Latitude Financial Services Group

COMBINED FINANCIAL REPORT 2018

Latitude Financial Services Group

Combined financial report for the year ended 31 December 2018

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Management's Declaration

In the opinion of the Management of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited (the "Group"), we report that:

(a) the Group is not a reporting entity

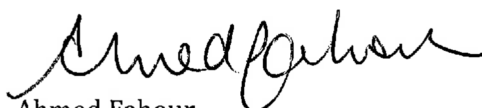
(b) the combined financial statements and notes set out on pages 8 to 68:

  (i) present fairly the financial position of the Group as at 31 December 2018 and of its performance, as represented by the results of its operations and its cash flows, for the year ended 31 December 2018 in accordance with the basis of accounting described in Section 1.1;

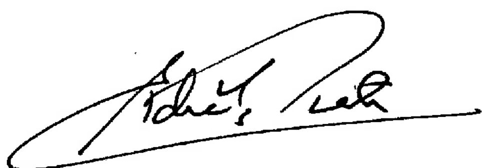
  (ii) complies with International Financial Reporting Standards to the extent described in Section 1.1; and

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

Signed by Management on behalf of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited.



Ahmed Fahour
Chief Executive Officer
Sydney
26 September 2019



Adrienne Duarte
Chief Financial Officer
Melbourne
26 September 2019

Independent Auditor's Report

To the Directors of KVD Australia Holdco Pty Ltd and the Directors of Latitude Financial Services Limited (the Directors)

Opinion

We have audited the ***Combined Financial Report*** of the Latitude Financial Services Group (the ***Combined Group***).

In our opinion, the accompanying Combined Financial Report presents fairly, in all material respects, the financial position of the Latitude Financial Services Group as at 31 December 2018 and 31 December 2017, and of its financial performance and its cash flows for each of the years then ended, in accordance with the combination basis of preparation described in Note 1.1 and *International Financial Reporting Standards (IFRS)* as issued by the International Accounting Standards Board.

The ***Combined Financial Report*** comprises:

- Combined balance sheets as at 31 December 2018 and 31 December 2017
- Combined income statements, Combined statements of changes in net investment, and Combined statements of cash flows for each of the years then ended
- Notes including a summary of significant accounting policies
- Management's Declaration

The ***Combined Group*** consists of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited, and their respective subsidiaries that have been combined to form the Latitude Financial Services Group.

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 Combined Financial Report* section of our report.

We are independent of the Combined Group in accordance with 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 Combined Financial Report in Australia. We have fulfilled our other ethical responsibilities in accordance with the Code.

KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Liability limited by a scheme approved under Professional Standards Legislation.

KPMG

Emphasis of matter – Basis of preparation

We draw attention to Note 1.1 of the Combined Financial Report, which describes its combination basis of preparation, including the approach taken to and the purpose of preparing it.

The Combined Financial Report has been prepared to assist the Directors for the purpose of their due diligence in relation to the Latitude Financial Services Group in connection with an Initial Public Offering. As a result, the Combined Financial Report and this Auditor’s Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter. A 2017 Combined Financial Report, presenting year-ended 31 December 2017 financial information, with 2016 comparative figures, has not been prepared nor audited.

Our report is intended solely for the Directors of KVD Australia Holdco Pty Ltd and the Directors of Latitude Financial Services Limited in accordance with the agreed terms of engagement, and for no other purpose. We disclaim any assumption of responsibility for any reliance on this report, or on the Combined Financial Report to which it relates, to any person other than the Directors of KVD Australia Holdco Pty Ltd and the Directors of Latitude Financial Services Limited or for any other purpose than that for which it was prepared.

Responsibilities of Management for the Combined Financial Report

Management are responsible for:

- the preparation and fair presentation of the Combined Financial Report in accordance with *International Financial Reporting Standards* and the combination basis of preparation described in Note 1.1 of the Combined Financial Report and have determined that the financial reporting framework is appropriate to meet the needs of the Directors for the purpose of their due diligence in relation to the Latitude Financial Services Group in connection with an Initial Public Offering.
- implementing necessary internal control to enable the preparation of a Combined Financial Report that is free from material misstatement, whether due to fraud or error
- assessing the Combined Group'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 Combined Group or to cease operations, or have no realistic alternative but to do so.

Auditor’s responsibilities for the audit of the Combined Financial Report

Our objective is:

- to obtain reasonable assurance about whether the Combined 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 this Combined Financial Report.

A further description of our responsibilities for the audit of the Combined Financial Report is located at the Auditing and Assurance Standards Board website at: http://www.auasb.gov.au/auditors_responsibilities/ar3.pdf. This description forms part of our Auditor's Report.

KPMG

KPMG

Melbourne

26 September 2019

Combined Income Statement

For the year ended 31 December 2018

	Notes	2018 $'000	2017 $'000
Interest income	2.2(a)	**1,135,651**	1,069,277
Interest expense	2.2(a)	**(363,157)**	(344,788)
Net interest income		**772,494**	724,489
Other operating income	2.2(b)	**56,826**	55,645
Net insurance income	2.2(c)	**60,212**	65,663
Total other operating income		**117,038**	121,308
Total operating income		**889,532**	845,797
Loan impairment expense		**(253,377)**	(256,113)
Operating expenses			
Depreciation and amortisation expense		**(68,838)**	(75,269)
Employee benefit expense		**(173,030)**	(154,255)
Other expenses	2.2(d)	**(262,292)**	(269,487)
Total operating expenses		**(504,160)**	(499,011)
Distribution to trust beneficiaries		**(74,487)**	(57,033)
Profit before income tax		**57,508**	33,640
Income tax expense	2.3(a)	**(13,231)**	(16,142)
Profit from continuing operations		**44,277**	17,498
Item that may be reclassified to income statement			
Cash flow hedges		**(3,461)**	46
Currency translation differences arising during the year		**1,566**	(2,623)
		(1,895)	(2,577)
Item that will not be reclassified to income statement			
Equity investment at FVOCI - net change in fair value		**(2,400)**	-
		(2,400)	-
Other comprehensive loss for the year, net of tax		**(4,295)**	(2,577)
Total comprehensive income for the year from continuing operations		**39,982**	14,921
Profit/(loss) is attributable to:			
Owners of Latitude Financial Services Group		**51,354**	18,349
Non-controlling interests		**(7,077)**	(851)
Profit for the year		**44,277**	17,498
Total comprehensive income/(loss) for the year is attributable to:			
Owners of Latitude Financial Services Group		**47,059**	15,772
Non-controlling interests		**(7,077)**	(851)
Total comprehensive income for the year		**39,982**	14,921

The above statement should be read in conjunction with the accompanying notes.

