo)** | |
| Eligibility | Group CEO and ExCo. |
| Grant | 50% of the CEO's Annual Variable Remuneration (AVR) and 33% of ExCo's Variable Remuneration (VR) received as deferred shares. |
| Conditions | Deferred evenly over four years from grant date. |
| **ii) ANZ Incentive Plan (ANZIP) and Business Unit Incentive Plans (BUIPs) – for grants from 1 October 2017** | |
| Eligibility | Employees participating in ANZ's standard VR arrangements. |
| Grant | If VR is at or exceeds AUD150,000, then 60% of incentive amounts exceeding AUD80,000 (subject to a minimum deferral amount of AUD42,000) is deferred as deferred shares. |
| Conditions | Deferred evenly over three years from grant date. |
| **iii) ANZ Employee Reward Scheme (ANZERS) and BUIPs – for grants up to 30 September 2017** | |
| Eligibility | Employees participating in ANZ's standard Short Term Incentive (STI) arrangements. |
| Grant | Half of all incentive amounts exceeding AUD100,000 (subject to a minimum deferral amount of AUD25,000) received as deferred shares. |
| Conditions | Deferred evenly over two years from grant date. |
| **iv) Total Incentives Performance Plan (TIPP) – for grants up to 30 September 2017** | |
| Eligibility | Employees participating in the Institutional TIPP. |
| Grant | 60% of incentive amounts exceeding AUD80,000 (subject to a minimum deferral amount of AUD18,000) received as deferred shares. |
| Conditions | Deferred evenly over three years from grant date. |
| **v) Long Term Incentives (LTIs)** | |
| Eligibility | Selected employees. |
| Grant | 100% deferred shares. |
| Conditions | Vest three years from grant date. |
| **vi) Exceptional circumstances** | |
| Remuneration foregone | In exceptional circumstances, we grant deferred shares to certain employees when they start with the Company to compensate them for remuneration they have foregone from their previous employer. The vesting period generally aligns with the remaining vesting period of the remuneration they have foregone, and therefore varies between grants. |
| Retention | We may grant deferred shares to high performing employees who are regarded as a significant retention risk to the Company. |
| **vii) Further information** | |
| Downward adjustment | Deferred shares remain at risk and the Board has the discretion to adjust the number of deferred shares downwards to zero at any time before the vesting date. The Company's downward adjustment provisions are detailed in section 4.3.4 of the 2018 Remuneration Report in the ANZ 2018 Group Annual Report. |
| Cessation | Unless the Board decides otherwise, employees forfeit their unvested deferred shares if they resign, are terminated on notice, or are dismissed for serious misconduct. The deferred shares may be held in trust beyond the deferral period. |
| Dividends | Dividends are paid in cash or reinvested in the Dividend Reinvestment Plan. |
| Instrument | Deferred share rights may be granted instead of deferred shares in some countries as locally appropriate (see deferred share rights section). |
| Allocation value | All deferred shares are issued based on the VWAP of ANZ shares traded on the ASX in the week leading up to and including the date of grant. |
| Expensing value (fair value) | We expense the fair value of deferred shares on a straight-line basis over the relevant vesting period and we recognise the expense as a share-based compensation expense with a corresponding increase in share capital. |
| FY 2018 grants | 2,232,563 deferred shares were granted with a weighted average grant price of $29.31. 2,632 deferred shares were adjusted downward to zero, based on Board discretion. |
| FY 2017 grants | 2,016,835 deferred shares were granted with a weighted average grant price of $28.03. No deferred shares were adjusted downward to zero, based on Board discretion. |

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 27. EMPLOYEE SHARE AND OPTION PLANS (continued)

### Expensing of the ANZ Employee Share Acquisition Plan

| | |
|---|---|
| Expensing value (fair value) | The fair value of shares we granted during 2018 under the Employee Share Offer and the Deferred Share Plan, measured as at the date of grant of the shares, is $80.9 million (2017: $56.7 million) based on 2,774,545 shares (2017: 2,016,835) at VWAP of $29.17 (2017: $28.09). |

### ANZ SHARE OPTION PLAN

| | |
|---|---|
| Allocation | We may grant selected employees options/rights which entitle them to acquire fully paid ordinary ANZ shares at a fixed price at the time the options/rights vest. Voting and dividend rights will be attached to the ordinary shares allocated on exercise of the options/rights.<br><br>Each option/right entitles the holder to one ordinary share subject to the terms and conditions imposed on grant. Exercise price of options, determined in accordance with the rules of the plan, is generally based on the VWAP of the shares traded on the ASX in the week leading up to and including the date of grant. For rights, the exercise price is nil. |
| Rules | Prior to the exercise of the option/right if the Company changes its share capital due to a bonus share issue, pro-rata new share issue or reorganisation the following adjustments are required:<br>• Issue of bonus shares - When the holder exercises their option, they are also entitled to be issued the number of bonus shares they would have been entitled to had they held the underlying shares at the time of the bonus issue;<br>• Pro-rata share offer - We will adjust the exercise price of the option in the manner set out in the ASX Listing Rules; and<br>• Reorganisation - In respect of rights, if there is a bonus issue or reorganisation of the Company's share capital, then the Board may adjust the number of rights or the number of underlying shares so that there is no advantage or disadvantage to the holder.<br><br>Holders otherwise have no other entitlements to participate:<br>• in any new issue of the Company's securities before they exercise their options/rights; or<br>• in a share issue of a body corporate other than ANZ (such as a subsidiary).<br><br>For equity grants made after 1 November 2012, any portion of the award which vests may, at the Board's discretion, be satisfied by a cash equivalent payment rather than shares. |
| Expensing | We expense the fair value of options/rights on a straight-line basis over the relevant vesting period and we recognise the expense as a share-based compensation expense with a corresponding increase in share options reserve. |
| Cessation | The provisions that apply if the employee's employment ends are in section 7.2 of the 2018 Remuneration Report in the ANZ 2018 Group Annual Report. |
| Downward adjustment | The Company's downward adjustment provisions are detailed in section 4.3.4 of the 2018 Remuneration Report in the ANZ 2018 Group Annual Report. |