Combined Balance Sheet

As at 31 December 2018

	Notes	2018 $'000	2017 $'000
Assets			
Cash and cash equivalents	3.1(b)	**518,604**	439,690
Assets classified as held for sale		**553**	187
Derivative financial instruments	3.1(d)	**376**	1,477
Loans and other receivables	3.1(c)	**7,095,709**	6,603,364
Other assets		**3,559**	4,413
Deferred tax assets	2.3(e)	**178,441**	166,793
Other financial assets		**-**	2,400
Property, plant and equipment		**7,268**	9,065
Intangible assets	5.1(a)	**894,530**	914,517
Total assets		**8,699,040**	8,141,906
Liabilities			
Trade and other liabilities	5.1(d)	**247,535**	214,122
Current tax liabilities		**14,804**	36,636
Derivative financial instruments	3.1(d)	**4,426**	1,323
Provisions	5.1(e)	**60,293**	45,393
Gross insurance policy liabilities	5.1(f)	**82,970**	90,840
Deferred tax liabilities	2.3(e)	**89,197**	108,031
Borrowings	3.1(e)	**7,820,091**	7,287,535
Total liabilities		**8,319,316**	7,783,880
Net assets		**379,724**	358,026
Net investment			
Parent investment		**496,987**	496,987
Reserves		**17,418**	22,122
Retained earnings		**(127,489)**	(160,968)
Net parent investment		**386,916**	358,141
Non-controlling interests		**(7,192)**	(115)
Total net investment		**379,724**	358,026

The above statement should be read in conjunction with the accompanying notes.

Combined Statement of Changes in Net Investment

For the year ended 31 December 2018

	Attributable to owners of Latitude Financial Services Group					
	Parent investment	Reserves	Retained earnings	Net parent investment	Non-controlling Interests	Total net investment
	$'000	$'000	$'000	$'000	$'000	$'000
At 1 January 2017	511,587	4,132	(179,317)	336,402	736	**337,138**
Profit/(Loss) for the year	-	-	18,349	18,349	(851)	**17,498**
Other comprehensive loss	-	(2,577)	-	(2,577)	-	**(2,577)**
Total comprehensive income/(loss) for the year	-	(2,577)	18,349	15,772	(851)	**14,921**
Transactions with owners in their capacity as owners:						
Share-based payments	-	20,567	-	20,567	-	**20,567**
Return of capital	(14,600)	-	-	(14,600)	-	**(14,600)**
At 31 December 2017	**496,987**	**22,122**	**(160,968)**	**358,141**	**(115)**	**358,026**
At 1 January 2018	496,987	22,122	(160,968)	358,141	(115)	**358,026**
Adjustment on initial adoption of new accounting standards [1]	-	-	(17,875)	(17,875)	-	**(17,875)**
At 1 January 2018 IFRS 9 and 15 adjusted balance	496,987	22,122	(178,843)	340,266	(115)	**340,151**
Profit/(Loss) for the year	-	-	51,354	51,354	(7,077)	**44,277**
Other comprehensive loss	-	(4,295)	-	(4,295)	-	**(4,295)**
Total comprehensive income/(loss) for the year	-	(4,295)	51,354	47,059	(7,077)	**39,982**
Transactions with owners in their capacity as owners:						
Share-based payments	-	(409)	-	(409)	-	**(409)**
At 31 December 2018	**496,987**	**17,418**	**(127,489)**	**386,916**	**(7,192)**	**379,724**

[1] The adjustment is as a result of the change in accounting policies as described in Section 1.3

The above statement should be read in conjunction with the accompanying notes.

Combined Statement of Cash Flows

For the year ended 31 December 2018

	Notes	2018 $'000	2017 $'000
Cash flows from operating activities			
Interest received		**1,145,195**	1,135,295
Interest paid		**(350,037)**	(328,555)
Other operating income received		**56,805**	61,249
Net insurance income			
Premiums received		**65,022**	83,640
Claims paid		**(17,020)**	(28,189)
Other		**333**	2,305
Investment income		**5,190**	5,288
Operating expenses paid		**(299,096)**	(308,459)
Distributions paid to trust beneficiaries		**(67,865)**	(39,381)
Income taxes paid		**(54,816)**	(6,297)
Cash flow from operating activities before changes in operating assets and liabilities		**483,711**	576,896
Changes in operating assets and liabilities arising from cash flow movements			
Net increase in loans and other receivables		**(878,574)**	(744,477)
Net (decrease)/increase in provisions		**(861)**	301
Net increase in trade and other liabilities		**16,704**	5,958
Net increase/(decrease) in gross insurance policy liabilities		**97**	(2,578)
Net decrease in other assets		**855**	2,575
Changes in operating assets and liabilities arising from cash flow movements		**(861,779)**	(738,221)
Net cash (used in)/provided by operating activities	**2.2(e)**	**(378,068)**	(161,325)
Cash flows from investing activities			
Net purchases of intangible assets and property plant & equipment		**(61,295)**	(41,233)
Net cash (used in)/provided by investing activities		**(61,295)**	(41,233)
Cash flows from financing activities			
Proceeds from borrowing issuances and drawdowns		**1,865,888**	4,102,846
Repayment of borrowings		**(1,341,503)**	(3,739,861)
Decrease in related party loans		**-**	(148,010)
Share based payments		**(2,080)**	-
Capital return		**-**	(14,600)
Payments of transaction costs from financing activities		**(4,949)**	(17,403)
Net cash provided by/(used in) financing activities		**517,356**	182,972
Net (decrease)/increase in cash and cash equivalents		**77,993**	(19,586)
Cash and cash equivalents at beginning of financial year		**439,690**	461,772
Effects of exchange rate changes on cash and cash equivalents		**921**	(2,496)
Cash and cash equivalents at end of financial year	**3.1(b)**	**518,604**	439,690

The above statement should be read in conjunction with the accompanying notes.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

Section 1 - Basis of preparation

1.1 Basis of preparation

(a) Combined report

The Combined financial report is for the Latitude Financial Services Group (the "Group") which consists of KVD Australia Holdco Pty Ltd, Latitude Financial Services Limited, and their respective subsidiaries.

KVD Australia Holdco Pty Ltd is a company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is 800 Collins Street, Docklands, Melbourne, Victoria, 3008.

Latitude Financial Services Limited is a company limited by shares, incorporated and domiciled in New Zealand. Its registered office and principal place of business is 8 Tangihua Street, Auckland Central, Auckland, 1010, New Zealand.