### Option Plans that operated during 2018 and 2017

i) Performance Rights

| | |
|---|---|
| Allocation | We grant performance rights to selected employees as part of the Company's incentive plans. Performance rights provide the holder with the right to acquire ANZ shares at nil cost, subject to a three year vesting period and Total Shareholder Return (TSR) performance hurdles. Further details on the performance hurdles are in section 4.3.3 of the 2018 Remuneration Report in the ANZ 2018 Group Annual Report. |
| FY 2018 and FY 2017 grants | During the 2018 year, we granted 1,023,239 performance rights (2017: 944,419). No performance rights were adjusted downward to zero in 2018 and 2017, based on Board discretion. |

## 27. EMPLOYEE SHARE AND OPTION PLANS (continued)

| ii) Deferred Share Rights (no performance hurdles) | |
|---|---|
| Allocation | Deferred share rights provide the holder with the right to acquire ANZ shares at nil cost after a specified vesting period. We adjust the fair value of rights for the absence of dividends during the restriction period. |
| Satisfying vestings | Any portion of the award of share rights may be satisfied by a cash equivalent payment rather than shares at the Board's discretion. All share rights were satisfied through a share allocation, other than 108,783 deferred share rights (2017: 67,573) for which Board discretion was exercised. |
| Downward adjustment | Board discretion was also exercised to adjust downward 1,638 deferred share rights to zero in 2018 and 3,835 in 2017. |
| FY 2018 and FY 2017 grants | During the 2018 year 2,546,333 deferred share rights (no performance hurdles) were granted (2017: 2,547,377). |

### Options, Deferred Share Rights and Performance Rights on Issue

As at 30 October 2018, there were 657 holders of 4,204,281 deferred share rights on issue and 159 holders of 2,865,941 performance rights on issue.

### Options/Rights Movements

This table shows the options/rights over unissued ANZ shares and their related weighted average (WA) exercise prices as at the beginning and end of 2018 and the movements during 2018:

| Number of options/rights | Opening balance 1 Oct 2017 | Options/ rights granted | Options/ rights forfeited[1] | Options/ rights expired | Options/ rights exercised | Closing balance 30 Sep 2018 |
|---|---|---|---|---|---|---|
| | 7,113,784 | 3,569,572 | (2,043,209) | (1,558) | (1,490,016) | 7,148,573 |
| WA exercise price | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 |
| WA closing share price | | | | | | $28.43 |
| WA remaining contractual life | | | | | | 2.1 years |
| WA exercise price of all exercisable options/rights outstanding | | | | | | $0.00 |
| Outstanding exercisable options/rights | | | | | | 67,666 |

This table shows the options/rights over unissued ANZ shares and their related weighted average exercise prices as at the beginning and end of 2017 and the movements during 2017:

| | Opening balance 1 Oct 2016 | Options/ rights granted | Options/ rights forfeited[1] | Options/ rights expired | Options/ rights exercised | Closing balance 30 Sep 2017 |
|---|---|---|---|---|---|---|
| Number of options/rights | 6,424,117 | 3,491,796 | (1,815,732) | (629) | (985,768) | 7,113,784 |
| WA exercise price | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 | $0.00 |
| WA closing share price | | | | | | $29.50 |
| WA remaining contractual life | | | | | | 2.4 years |
| WA exercise price of all exercisable options/rights outstanding | | | | | | $0.00 |
| Outstanding exercisable options/rights | | | | | | 143,839 |

1. Refers to any circumstance where equity can be forfeited (for example on cessation, downward adjustment and performance conditions not met).

All of the shares issued as a result of the exercise of options/rights during 2017 and 2018, were issued at a nil exercise price.

As at the date of the signing of the Directors' Report on 30 October 2018:

- no options/rights over ordinary shares have been granted since the end of 2018; and
- no shares have been issued as a result of the exercise of options/rights since the end of 2018.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 27. EMPLOYEE SHARE AND OPTION PLANS (continued)

### Fair Value Assumptions

When determining the fair value, we apply the standard market techniques for valuation, including Monte Carlo and/or Black Scholes pricing models. We do so in accordance with the requirements of AASB 2 *Share-based Payments*. The models take into account early exercise of vested equity, non-transferability and internal/external performance hurdles (if any).

The table below shows the significant assumptions we used as inputs into our fair value calculation of instruments granted during the period. We present the values as weighted averages, but the specific values we use for each allocation are the ones we use for the fair value calculation.

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Deferred Share Rights | Performance Rights | Deferred Share Rights | Performance Rights |
| Exercise price ($) | 0.0 | 0.0 | 0.00 | 0.00 |
| Share closing price at grant date ($) | 29.24 | 29.21 | 27.95 | 28.18 |
| Expected volatility of ANZ share price (%)[1] | 20.0 | 20.0 | 24.9 | 25.0 |
| Equity term (years) | 2.4 | 5.0 | 2.3 | 5.0 |
| Vesting period (years) | 2.1 | 3.0 | 2.1 | 3.0 |
| Expected life (years) | 2.1 | 3.0 | 2.1 | 3.0 |
| Expected dividend yield (%) | 5.75 | 5.75 | 6.49 | 6.46 |
| Risk free interest rate (%) | 1.65 | 1.95 | 1.76 | 1.86 |
| Fair value ($) | 26.03 | 12.24 | 24.59 | 13.73 |

1. Expected volatility represents a measure of the amount by which ANZ's share price is expected to fluctuate over the life of the rights. The measure of volatility used in the model is the annualised standard deviation of the continuously compounded rates of return on the historical share price over a deferred period of time preceding the date of grant. This historical average annualised volatility is then used to estimate a reasonable expected volatility over the expected life of the rights.

### SATISFYING EQUITY AWARDS

All shares underpinning equity awards may be purchased on market, reallocated or be newly issued shares, or a combination.

The equity we purchased on market during the 2018 financial year (either under the ANZ Employee Share Acquisition Plan and the ANZ Share Option Plan, or to satisfy options or rights) for all employees amounted to 3,936,773 shares at an average price of $29.00 per share (2017: 2,704,206 shares at an average price of $27.83 per share).

# 28. RELATED PARTY DISCLOSURES

## KEY MANAGEMENT PERSONNEL COMPENSATION

Key Management Personnel (KMP) are defined as all directors and those executives who report directly to the CEO:

- with responsibility for the strategic direction and management of a major income generating division; or
- who control material income and expenses.

KMP compensation included within total personnel expenses in Note 3 Operating Expenses as follows:

| | 2018[1] $000 | 2017[1] $000 |
|---|---|---|
| Short-term benefits | 19,484 | 21,002 |
| Post-employment benefits | 333 | 1,046 |
| Other long-term benefits | 150 | 169 |
| Termination benefits | 454 | 563 |
| Share-based payments | 8,910 | 14,926 |
| Total | 29,331 | 37,706 |

1. Includes former disclosed KMP until the end of their employment.

## KEY MANAGEMENT PERSONNEL LOAN TRANSACTIONS

Loans made to KMP are made in the ordinary course of business and on normal commercial terms and conditions that are no more favourable than those given to other employees or customers, including: the term of the loan, security required and the interest rate. The aggregate of loans made, guaranteed or secured to KMP, including their related parties, were as follows:

| | 2018 $000 | 2017 $000 |
|---|---|---|
| Loans advanced[1] | 12,710 | 14,497 |
| Interest charged[2] | 477 | 550 |

1. Balances are at the balance sheet date (for KMP in office at balance sheet date) and at termination date (for KMP who ceased employment during the year).
2. Interest is for all KMP's during the period.

## KEY MANAGEMENT PERSONNEL HOLDINGS OF ANZ SECURITIES

KMP, including their related parties, held subordinated debt, shares, share rights and options over shares in the Company directly, indirectly or beneficially as shown below:

| | 2018 Number[1] | 2017 Number[1] |
|---|---|---|
| Shares, options and rights | 2,293,271 | 2,233,182 |
| Subordinated debt | 13,152 | 17,152 |

- For KMP who ceased employment during the year, the balances are calculated as at their termination date.

## OTHER TRANSACTIONS OF KEY MANAGEMENT PERSONNEL AND THEIR RELATED PARTIES

All other transactions with KMP and their related parties are made on terms equivalent to those that prevail in arm's length transactions. These transactions generally involve providing financial and investment services, including services to eligible international assignees ensuring they are neither financially advantaged nor disadvantaged by their relocation. All such transactions that have occurred with KMP and their related parties have been trivial or domestic in nature. In this context, we disclose only those transactions considered of interest to the users of the financial report in making and evaluating decisions about the allocation of scarce resources.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 28. RELATED PARTY DISCLOSURES (continued)

### ASSOCIATES

During the course of the financial year, the Company conducted transactions with all associates on terms equivalent to those made on an arm's length basis as shown below:

| | 2018 $000 | 2017 $000 |
|---|---|---|
| Amounts receivable from associates | 34,364 | 76,247 |
| Amounts payable to associates | 608 | 587 |
| Interest income from associates | 1,704 | 2,728 |
| Interest expense to associates | - | 18 |
| Other expenses paid to associates | 6,735 | 8,424 |
| Costs recovered from associates | - | 748 |

There have been no material guarantees given or received by the Company to or from associates. No outstanding amounts between the Company and associates have been written down or recorded as allowances, as they are considered fully collectible by the Company.

### SUBSIDIARIES

We disclose material controlled entities in Note 23 Shares in Controlled Entities. During the financial year, subsidiaries conducted transactions with each other and with associates on terms equivalent to those on an arm's length basis. As of 30 September 2018, we consider all outstanding amounts on these transactions to be fully collectible.

Transactions between the Company and its subsidiaries include providing a wide range of banking and other financial facilities. Details of amounts paid to, or received from, related parties, in the form of dividends or interest, are set out in Note 2 Operating Income.

Other intragroup transactions include providing management and administrative services, staff training, data processing facilities, transfer of tax losses, and the leasing of property plant and equipment.

## 29. COMMITMENTS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

### PROPERTY RELATED COMMITMENTS

| | 2018 $m | 2017 $m |
|---|---|---|
| **Lease rentals** | | |
| Land and buildings | 1,533 | 1,818 |
| Furniture and equipment | 112 | 145 |
| **Total lease rental commitments[1]** | 1,645 | 1,963 |
| Due within 1 year | 321 | 394 |
| Due later than 1 year but not later than 5 years | 769 | 908 |
| Due later than 5 years | 555 | 661 |
| **Total lease rental commitments[1]** | 1,645 | 1,963 |

1. Total future minimum sublease payments we expect to receive under non-cancellable subleases at 30 September 2018 is $81 million (2017: $91 million). During the year, we received sublease payments of $29 million (2017: $28 million) and netted them against rent expense.