This note provides a list of all significant accounting policies adopted in the preparation of these combined financial statements. These policies have been consistently applied to all the years presented, unless otherwise stated. The combined financial statements are for the Group, consisting of KVD Australia Holdco Pty Ltd, Latitude Financial Services Limited, and their respective subsidiaries. The combined financial statements have been prepared for the purpose of providing historical financial information of the Latitude Financial Services Group for disclosure in a Prospectus pursuant to an Initial Public Offering ("IPO").

The financial statements were authorised for issue on 25 September 2019.

(b) Basis of preparation

The Group does not have a separate single parent entity, however, both KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited are under the ultimate control of KVD Singapore Pte. Ltd. As a result of there being no parent entity, the combined financial statements have not been prepared on a consolidation basis, but rather, represent a combination of individual consolidated financial statements of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited, and their respective subsidiaries. In all other respects, the combined financial statements have been prepared in accordance with the recognition, measurement and classification requirements of all applicable International Financial Reporting Standards issued by the International Accounting Standards Board (IFRS).

In preparing these combined financial statements, the financial information of the Group has been extracted from the reporting records of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited, and their respective subsidiaries. The combined financial statements have been prepared on a 'carve-out' basis from KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited consolidated financial statements for the purposes of presenting the financial position, results of operations and cash flows of the Group on a stand-alone basis. The combined financial statements of the Group reflect assets, liabilities, revenues and expenses directly attributable to the Group, as well as allocations deemed reasonable by the Directors of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited.

The financial information included herein may not reflect the combined financial position,

1.1 Basis of preparation (continued)

results of operations, changes in net investment and cash flows of the Group in the future or what they may have been had the Group been a separate, stand-alone entity during the periods presented. All intragroup (between the combining entities) balances, and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the combined financial statements.

(c) Basis of measurement

These financial statements have been prepared under the historical cost basis, except for the following:

- Financial instruments measured at fair value, including financial assets backing insurance policies designated at fair value through profit or loss, equity investments designated at fair value though other comprehensive income and derivatives
- Assets held for sale - measured at fair value less cost of disposal.

(d) Functional and presentation currency

These Financial statement are presented in Australian Dollars, which is Latitude Financial Services Group's deemed functional and presentation currency.

(e) Rounding of amounts

Amounts in the financial statements have been rounded off to the nearest thousand dollars, or in certain cases, the nearest dollar.

(f) Significant estimates and judgements

The preparation of financial statements that conform to accounting standards requires Management to exercise judgement in applying the Group’s accounting policies and to make estimates and assumptions. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that may have a financial impact on the Group and that are believed to be reasonable under the circumstances.

Areas involving assumptions and estimates that are significant to the financial statements or areas requiring a higher degree of judgement, are disclosed in the following notes:

- Section 3.1: Recoverability of loans and other receivables
- Section 5: Estimation of insurance claims liability
- Section 5: Recoverability of goodwill and other intangible assets and estimated useful life (other than goodwill)

1.2 Other significant accounting policies

Significant accounting policies adopted in the preparation of these combined financial statements have been included in the relevant notes to which the policies relate. Other significant accounting policies are listed below. These policies have been consistently applied to all the years presented, unless otherwise stated.

1.2 Other significant accounting policies (continued)

(a) Foreign currency translation

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency').

Transactions and balances
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the combined income statement. Non-monetary items that are measured based on historical cost in a foreign currency are translated using the spot exchange rate at the date of the transaction. Foreign exchange gains and losses are presented in the combined income statement on a net basis within other operating income or other expenses.

Group companies
The results and financial position of foreign operations that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet,
- Income and expenses for each combined income statement are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions), and
- All resulting exchange differences are recognised in other comprehensive income.

(b) Principles of consolidation

Subsidiaries
Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases. The acquisition method of accounting is used to account for business combinations by the Group. Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Non-controlling interests in the results and net investment of subsidiaries are shown separately in the combined income statement, combined statement of changes in net investment and combined balance sheet respectively.

1.3 New and amended standards

(a) New and amended standards adopted

IFRS 9 Financial instruments (2014) became effective to the Group at 1 January 2018. The main impact of adopting IFRS 9 has been on the measurement of the Group's collective provisioning

Notes to the Combined Financial Statements

For the year ended 31 December 2018

1.3 New and amended standards (continued)

models where a new accounting policy on provision for losses on loans and advances was applied from 1 January 2018 (refer Section 3.1). The requirements were applied using the modified retrospective method and on transition, the opening balance sheet was adjusted where the provision for impairment losses increased $24.3 million (Refer Section 3.2 Provision for impairment losses) and retained earnings reduced $17.1 million, net of income taxes. Comparative information has not been restated.

The Group has elected to designate an equity investment that is not held for trading as fair value through other comprehensive income (FVOCI). This investment was previously classified as available-for-sale under IAS 39 and is shown within Other financial assets on the balance sheet. All financial assets backing insurance policies continue to be designated as fair value through profit or loss (FVPL). There have been no other significant changes to the classification and measurement of the Group's financial instruments.

As permitted by the provisions, the Group continues to apply general hedge accounting requirements under IAS 39 (with the exception of hedge accounting disclosure which is applicable under the new standard). Refer to Sections 3.1 and 3.2 for hedge accounting disclosure.

IFRS 15 Revenue from Contracts with Customers became effective at 1 January 2018. It replaced IAS 18 Revenue and related interpretations. The Standard requires revenue to be recognised when control of a good or service transfers to a customer.

The Group adopted the Standard on a cumulative basis. On transition, deferred income increased $1.0 million and retained earnings reduced by $0.8 million, net of income taxes. Comparative information has not been restated.

Other amended standards

Other amended Standards that became effective for the financial year ended 31 December 2018 did not have a material impact on the Group.

(b) New standards and interpretations not yet adopted

The following standards have been published that are not mandatory for 31 December 2018 reporting periods and have not been early adopted by the Group. The Group expects to adopt these on their effective dates.

IFRS 16 Leases - IFRS 16 is effective for financial years commencing on or after 1 January 2019 and will replace IAS 17 Leases. IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right of use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. There are recognition exemptions for short-term leases and leases of low value items. An assessment of the impact of the adoption of IFRS 16 on the Group's operating leases has been undertaken, and it is estimated that on transition, retained earnings would reduce by $2.3 million as a result of the additional recognition of $74.0 million of right of use assets, $80.5 million of lease liabilities, $23.2 million of deferred tax assets and $22.2 million of deferred tax liabilities. In addition, other adjustments of $3.2 million for the pre-existing straight lining liability and onerous lease provision will be taken as an adjustment

1.3 New and amended standards (continued)

to retained earnings.