## 29. COMMITMENTS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (continued)

### CREDIT RELATED COMMITMENTS AND CONTINGENCIES

| | 2018 $m | 2017 $m |
|---|---|---|
| Contract amount of: | | |
| Undrawn facilities | 164,944 | 150,339 |
| Guarantees and letters of credit | 16,363 | 18,062 |
| Performance related contingencies | 22,176 | 18,890 |
| Total | 203,483 | 187,291 |

**UNDRAWN FACILITIES**

The majority of undrawn facilities are subject to customers maintaining specific credit and other requirements or conditions. Many of these facilities are expected to be only partially used, and others may never be used at all. As such, the total of the nominal principal amounts is not necessarily representative of future liquidity risks or future cash requirements. Based on the earliest date on which the Company may be required to pay, the total undrawn facilities of $164,944 million (2017: $150,339 million) mature within 12 months.

**GUARANTEES, LETTERS OF CREDIT AND PERFORMANCE CONTINGENCIES**

Guarantees and contingent liabilities relate to transactions that the Company has entered into as principal – including: guarantees, standby letters of credit and documentary letters of credit.

Documentary letters of credit involve the Company issuing letters of credit guaranteeing payment in favour of an exporter. They are secured against an underlying shipment of goods or backed by a confirmatory letter of credit from another bank.

Performance related contingents are liabilities that oblige the Company to make payments to a third party if the customer fails to fulfil its non-monetary obligations under the contract.

To reflect the risk associated with these transactions, we apply the same credit origination, portfolio management and collateral requirements that we apply to loans. The contract amount represents the maximum potential amount that we could lose if the counterparty fails to meet its financial obligations. As the facilities may expire without being drawn upon, the notional amounts do not necessarily reflect future cash requirements. Based on the earliest date on which the Company may be required to pay, the total guarantees and letters of credit of $16,363 million (2017: $18,062 million) and total performance related contingencies of $22,176 million (2017: $18,890 million) mature within 12 months.

### OTHER CONTINGENT LIABILITIES

As at 30 September 2018, the Company had contingent liabilities in respect of the matters outlined below. Where relevant, expert legal advice has been obtained and, in the light of such advice, provisions and/or disclosures as deemed appropriate have been made. In some instances we have not disclosed the estimated financial impact of the individual items either because it is not practicable to do so or because such disclosure may prejudice the interests of the Company.

**BANK FEES LITIGATION**

A litigation funder commenced a class action against the Company in 2010, followed by a second similar class action in March 2013. The applicants contended that certain exception fees (honour, dishonour and non-payment fees on transaction accounts and late payment and over-limit fees on credit cards) were unenforceable penalties and that various of the fees were also unenforceable under statutory provisions governing unconscionable conduct, unfair contract terms and unjust transactions. A further action, limited to late payment fees only, commenced in August 2014.

The penalty and statutory claims in the March 2013 class action failed and the claims have been dismissed. The August 2014 action was discontinued in October 2016.

The original claims in the 2010 class action have been dismissed. In 2017, a new claim was added to the 2010 class action, in relation to the Company's entitlement to charge certain periodical payment non-payment fees.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 29. COMMITMENTS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (continued)

### BENCHMARK/RATE ACTIONS

In July and August 2016, class action complaints were brought in the United States District Court against local and international banks, including the Company – one action relating to the bank bill swap rate (BBSW), and one action relating to the Singapore Interbank Offered Rate (SIBOR) and the Singapore Swap Offer Rate (SOR). The class actions are expressed to apply to persons and entities that engaged in US-based transactions in financial instruments that were priced, benchmarked, and/or settled based on BBSW, SIBOR, or SOR. The claimants seek damages or compensation in amounts not specified, and allege that the defendant banks, including the Company, violated US anti-trust laws, anti-racketeering laws, the *Commodity Exchange Act*, and (in the BBSW case only) unjust enrichment principles. The Company is defending the proceedings. The matters are at an early stage.

In February 2017, the South African Competition Commission commenced proceedings against local and international banks including the Company alleging breaches of the cartel provisions of the *South African Competition Act* in respect of trading in the South African rand. The potential civil penalty or other financial impact is uncertain. The matter is at an early stage.

### CAPITAL RAISING ACTIONS

In June 2018, the Commonwealth Director of Public Prosecutions commenced criminal proceedings against the Company and a senior employee alleging that they were knowingly concerned in cartel conduct by the joint lead managers of the Company's August 2015 underwritten institutional equity placement of approximately 80.8 million ordinary shares. The matter is at an early stage. The Company and its senior employee are defending the allegations.

In September 2018, the Australian Securities and Investments Commission (ASIC) commenced civil penalty proceedings against the Company alleging failure to comply with continuous disclosure obligations in connection with the Company's August 2015 underwritten institutional equity placement. ASIC alleges the Company should have advised the market that the joint lead managers took up approximately 25.5 million ordinary shares of the placement. The matter is at an early stage. The Company is defending the allegations.

### FRANCHISEE LITIGATION

In February 2018, two related class actions were brought against the Company. The primary action alleges that the Company breached contractual obligations and acted unconscionably when it lent to the applicant, and other 7-Eleven franchisees. The action seeks to set aside the loans to those franchisees and claims unspecified damages. The second action seeks to set aside related mortgages and guarantees given to the Company. The matters are at an early stage.

### REGULATORY AND CUSTOMER EXPOSURES

In recent years there has been an increase in the number of matters on which ANZ engages with its regulators. There have been significant increases in the nature and scale of regulatory investigations and reviews, enforcement actions (whether by court action or otherwise) and the quantum of fines issued by regulators, particularly against financial institutions both in Australia and globally. The Company also instigates engagement with its regulators. The nature of these interactions can be wide ranging and, for example, currently include a range of matters including responsible lending practices, product suitability, wealth advice, pricing and competition, conduct in financial markets and capital market transactions and product disclosure documentation. The Company has received various notices and requests for information from its regulators as part of both industry-wide and Company-specific reviews and has also made disclosures to its regulators at its own instigation. There may be exposures to customers which are additional to any regulatory exposures. These could include class actions, individual claims or customer remediation or compensation activities. The outcomes and total costs associated with such reviews and possible exposures remain uncertain.