IFRS 17 Insurance Contracts - IFRS 17 is effective for financial years commencing on or after 1 January 2022. The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts. The objective of IFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows. The Group is currently assessing the impact of the new requirements on the Group's Insurance business.

IFRIC 23 Uncertainty over Income Tax Treatments – The Interpretation is effective for financial years commencing on or after 1 January 2019. The new interpretation clarifies the accounting for uncertainties in income taxes in relation to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. This has had an immaterial impact on the Group.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

Section 2 - Results

2.1 Segment information

(a) Description of segments

The Group's Chief Executive Officer (CEO) and Executive Committee (EC) are responsible for the overall performance of the Group and take accountability for monitoring the Group's business, affairs and setting its strategic direction, establishing policies and overseeing the Group's financial position. The CEO and EC assess the business on a Risk Adjusted Income basis (RAI), where RAI is total revenue, being interest income and other operating income, net of interest expense, loan impairment expense and insurance claims and expenses. Operating expenditure is not allocated to any segments or business units, but rather managed at a Group level.

The CEO and EC have identified three reportable segments of its business:

- **Australia:** Sales finance, credit cards, personal loans and auto loans
- **New Zealand:** Sales finance, credit cards and personal loans
- **Other/unallocated:** Consumer credit insurance (Hallmark life and general companies), other statutory adjustments not directly attributable to segments for management decision making purposes and unallocated operating expenses.

The Group's business segments operate principally in Australia and New Zealand. The Hallmark Insurance business also operates business in New Zealand, which is not material for geographic segment information disclosure purposes.

A segment overview is presented below. During the year, $1,011.2 million of external revenue was generated within the country of Australia (2017: 992.5 million) and $261.1 million of external revenue was generated within the country of New Zealand (2017: $236.9 million). At 31 December 2018 there were $3,203.6 million non-current assets in the country of Australia (2017: $2,934.5 million) and $1,361.6 million non-current assets in the country of New Zealand (2017: $1,185.2 million).

Australia charges Hallmark insurance and New Zealand a management fee and Hallmark insurance pays commission to other segments. Sales between segments are carried out at arm's length and are eliminated on combination when they arise within the Group.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

2.1 Segment information (continued)

(b) Segment overview

Year ended 2018	Australia $'000	New Zealand $'000	Other/ Unallocated $'000	Total $'000
Interest income	914,896	240,745	(19,990)	1,135,651
Interest expense	(215,505)	(54,356)	(93,296)	(363,157)
Other operating income	58,872	8,171	1,057	68,100
Net insurance income	-	-	48,938	48,938
Loan impairment expense	(208,979)	(44,398)	-	(253,377)
Risk adjusted income before inter-seg. adjustment	**549,284**	**150,162**	**(63,291)**	**636,155**
Inter-segment risk adjusted income	(6,743)	(4,532)	11,275	-
Risk adjusted income as reported by the Combined Group	542,541	145,630	(52,016)	636,155
Operating expenses	-	-	(504,160)	(504,160)
Distribution to Trust beneficiaries	-	-	(74,487)	(74,487)
Income tax expense	-	-	(13,231)	(13,231)
Profit/(loss) from continuing operations	542,541	145,630	(643,894)	44,277
Segment balance sheet information				
Total segment assets	5,901,076	1,563,819	1,239,726	8,704,621
Inter-segment assets eliminated on consolidation	(4,512)	-	(1,069)	(5,581)
Total assets reported by the Combined Group	**5,896,564**	**1,563,819**	**1,238,657**	**8,699,040**
Total segment liabilities	5,481,306	1,555,666	1,287,925	8,324,897
Inter-segment liabilities eliminated on consolidation	-	(5,581)	-	(5,581)
Total liabilities reported by the Combined Group	**5,481,306**	**1,550,085**	**1,287,925**	**8,319,316**

Year ended 2017	Australia $'000	New Zealand $'000	Other/ Unallocated $'000	Total $'000
Interest income	891,540	216,536	(38,799)	1,069,277
Interest expense	(195,545)	(48,634)	(100,609)	(344,788)
Other operating income	61,971	7,013	-	68,984
Net insurance income	-	-	52,324	52,324
Loan impairment expense	(219,225)	(36,888)	-	(256,113)
Risk adjusted income before inter-seg. adjustment	**538,741**	**138,027**	**(87,084)**	**589,684**
Inter-segment risk adjusted income	(9,447)	(3,859)	13,306	-
Risk adjusted income as reported by the Combined Group	529,294	134,168	(73,778)	589,684
Operating expenses	-	-	(499,011)	(499,011)
Distribution to Trust beneficiaries	-	-	(57,033)	(57,033)
Income tax expense	-	-	(16,142)	(16,142)
Profit/(loss) from continuing operations	529,294	134,168	(645,964)	17,498
Segment balance sheet information				
Total segment assets	5,660,949	1,343,144	1,151,162	8,155,255
Inter-segment assets eliminated on consolidation	(11,848)		(1,501)	(13,349)
Total assets reported by the Combined Group	**5,649,101**	**1,343,144**	**1,149,661**	**8,141,906**
Total segment liabilities	5,534,644	1,264,289	998,296	7,797,229
Inter-segment liabilities eliminated on consolidation	-	(9,448)	(3,901)	(13,349)
Total liabilities reported by the Combined Group	**5,534,644**	**1,254,841**	**994,395**	**7,783,880**

Notes to the Combined Financial Statements

For the year ended 31 December 2018

2.2 Revenue and expenses

Accounting Policy

Revenue Recognition
(IFRS 15 – applied from 1 January 2018)
The adoption of IFRS 15 did not significantly change the accounting policies relating to revenue recognition as shown below. Under IFRS 15, interest is applied to the gross carrying value of a financial asset unless the asset is credit impaired, in which case it is applied to the net carrying value.

Revenue Recognition
(IAS 18 – 2017 comparative year)
The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities below. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Revenue from customer loans
Interest income on loans is recognised using the effective interest method. The effective interest method is a way of calculating the amortised cost using the effective interest rate (EIR) of the financial asset or financial liability. The EIR is a rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument, or when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. Loan origination fees and costs are deferred over the life of the loan and are recognised as an adjustment of the yield. Unless included in the EIR calculation, fees and commissions are recognised on an accruals basis when the service has been provided and all other loan-related costs are expensed as occurred.

Fair value adjustments in relation to acquisition date fair value measurement of loan receivables recorded as a result of business combinations are amortised and included as part of interest income over the estimated customer repayment period. The amortisation period is accelerated when the remaining fair value adjustment is determined to be less than 10% of the original amount.

Insurance premium revenue
Premium revenue comprises amounts charged to policyholders (direct premium) for insurance contracts, excluding stamp duties and taxes collected on behalf of third parties, including GST. Premium revenue is recognised in the profit or loss with the incidence of the pattern of risk. Generally, the premium is earned according to the passing of time, but where time does not approximate the pattern of risk, previous claims experience is used to derive the incidence of risk. Premium for unclosed business (business written close to reporting date where attachment of risk is prior to reporting date and there is insufficient information to accurately identify the business) is brought to account based on previous experience with due allowance for any changes in the pattern of new business and renewals. The unearned portion of premium is recognised within unearned premium liability in the balance sheet.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

2.2 Revenue and expenses (continued)

Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not recoverable from the taxation authority. In this case, it is recognised as part of the cost of acquisition of the asset or as part of the expense. Receivables and payables are stated inclusive of the amount of GST receivable or payable. The net GST recoverable from, or payable to, the taxation authority is included with other receivables or payables in the combined balance sheet. Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities which are recoverable from, or payable to the taxation authority, are presented as operating cash flows.

(a) Net interest income

	2018 $'000	2017 $'000
Interest income		
Interest income	**1,135,651**	1,069,277
Total interest income	**1,135,651**	1,069,277
Interest expense		
Finance costs on borrowings	**(363,157)**	(344,788)
Net interest income	**772,494**	724,489

Interest income includes adjustments in relation to acquisition date fair value measurement of loan receivables of $20.0 million (2017: $38.8 million).

(b) Other operating income

	2018 $'000	2017 $'000
Interchange and operating fees	**52,405**	53,454
Other	**4,421**	2,191
Total other operating income	**56,826**	55,645

(c) Net insurance income

	2018 $'000	2017 $'000
Insurance premium revenue	**74,112**	79,171
Insurance claims and expenses	**(19,090)**	(19,350)
Investment income	**5,190**	5,842
Total net insurance income	**60,212**	65,663

Notes to the Combined Financial Statements

For the year ended 31 December 2018

2.2 Revenue and expenses (continued)

(d) Other operating expenses

	2018 $'000	2017 $'000
Administrative and professional expenses	**(85,288)**	(58,784)
Occupancy and operating expenses	**(45,533)**	(54,730)
Marketing expenses	**(40,661)**	(38,918)
IT and data processing expenses	**(42,327)**	(62,477)
Other expenses	**(14,980)**	(25,310)
Impairment loss on intangible assets and PPE	**(16,319)**	(444)
Remediation	**(10,988)**	-
Transition and replatforming	**(5,734)**	(16,434)
Latitude 2.0 transformation	**(462)**	-
Restructuring costs	**-**	(12,390)
Total other operating expenses	**(262,292)**	(269,487)

(e) Reconciliation of profit after income tax to net cash inflow from operating activities

	2018 $'000	2017 $'000
Net profit after income tax	**44,277**	17,498
Decrease in interest receivable	**10,823**	66,019
Increase in interest payable	**13,120**	16,233
Depreciation and amortisation	**68,838**	75,269
Loan impairment expense	**350,963**	351,815
Other (income)/expenses and write downs	**(4,312)**	50,064
Increase in loans and other receivables	**(878,574)**	(744,477)
Net decrease in other assets	**855**	2,575
Increase in deferred tax assets	**(11,943)**	(5,715)
(Decrease)/increase in provisions	**47,188**	301
Increase/(decrease) in gross insurance policy liabilities	**(861)**	(2,578)
Increase in trade and other liabilities	**98**	33,593
Decrease in deferred tax liabilities	**(18,540)**	(21,922)
Net cash (used in)/provided by operating activities	**(378,068)**	(161,325)

Notes to the Combined Financial Statements

For the year ended 31 December 2018

2.3 Income tax expense and deferred tax

Accounting Policy

Taxation

For the purposes of the Combined Financial Statements, income tax is accounted:
-For the Australian tax consolidation group, being KVD Australia Holdco Pty Ltd and its Australian subsidiaries, on the basis as detailed in the tax consolidation legislation policy below; and
-The Australian tax consolidation Group is aggregated with Latitude Financial Services Limited and its New Zealand subsidiaries in accordance with the principles as described in the Basis of Preparation.

Income tax

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses. The current income tax charge is calculated based on the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Companies subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate, based on amounts expected to be paid to the tax authorities.

Deferred tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts. Deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill. Deferred income tax is also not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination, that, at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses. Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and liabilities are offset when there is a legally enforceable right to offset and an intention to settle the liability simultaneously. Current and deferred tax is recognised in the combined income statement except to the extent that it relates to items recognised in other comprehensive income or directly in net investment. In this case, the tax is also recognised in other comprehensive income or directly in net investment respectively.

Tax consolidation legislation (Australian Parent and Group only)

KVD Australia Holdco Pty Ltd, which is the parent of the Australian Group and its wholly-owned controlled entities have implemented the tax consolidation legislation from December 2015. On adoption of the tax consolidation legislation, the entities in the tax consolidated group entered into a tax sharing agreement which limits the joint and several liability of the wholly-

2.3 Income tax expense and deferred tax (continued)

owned entities in the case of a default by the head entity, KVD Australia Holdco Pty Ltd. The entities are taxed as a single entity and the deferred tax assets and liabilities of these entities are set-off in the consolidated financial statements. The head and controlled entities in the tax consolidated group account for their own current and deferred tax accounts. These tax amounts are measured as if each entity in the tax consolidation group was a separate taxpayer with the group. In addition to its own current and deferred tax amounts, the Australian parent company also recognises the current tax liabilities (assets) and the deferred tax assets arising from unused tax losses and unused tax credits assumed from controlled entities in the tax consolidation group.

The entities have also entered into a tax funding agreement under which the wholly-owned entities fully compensate the Australian parent company for any current tax payable assumed. The funding amounts are determined by reference to the amounts recognised in the wholly-owned entities' financial statements. The amounts receivable or payable under the tax funding agreement are due upon receipt of the funding advice from the head entity, which is used as practicable after the end of the financial year. The funding amounts are recognised as intercompany receivables. Where a member of the income tax consolidated group recognises a taxable loss, the funding amount is nil with no compensation for the tax losses, unless the member is subject to prudential regulation by the Australian Prudential Regulation Authority, in which case the regulated entity will be compensated for its tax losses. Assets or liabilities arising under tax funding agreements with the tax consolidated entities are recognised as amounts receivable from or payable to other entities in the Group. Any difference between the amounts assumed and amounts receivable or payable under the agreement are recognised as an equity contribution to (or distribution from) wholly-owned tax consolidation entities.