### ROYAL COMMISSION

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was established on 14 December 2017. The Commission has been asked to submit its final report by 1 February 2019 (an interim report was released on 28 September 2018). The Commission is likely to result in additional costs and may lead to further exposures, including exposures associated with further regulator activity or potential customer exposures such as class actions, individual claims or customer remediation or compensation activities. The outcomes and total costs associated with these possible exposures remain uncertain.

### SECURITY RECOVERY ACTIONS

Various claims have been made or are anticipated, arising from security recovery actions taken to resolve impaired assets. These claims will be defended.

### WARRANTIES AND INDEMNITIES

The Company has provided warranties, indemnities and other commitments in favour of the purchaser and other persons in connection with various disposals of businesses and assets and other transactions, covering a range of matters and risks. It is exposed to potential claims under those warranties, indemnities and commitments.

## 29. COMMITMENTS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (continued)

### CLEARING AND SETTLEMENT OBLIGATIONS

Under the following arrangements, the Company has a commitment to comply with rules which could result in a bilateral exposure and loss if a member institution fails to settle: the Australian Payments Nework Limited's Regulations for the Australian Paper Clearing System, the Bulk Electronic Clearing System, the Issuers and Acquirers Community and the High Value Clearing System (HVCS). The Company's potential exposure arising from these arrangements is unquantifiable in advance.

Under the Austraclear System Regulations (Austraclear), and the CLS Bank International Rules, the Company has a commitment to participate in loss-sharing arrangements if a member institution fails to settle. The Company's potential exposure arising from these arrangements is unquantifiable in advance. For HVCS and Austraclear, the above obligation arises in only limited circumstances.

The Company is a member of various central clearing houses globally, including ASX Clear (Futures), London Clearing House (LCH) SwapClear, Korea Exchange (KRX), Hong Kong Exchange (HKEX) and the Shanghai Clearing House. These memberships allow the Company to centrally clear derivative instruments in line with cross-border regulatory requirements. Common to all of these memberships is the requirement for the Company to make default fund contributions. In the event of a default by another member, the Company could potentially be required to commit additional default fund contributions which are unquantifiable in advance.

### PARENT ENTITY GUARANTEES

The Company has issued letters of comfort and guarantees in respect of certain subsidiaries in the normal course of business. Under these letters and guarantees, the Company undertakes to ensure that those subsidiaries continue to meet their financial obligations, subject to certain conditions including that the entity remains a controlled entity of the Company.

### SALE OF GRINDLAYS BUSINESSES

On 31 July 2000, the Company completed the sale to Standard Chartered Bank (SCB) of ANZ Grindlays Bank Limited and the private banking business of ANZ in the United Kingdom and Jersey, together with ANZ Grindlays (Jersey) Holdings Limited and its subsidiaries for USD1.3 billion in cash. The Company provided warranties and certain indemnities relating to those businesses and, where it was anticipated that payments would be likely under the warranties or indemnities, made provisions to cover the anticipated liabilities. The issue below has not adversely impacted the reported results. All settlements and penalties to date have been covered within existing provisions.

In 1991 certain amounts were transferred from non-convertible Indian Rupee accounts maintained with Grindlays in India. These transactions may not have complied with the provisions of the Foreign Exchange Regulation Act, 1973 (India). Grindlays, on its own initiative, brought these transactions to the attention of the Reserve Bank of India. The Indian authorities served notices on Grindlays and certain of its officers in India and civil penalties have been imposed which are the subject of appeals. Criminal prosecutions are pending and will be defended. The amounts in issue are not material.

## CONTINGENT ASSETS

### NATIONAL HOUSING BANK

The Company is pursuing recovery of the proceeds of certain disputed cheques which were credited to the account of a former Grindlays customer in the early 1990s.

The disputed cheques were drawn on the National Housing Bank (NHB) in India. Proceedings between Grindlays and NHB concerning the proceeds of the cheques were resolved in early 2002.

Recovery is now being pursued from the estate of the Grindlays customer who received the cheque proceeds. Any amounts recovered are to be shared between the Company and NHB.

# NOTES TO THE FINANCIAL STATEMENTS (continued)

## 30. COMPENSATION OF AUDITORS

| | 2018 $'000 | 2017 $'000 |
|---|---|---|
| **KPMG Australia** | | |
| Audit or review of financial reports | 6,674 | 6,318 |
| Audit-related services[1] | 4,152 | 3,668 |
| Non-audit services[2] | 100 | 220 |
| Total[3] | 10,926 | 10,206 |
| | | |
| **Overseas related practices of KPMG Australia** | | |
| Audit or review of financial reports | 1,642 | 1,645 |
| Audit-related services[1] | 545 | 523 |
| Non-audit services[2] | 2 | - |
| Total | 2,189 | 2,168 |
| **Total compensation of auditors** | 13,115 | 12,374 |

1. Comprises prudential and regulatory services of $2.41 million (2017: $3.11 million), comfort letters $0.45 million (2017: $0.55 million) and other $1.84 million (2017: $0.53 million).
2. The nature of the non-audit services includes general market insights, controls related assessments and training.
3. Inclusive of goods and services tax.

The Company's policy allows KPMG Australia or any of its related practices to provide assurance and other audit-related services that, while outside the scope of the statutory audit, are consistent with the role of external auditor. These include regulatory and prudential reviews requested by regulators such as APRA. Any other services that are not audit or audit-related services are non-audit services. The Policy allows certain non-audit services to be provided where the service would not contravene auditor independence requirements. KPMG Australia or any of its related practices may not provide services that are perceived to be in conflict with the role of the external auditor or breach auditor independence. These include consulting advice and subcontracting of operational activities normally undertaken by management, and engagements where the auditor may ultimately be required to express an opinion on its own work.

## 31. EVENTS SINCE THE END OF THE FINANCIAL YEAR

There have been no significant events from 30 September 2018 to the date of signing this report.

# DIRECTORS' AND LEAD AUDITOR'S INDEPENDENCE DECLARATION

## DIRECTORS' DECLARATION

The Directors of Australia and New Zealand Banking Group Limited declare that:

a) in the Directors' opinion, the financial statements and notes of the Company:

   i) are prepared in accordance with Part 7.8 of the *Corporations Act 2001*, including that they comply with the Australian Accounting Standards and the applicable regulations of the *Corporations Regulations 2001*; and

   ii) give a true and fair view of the financial position of the Company as at 30 September 2018 and of its performance for the year ended on that date; and

b) The auditor's report lodged with the financial statements is a true copy of the report on the financial statements.

Signed in accordance with a resolution of the Directors.

David M Gonski, AC
Chairman

Shayne C Elliott
Director

30 October 2018

## LEAD AUDITOR'S INDEPENDENCE DECLARATION UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

To the Directors of Australia and New Zealand Banking Group Limited

I declare that, to the best of my knowledge and belief, in relation to the audit of Australia and New Zealand Banking Group Limited for the financial year ended 30 September 2018 there have been:

i) no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the audit; and

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

KPMG

Alison Kitchen
*Partner*
Melbourne

30 October 2018

## TO THE SHAREHOLDERS OF AUSTRALIA AND NEW ZEALAND BANKING GROUP LIMITED

## REPORT ON THE AUDIT OF THE FINANCIAL REPORT

### OPINION

We have audited the Financial Report of Australia and New Zealand Banking Group Limited (the Company).

In our opinion, the accompanying Financial Report of the Company is in accordance with part 7.8 of the Corporations Act 2001, including:

- giving a true and fair view of the Company's financial position as at 30 September 2018 and of its financial performance for the year ended on that date; and
- complying with Australian Accounting Standards and the relevant Corporations Regulations 2001.

The Financial Report comprises the:

- statement of financial position as at 30 September 2018;
- income statement, statement of comprehensive income, statement of changes in equity, and statement of cash flows for the year then ended;
- notes 1 to 31 including a summary of significant accounting policies; and
- Directors' Declaration.

### BASIS FOR OPINION

We conducted our audit in accordance with *Australian Auditing Standards*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the Financial Report* section of our report.

We are independent of the Company in accordance with the *Corporations Act 2001* and the ethical requirements of the *Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the Financial Report in Australia. We have fulfilled our other ethical responsibilities in accordance with the Code.

### KEY AUDIT MATTERS

The Key Audit Matters we identified are:

- Provision for credit impairment and disclosures for the expected impact of AASB 9 *Financial Instruments* applicable on 1 October 2018;
- Valuation of Financial Instruments held at Fair Value;
- Provision for Customer Remediation; and
- IT Systems and Controls.

Key Audit Matters are those matters that, in our professional judgement, were of most significance in our audit of the Financial Report of the current period.

These matters were addressed in the context of our audit of the Financial Report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

## KEY AUDIT MATTERS (continued)

### PROVISION FOR CREDIT IMPAIRMENT ($2,780M) AND DISCLOSURES FOR THE EXPECTED IMPACT OF AASB 9 *FINANCIAL INSTRUMENTS* APPLICABLE ON 1 OCTOBER 2018

*Refer to the critical accounting estimates and judgements and disclosures in relation to credit impairment provisioning in Note 12, and to the disclosures in relation to accounting standards not yet early adopted for the expected impact of AASB 9 Financial Instruments in Note 1 to the Financial Report.*

**The Key Audit Matter**

The provision for credit impairment is a Key Audit Matter as the Company has significant credit risk exposure to a large number of counterparties across a wide range of lending and other products, industries and geographies. The value of loans and advances on the balance sheet is significant and there is a high degree of complexity and judgement involved for the Company in estimating individual and collective credit impairment provisions against these loans. These features resulted in significant audit effort to address the risks around loan recoverability and the determination of related provisions.

In preparation for adoption of AASB 9 Financial Instruments on 1 October 2018, the Company disclosed the expected impact of adoption. This added effort to our FY18 audit given the complexity of the accounting standard and its expected pervasive impact on the industry. We focused on the Company's disclosure of the expected impact of measuring expected credit losses (ECLs) on loans and advances and the significant judgement exercised by the Company. The Company's models to calculate ECLs are inherently complex and judgement is applied in determining the correct construct of the models. There are also a number of key assumptions made by the Company in applying the accounting standard requirements to the models, including the selection and input of forward-looking information.

**How the matter was addressed in our audit**

Our audit procedures for the provision for credit impairment and disclosures for the expected impact of AASB 9 *Financial Instruments* applicable on 1 October 2018 included:

*Provisions against specific individual loans (individual provision)*

- Testing the key controls over counterparty risk grading for wholesale loans (larger customer exposures that are monitored individually). We tested the approval of new lending facilities against the Company's lending policies, the performance of annual loan assessments, and controls over the monitoring of counterparty credit quality. This included testing controls over the identification of exposures showing signs of stress, either due to internal factors specific to the counterparty or external macroeconomic factors, and testing the timeliness of and the accuracy of counterparty risk assessments and risk grading against the requirements of the Company's lending policies and regulatory requirements;
- Performing credit assessments of a sample of wholesale loans managed by the Company's specialist workout and recovery team assessed as higher risk or impaired, and a sample of other loans, focusing on larger exposures assessed by the Company as showing signs of deterioration, or in areas of emerging risk (assessed against external market conditions). We challenged the Company's risk grading of the loan, their assessment of loan recoverability and the impact on the credit provision. To do this, we used the information on the Company's loan file, discussed the case with the loan officer and management, and performed our own assessment of recoverability. This involved using our understanding of relevant industries and the macroeconomic environment, engaging KPMG specialists where required, and comparing assumptions of inputs used by the Company in recoverability assessments to externally sourced evidence, such as commodity prices, publicly available audited financial statements, and comparable external valuations of collateral held; and
- For retail loans (smaller customer exposures not monitored individually), testing controls over the systems which record lending arrears, company exposures into delinquency buckets based on the number of days loans are overdue, and calculate individual provisions. We tested automated calculation and change management controls and evaluated the Company's oversight of the portfolios, with a focus on controls over delinquency statistics monitoring. We tested a sample of the level of provisions held against different loan products based on the delinquency profile and challenged assumptions made in respect of expected recoveries, primarily from collateral held.