2.3 Income tax expense and deferred tax (continued)

(a) Income tax expense

	2018 $'000	2017 $'000
Current tax on profits for the year	**39,253**	43,933
Deferred tax expenses	**(20,293)**	(30,603)
(Over)/under provision in prior year	**(5,541)**	2,853
Foreign exchange differences arising on translation	**(188)**	(41)
Income tax expense	**13,231**	16,142

(b) Numerical reconciliation of income tax expense to prima facie tax payable

	2018 $'000	2017 $'000
Profit from continuing operations before income tax expense	**57,508**	33,640
Tax at the Australian tax rate of 30%	17,253	10,092
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:		
Permanent differences (^)	**2,036**	3,291
Effect of differences in tax rates in foreign jurisdictions	**(517)**	(101)
Other	**-**	7
Adjustments of prior periods	**(5,541)**	2,853
Income tax expense	**13,231**	16,142

(^) Includes monitoring & advisory fees, income from trust operations, amortisation of acquisition costs and other items.

(c) Amounts recognised directly in net investment

	2018 $'000	2017 $'000
Deferred income tax expense/(benefit) related to items taken directly to equity	**(8,660)**	159

The above amount primarily relates to the adoption of IFRS 9 ($7.3 million), impacting the provision and other liabilities deferred tax asset.

(d) Deferred tax expense represents movements in deferred tax assets/liabilities

	2018 $'000	2017 $'000
Provisions and other liabilities	**(9,359)**	(11,285)
Carried forward tax losses	**-**	1,642
Deferred income	**2,336**	3,184
Acquisition transaction costs	**3,435**	3,532
Property, plant and equipment	**6,744**	(2,742)
Intangible assets	**(14,687)**	(25,905)
Deferred expenses and prepayments	**1,189**	638
Others	**(9,951)**	333
	(20,293)	(30,603)

Notes to the Combined Financial Statements

For the year ended 31 December 2018

2.3 Income tax expense and deferred tax (continued)

(e) Deferred tax assets and liabilities

	2018 $'000	2017 $'000
Deferred tax assets		
Provisions and other liabilities	**119,248**	102,003
Deferred income	**47,068**	49,075
Acquisition transaction costs	**3,568**	7,115
Property, plant and equipment	**2,496**	8,577
Others	**6,061**	23
	178,441	166,793
Deferred tax liabilities		
Intangible assets	**81,378**	101,199
Deferred expenses & prepayments	**7,295**	6,072
Other	**524**	760
	89,197	108,031
Net deferred tax assets/ (liabilities)	**89,244**	58,762
Amounts expected to be settled within 12 months	**85,272**	78,417
Amounts expected to be settled after more than 12 months	**3,972**	(19,655)
	89,244	58,762

The movement during the period in the above deferred tax assets and deferred tax liabilities are shown in Note 2.3(c) and 2.3(d), with some immaterial foreign exchange translation.

2.4 Shareholder returns

Accounting Policy

Dividends

Provision is made for the amount of any dividend declared, being appropriately authorised and no longer at the discretion of the Group, on or before the end of the reporting period but not distributed at the end of the reporting period.

Distributions

In accordance with the relevant Trust Constitution, the Trustee distributes income from structured trusts of the Group to a unit holder which is a non-controlled related party of the Group. These distributions have been treated as distributions to a non-controlling interest.

(a) Dividends

No ordinary share dividends were declared or paid during the year (2017: $nil).

Notes to the Combined Financial Statements

For the year ended 31 December 2018

Section 3 - Financial Instruments and Risk Management

3.1 Financial assets and liabilities

Accounting Policy

Classification - Financial assets and liabilities (IFRS 9 - applied from 1 January 2018)

Amortised cost

Debt instruments are measured at amortised cost if both the following conditions apply:
(a) the instrument is held to collect contractual cash flows, rather than being sold prior to contractual maturity to realise fair value changes; and
(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Loans and other receivables

Loan receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Group did not intend to sell immediately or in the near term. Loans and advances are amounts due from customers in the ordinary course of business, being the provision of consumer finance via credit cards, sales finance, personal loans and automotive loans. They are initially recognised at fair value plus directly attributable transaction costs and subsequently measured at amortised cost, using the effective interest method, net of any provision for doubtful debts.

Trade and other liabilities

These amounts represent liabilities for goods and services provided to the Group prior to the end of the financial year which are unpaid. The amounts are unsecured and are usually paid within 60 days of recognition.

Borrowings

Borrowings are initially recognised at fair value, net of directly attributable transaction costs and subsequently measured at amortised cost, using the effective interest method. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in profit or loss over the period of the borrowings using the effective interest method. Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. Borrowings are removed from the balance sheet when the obligation specified in the contract is discharged, cancelled or expired.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held at call with financial institutions, restricted cash and other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash.

Fair value through profit or loss (FVPL)

The Group may choose to designate, at initial recognition, a financial asset or a financial liability at FVPL if it eliminates or reduces an accounting mismatch. Equity investments are measured at FVPL unless the Group has elected to measure them as FVOCI below.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

3.1 Financial assets and liabilities (continued)

Financial assets backing insurance liabilities
Financial assets backing insurance policies are measured at fair value through profit or loss, with gains and losses being recognised through profit or loss.

Fair value through other comprehensive income (FVOCI)

Other financial assets
The Group may elect to measure its non-traded equity instruments at fair value through other comprehensive income, with only dividend income being recognised in profit or loss.

Classification - Financial assets and liabilities (IAS 39 - 2017 comparative year)

Amortised cost

Loans and other receivables
Loan receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Group did not intend to sell immediately or in the near term. Loans and advances are amounts due from customers in the ordinary course of business, being the provision of consumer finance via credit cards, sales finance, personal loans and automotive loans. They are initially recognised at fair value plus directly attributable transaction costs and subsequently measured at amortised cost, using the effective interest method, net of any provision for doubtful debts.

Trade and other liabilities
These amounts represent liabilities for goods and services provided to the Group prior to the end of financial year which are unpaid. The amounts are unsecured and are usually paid within 60 days of recognition.

Borrowings
Borrowings are initially recognised at fair value, net of directly attributable transaction costs and subsequently measured at amortised cost, using the effective interest method. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in profit or loss over the period of the borrowings using the effective interest method. Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. Borrowings are removed from the balance sheet when the obligation specified in the contract is discharged, cancelled or expired.