*Provisions estimated across loan portfolios (collective provision)*

- Testing the Company's processes to validate the models used to calculate collective provisions, and evaluating the Company's model methodologies against established market practices and criteria in the accounting standards;
- Testing the key controls within IT systems used to calculate the collective provision, specifically those relating to data management and the completeness and accuracy of data transfer from underlying source systems to the collective provision models;
- Testing the accuracy of key inputs into models by checking a sample of year-end balances to the general ledger, and repayment history and risk ratings to source systems;
- Challenging the key assumptions in the models such as emergence periods, probability of default and loss given default, for a sample of retail and wholesale portfolios. We compared modelled estimates against actual losses incurred by the Company; and
- Re-performing, for a sample of retail and wholesale portfolios and using a KPMG-constructed calculation tool, the calculation of collective provisions, to determine the accuracy of model output.

# INDEPENDENT AUDITOR'S REPORT (continued)

## KEY AUDIT MATTERS (continued)

We also challenged key assumptions in the components of the Company's collective provision balance held above modelled provision estimates. This included:

- Evaluating inputs to the concentration risk and economic cycle provisions by comparing underlying portfolio characteristics to recent loss experience, current market conditions and specific risks inherent in the Company's loan portfolios;
- Assessing the requirement for other additional provisions by considering model or data deficiencies identified by the Company's model validation processes; and
- Assessing the completeness of additional provisions by checking the consistency of risks identified in the portfolios to their inclusion in the Company's assessment.

*AASB 9 Financial Instruments*

We assessed the Company's disclosures for the expected impact of AASB 9 *Financial Instruments* which is applicable on 1 October 2018. Together with KPMG credit risk and economics specialists, our procedures included:

- Assessing the Company's significant accounting policies against the requirements of the accounting standard;
- Assessing the Company's ECL modelling methodology and for a sample of models testing key credit modelling assumptions incorporated in the ECL models against the requirements of the standard and underlying accounting records;
- Assessing forward-looking economic assumptions and the development of economic scenarios against external economic information, and the application into the ECL models ;
- Testing data reconciliation controls between the ECL models and source systems;
- Testing the accuracy of the modelled calculations by re-performing the ECL calculations on a sample basis;
- Assessing the disclosures in the financial report against the requirements of Australian accounting standards.

**VALUATION OF FINANCIAL INSTRUMENTS HELD AT FAIR VALUE:**
**- ASSETS HELD AT FAIR VALUE $158,696M**
**- LIABILITIES HELD AT FAIR VALUE $68,195M**

*Refer to the critical accounting estimates, judgements and disclosures of fair values in Note 16 to the Financial Report.*

### The Key Audit Matter

Financial instruments held at fair value on the Company's balance sheet include available for sale assets, trading securities, derivative assets and liabilities, investments backing policy liabilities, certain policy liabilities, certain debt securities, and other assets and liabilities designated as measured at fair value through profit or loss. The instruments are mainly risk management products sold to customers and used by the Company to manage its own interest rate and foreign exchange risk.

The valuation of financial instruments held at fair value is considered a Key Audit Matter as:

- Financial instruments held at fair value are significant (19% of assets and 9% of liabilities);
- The significant volume and range of products transacted, in a number of international locations, increases the risk of inconsistencies in transaction management processes that could lead to inaccurate valuation;
- Determining the fair value of trading securities and derivatives involves a significant level of judgement by the Company, increasing the risk of error, and adding complexity to our audit. The level of judgement increases where internal models, as opposed to quoted market prices, are used to determine fair value of an instrument, or where inputs to the internal models, such as discount rates and measures of volatility, are not observable; and
- The valuation of certain derivatives held by the Company is sensitive to inputs including funding rates, probabilities of default and loss given default, and industry practice is evolving as to how the impact of both funding and credit risk is incorporated within the valuation of certain derivative instruments. This increased our audit effort in this area and necessitated the involvement of valuation specialists.

### How the matter was addressed in our audit

Our audit procedures for the valuation of financial instruments held at fair value included:

- Testing access rights and change management controls for key valuation systems;
- Testing interface controls, notably the completeness and accuracy of data transfers between transaction processing systems, key systems used to generate valuations and any related valuation adjustments, and the Company's market risk management and finance systems to identify inconsistencies in transaction management and valuation processes across products and locations;
- Testing the governance and approval controls, such as management review and approval of the valuation models, and approval of new products against policies and procedures;

## KEY AUDIT MATTERS (continued)

- Testing the front office management review and approval of the daily financial instrument trading profit and loss reconciliations prepared by the Company's independent product control function;
- Testing the management review and approval of model construction and validation, aimed at assessing the validity and robustness of underlying valuation models; and
- Testing the Company's data validation controls, such as those over key inputs in generating the fair value to market data where fair values were determined by front office teams.

We carried out testing over the valuation of financial instruments with both observable and unobservable inputs. Our specific testing involved valuation specialists and included:

- Re-performing the valuation of 'level 1' and 'level 2' available for sale assets and trading securities, which are primarily government, semi-government and corporate debt securities, by comparing the observable inputs, including quoted prices, to independently sourced market data;
- Using independent models, re-calculating the valuation of a sample, across locations, of derivative assets and liabilities where the fair value was determined using observable inputs. This included comparing a sample of observable inputs used in the Company's derivative valuations to independently-sourced market data, such as interest rates, foreign exchange rates and volatilities;
- Where the fair value of derivatives and other financial assets and liabilities were determined using unobservable inputs ('level 3' instruments), challenging the Company's valuation model by testing the key inputs used to comparable data in the market, including the use of proxy instruments and available alternatives. We compared the Company's valuation methodology to industry practice and the criteria in the accounting standards; and
- Evaluating the appropriateness of the Company's valuation methodology for derivative financial instruments, having regard to current and emerging derivative valuation practices across a range of peer institutions, and against the required criteria in the accounting standards. We tested adjustments made to valuations, particularly funding and credit valuation adjustments on un-collateralised derivatives. In particular, for a sample of individual counterparties, across locations, we tested key inputs to the credit valuation adjustment calculation, including the probability of default, against observable market data. Where proxies were used, we assessed the proxy against available alternatives, across a number of locations.

### PROVISION FOR CUSTOMER REMEDIATION ($556M)

*Refer to the critical accounting estimates, judgements and disclosures in Notes 20 and 29 to the Financial Report.*

#### The Key Audit Matter

The Company has assessed the need to recognise provisions in relation to certain customer remediation activities arising from both internal and external investigations, and reviews.

The provision for customer remediation activities is a Key Audit Matter due to the judgements required by us in assessing the Company's determination of:

- The existence of a present legal or constructive obligation arising from a past event using the conditions of the event against the criteria in the accounting standards;
- The number of investigations and the quantum of amounts being paid arising from the present obligation;
- Reliable estimates of the amounts which may be paid arising from investigations, including estimates of related costs;
- The potential for legal proceedings, further investigations, and reviews from its regulators leading to a wider range of estimation outcomes for us to consider.

#### How the matter was addressed in our audit

Our audit procedures for customer remediation provisions included:

- Obtaining an understanding of the Company's processes for identifying and assessing the potential impact of the investigations into customer remediation activities;
- Enquiring with the Company regarding ongoing legal, regulatory and investigation into other remediation activities;
- Reading the minutes and other relevant documentation of the Company's Board of Directors, Board Committees, various management committees, and attending the Company's Audit and Risk Committee meetings;
- Inspecting correspondence with relevant regulatory bodies and the Company's key submissions to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry;
- For a sample of individual customer remediation matters, assessing the basis for recognition of a provision and associated costs against the requirements of the accounting standards. We did this by understanding and challenging the provisioning methodologies and underlying assumptions;

# INDEPENDENT AUDITOR'S REPORT (continued)

## KEY AUDIT MATTERS (continued)

- Testing completeness by evaluating where exposures may have arisen based upon our knowledge and experience of broader industry matters, the Company's documentation and the current regulatory environment. We also checked these features of these exposures against the criteria defining a provision or a contingency in the accounting standards;
- Assessing the appropriateness of the Company's conclusions against the requirements of Australian Accounting Standards where estimates were unable to be reliably made for a provision to be recognised;
- Evaluating the related disclosures against the requirements of Australian Accounting Standards.

### IT SYSTEMS AND CONTROLS

**The Key Audit Matter**

As a major Australian bank, the Company's businesses utilise a large number of complex, interdependent Information Technology (IT) systems to process and record a high volume of transactions. Controls over access and changes to IT systems are critical to the recording of financial information and the preparation of a financial report which provides a true and fair view of the Company's financial position and performance. The IT systems and controls, as they impact the financial recording and reporting of transactions, is a key audit matter and our audit approach could significantly differ depending on the effective operation of the Company's IT controls. KPMG IT specialists were used throughout the engagement as a core part of our audit team.

**How the matter was addressed in our audit**

We tested the control environment for key IT applications (systems) used in processing significant transactions and recording balances in the general ledger. We also tested automated controls embedded within these systems. Our audit procedures included:

- Testing the governance controls used by the Company's technology teams to monitor system integrity, by checking matters impacting the operational integrity of core systems for escalation and action in accordance with the Company's policies;
- Testing the access rights given to staff by checking them to approved records, and inspecting the reports over the granting and removal of access rights. We also looked for evidence of escalation of breaches;
- Testing preventative controls designed to enforce segregation of duties between users within particular systems;
- Testing the operating effectiveness of automated controls, principally relating to the automated calculation of financial transactions. We tested the inputs used within automated calculations to source data and also tested the accuracy of the calculation logic for a sample of transactions within each identified control; and
- Testing the operating effectiveness of automated reconciliation controls, both between systems and intra-system. We checked a sample of identified breaks in reconciliations were recorded on exception reports, and subsequently investigated and cleared by the Company.

## RESPONSIBILITIES OF DIRECTORS FOR THE FINANCIAL REPORT

The Directors are responsible for:

- preparing a Financial Report that gives a true and fair view in accordance with *Australian Accounting Standards* and part 7.8 of the *Corporations Act 2001*
- implementing necessary internal control to enable the preparation of a Financial Report that gives a true and fair view and is free from material misstatement, whether due to fraud or error
- assessing the Company's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

## AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL REPORT

Our objective is:

- to obtain reasonable assurance about whether the Financial Report as a whole is free from material misstatement, whether due to fraud or error; and
- to issue an Auditor's Report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

A further description of our responsibilities for the audit of the Financial Report is located at the Auditing and Assurance Standards Board website at: http://www.auasb.gov.au/auditors_responsibilities/ar2.pdf. This description forms part of our Auditor's Report.

KPMG

KPMG

A M Kitchen

Alison Kitchen
*Partner*
Melbourne
30 October 2018