Fair value through profit or loss (FVPL)

Cash and cash equivalents
Cash and cash equivalents include cash on hand, deposits held at call with financial institutions, restricted cash and other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash.

Financial assets backing insurance liabilities
Financial assets backing insurance policies are measured at fair value through profit or loss, with gains and losses being recognised through profit or loss.

3.1 Financial assets and liabilities (continued)

Available-for-sale (AFS)

Other financial assets

The Group may elect to designate equity instruments not held for trading as available-for-sale, where fair value gains and losses are recognised in other comprehensive income.

Loss provisioning (under IFRS 9 - applied from 1 January 2018)

Provision for losses on loans and advances

Loss provisioning is based on a three-stage approach to measuring expected credit losses (ECLs) for loans and advances which is based on the change in credit quality of financial assets since initial recognition:

Stage 1: Where there has been no significant increase in the risk of default since origination, reserves reflect the portion of the lifetime ECL from expected defaults in the following twelve months.
Stage 2: For assets where there has been a significant increase in risk since origination but are not credit impaired, a lifetime ECL is recognised.
Stage 3: For assets deemed as credit impaired, a lifetime ECL is recognised.

The Group determines that a significant increase in risk occurs when an account is more than 30 days delinquent since origination. Exposures are assessed as credit impaired where the Group determines that an account is in default, being an account that is either 90 days or more past due or it is an account identified as bankrupt, deceased or fraudulent or any account in litigation or in hardship. ECLs are derived from probability-weighted estimated loss measures taking account of possible outcomes, the time value of money and current and future economic conditions. Customer loans are grouped on the basis of shared credit risk characteristics and lending type, by product category. As asset quality deteriorates an exposure will move through ECL stages. As asset quality improves, an asset that was previously assessed as a significant increase in credit risk that had lifetime ECL, may in subsequent periods revert back to Stage 1.

Modified loans comprise financial assets under a hardship arrangement or those in the process of litigation. When a flag indicator is removed from the account of a modified financial asset, signalling the end of the modification arrangement, then the loss allowance for the financial asset will revert to being measured at an amount equal to Stage 1 12-month ECL if the financial asset is less than 30 days past due and is not flagged as bankrupt, deceased, fraud, hardship or litigation status. ECL for a previously modified financial asset can subsequently be remeasured at an amount equal to lifetime ECL when the delinquency is between 30 and 89 days past due (Stage 2), or when the delinquency is greater than or equal to 90 days past due, or is flagged as bankrupt, deceased, fraud, hardship or litigation status (Stage 3).

Loans and advances from customers are written off when they are deemed non-collectable at a portfolio level, or at an earlier date depending on customer status. Subsequent recoveries of loans from legal enforcement relating to an amount previously charged off are set off against loan impairment expenses in the statement of profit or loss and other comprehensive income.

3.1 Financial assets and liabilities (continued)

Loss provisioning (under IAS 39 - 2017 comparative year)

Provision for losses on loans and advances

Impaired loans are defined as loans and advances where the contractual interest or principal repayments have not been met by the contractual due date. Customer delinquency status is based on the cumulative number of contractual payments outstanding. A loan that is past due may return to current status where certain conditions have been satisfied. Losses on loan receivables are recognised when they are incurred, which requires the Group to identify objective evidence that the receivable is impaired and make the best estimate of incurred losses inherent in the portfolio. Financial assets are grouped based on similar credit risk characteristics and collectively assessed for impairment. When evidence of impairment exists, the allowance for losses is based upon historical loss experience for portfolios with similar payment history and judgements about probable effects of observable data. The Group updates its assumptions and estimates periodically, to reflect current conditions. Managements' judgement is used to measure impairment of loans and advances at the reporting date. The key judgements used in determining the collective provision are estimated cash flows; historical loss experience of assets with similar characteristics; and assessment of the economic cycle.

Derivative Financial Instruments (The Group continues to apply hedge accounting under IAS 39).

Derivatives are classified as FVPL unless they are designated hedging instruments. They are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured to their fair value at the end of each reporting period. The accounting for subsequent changes in fair value depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates derivatives as hedges of a particular risk associated with the cash flows of recognised assets and liabilities and highly probable forecast transactions (cash flow hedges). The Group documents at the inception of the hedging transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. It also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions have been and will continue to be highly effective in offsetting changes in fair values of cash flows on hedged items.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income and accumulated in reserves in net investment. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss within other income or other expenses. When a hedging instrument expires or is sold or terminated, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in net investment at that time remains in net investment and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in net investment is immediately reclassified to profit or loss.

Derivatives that do not qualify for hedge accounting

Changes in the fair value of any derivative instrument that does not quality for hedge accounting are recognised immediately in profit or loss and are included in other income or other expenses.

3.1 Financial assets and liabilities (continued)

(a) Financial assets and financial liabilities

Financial assets	**Notes**	**Assets designated FVOCI $'000**	**Assets designated FVPL $'000**	**Derivatives used for hedging $'000**	**Assets at amortised cost $'000**	**Total $'000**
2018						
Cash and cash equivalents	3.1(b)	**-**	**206,120**	**-**	**312,484**	**518,604**
Loans and other receivables	3.1(c)	**-**	**-**	**-**	**7,095,709**	**7,095,709**
Derivative financial instruments	3.1(d)	**-**	**-**	**376**	**-**	**376**
		-	**206,120**	**376**	**7,408,193**	**7,614,689**
2017						
Cash and cash equivalents	3.1(b)	-	203,090	-	236,600	439,690
Loans and other receivables	3.1(c)	-	-	-	6,603,364	6,603,364
Derivative financial instruments	3.1(d)	-	-	1,477	-	1,477
Other financial assets		2,400	-	-	-	2,400
		2,400	203,090	1,477	6,839,964	7,046,931

Financial liabilities	**Notes**	**Liabilities at FVPL $'000**	**Derivatives used for hedging $'000**	**Liabilities at amortised cost $'000**	**Total $'000**
2018					
Trade and other liabilities	5.1(d)	**-**	**-**	**247,535**	**247,535**
Derivative financial instruments	3.1(d)	**-**	**4,426**	**-**	**4,426**
Borrowings	3.1(e)	**-**	**-**	**7,820,091**	**7,820,091**
		-	**4,426**	**8,067,626**	**8,072,052**
2017					
Trade and other liabilities	5.1(d)	-	-	214,122	214,122
Derivative financial instruments	3.1(d)	139	1,184	-	1,323
Borrowings	3.1(e)	-	-	7,287,535	7,287,535
		139	1,184	7,501,657	7,502,980

The above tables provide information regarding the measurement of financial assets and financial liabilities, which were unchanged subsequent to the adoption of IFRS 9. Refer to Note 1.3(a) for further details regarding changes in classification for IFRS 9 purposes.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

3.1 Financial assets and liabilities (continued)

(b) Cash and cash equivalents

	2018 $'000	2017 $'000
Current assets		
Cash and cash equivalents	**311,439**	237,835
Short term deposits	**199,789**	196,385
Restricted cash	**7,376**	5,470
	518,604	439,690

(c) Loans and other receivables

	2018 $'000	2017 $'000
Loans and advances		
Loans and advances	**7,575,455**	7,050,960
Unearned income	**(175,439)**	(184,606)
Provision for impairment losses	**(324,867)**	(286,742)
Total loans and advances	**7,075,149**	6,579,612
Other receivables		
Trade receivables	**12,398**	9,881
Other receivables	**8,162**	13,871
Total other receivables	**20,560**	23,752
Total loans and other receivables	**7,095,709**	6,603,364
Current	**3,510,264**	3,676,002
Non-current	**3,585,445**	2,927,362
Total loans and other receivables	**7,095,709**	6,603,364

Due to the short-term nature of the current receivables, their fair value is assumed to be the same as their carrying value. For the majority of the non-current receivables, the fair values are also not significantly different to their carrying amounts.

Information about the impairment of loans and other receivables, their credit quality and the group's exposure to credit risk and other risks can be found in section 3.2.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

3.1 Financial assets and liabilities (continued)

(d) Derivatives

	2018 $'000	2017 $'000
Current derivative assets		
Interest rate swap contracts - cash flow hedges	**19**	9
Forward foreign exchange contracts	**350**	-
Total current derivative financial instrument assets	**369**	9
Non-current derivative assets		
Interest rate swap contracts - cash flow hedges	**7**	1,468
Total non-current derivative financial instruments	**7**	1,468
Total derivative assets	**376**	1,477
Current derivative liabilities		
Interest rate swap contracts - cash flow hedges	**151**	29
Forward foreign exchange contracts	**-**	139
Total current derivative financial instrument liabilities	**151**	168
Non-current derivative liabilities		
Interest rate swap contracts - cash flow hedges	**4,275**	1,155
Total non-current derivative financial instrument liabilities	**4,275**	1,155
Total derivative liabilities	**4,426**	1,323

The Group enters into derivative transactions for economic hedging purposes under International Swaps and Derivatives Association ('ISDA') master agreements. The agreements generally allow for simultaneous netting of payments in relation to each party's obligations for derivative assets and liabilities. Therefore, although the Group does not have a current legal enforceable right of set off and does not offset the assets and liabilities on the balance sheet, it will settle the derivative on a net basis simultaneously when the amounts due or owed are with the same counterparty.

No financial assets or liabilities have been offset in the balance sheet.

3.1 Financial assets and liabilities (continued)

(e) Borrowings

			2018			2017
	Current $'000	Non-current $'000	Total $'000	Current $'000	Non-current $'000	Total $'000
Secured						
Securitisation liabilities	**231,132**	**6,681,042**	**6,912,174**	2,512	6,388,805	6,391,317
Total secured borrowings	**231,132**	**6,681,042**	**6,912,174**	2,512	6,388,805	6,391,317
Unsecured						
Shareholder loan	**1,736**	**906,181**	**907,917**	1,267	894,951	896,218
Total unsecured borrowings	**1,736**	**906,181**	**907,917**	1,267	894,951	896,218
Total borrowings	**232,868**	**7,587,223**	**7,820,091**	3,779	7,283,756	7,287,535

Borrowings are shown net of capitalised transaction costs, where unamortised transaction costs of $43.6 million are set off against borrowings at 31 December 2018 (2017: $57.6 million). During the year $4.9 million (2017: $17.4 million) of borrowing costs were capitalised.

The contractual maturities attached to the securitisation liabilities range between 3-25 years. Actual securitisation liability repayments occur once the trust reaches contractual amortisation periods (commencing in 0-5 years) based on assumed repayment patterns in the underlying receivables. Refer to Note 3.2(u) for further details relating to liquidity management.

The movement in shareholder loan during the year include non-cash movements of; $9.4 million increase from the effects of exchange rate differences on translation of foreign operations; $0.5 million decrease in accrued interest and $2.8 million increase in adjustments to transaction costs. The movement in securitisation liabilities during the year include proceeds from issuances and drawdowns of $1,865.9 million, net of repayments of borrowings of $1,341.5 million and transaction costs paid of $4.9 million. In addition there were non-cash movements of $1.4 million from the effects of exchange rate differences on translation of foreign operations, adjustments to transaction costs and accrued interest.

In 2018 the Group continued to develop and enhance its funding capacity via securitisation vehicles. On 27 March 2018 a further $500 million of notes (Series 2018-1) were issued from the Latitude Australia Credit Card Loan Note Trust. On 22 December 2018, an increase of $380 million in the committed facilities to the Australian Auto Loans Trust was agreed with existing and new lenders, effective 21 January 2019. A New Zealand credit card master trust programme was established during the year to further diversify the group's funding, securitising eligible revolving product receivables. In 2018, the programme issued NZ$200 million of notes (Series 2018-1) and a NZ$20 million variable funding note to a bank. On 10 December 2018 an increase of NZ$50 million in the committed facilities to the New Zealand Personal Loans Trust was agreed with existing lenders. The note holders have full recourse to the pool of loans and advances which have been securitised.

3.1 Financial assets and liabilities (continued)

KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited each have a committed facility that can provide funding for the business. At 31 December 2018, the facilities remained unutilised (2017: $nil). The facilities are secured by a fixed charge over the Group's assets (excluding customer receivables sold into the securitisation trusts above, all collections related to these assets and Insurance assets) and secured by a pledge that imposes certain covenants on the subsidiary that has received those loans. The pledge states that (subject to certain exceptions) the Group will not, unless required by law, under a Trust Document or expressly part of a retailer agreement; provide any other security over the pledged assets; sell or dispose of any assets subject to the pledge, or commingle any pledged assets with non-pledged assets.

Under the terms of the major borrowing facilities, the Group is required to comply with financial covenants. The Group has complied with these covenants during the 2018 reporting year.

For the Group's borrowings, the fair values are not materially different to their carrying amounts, since the interest payable on those borrowings is either close to current market rates or the borrowings are of a short-term nature.

3.1 Financial assets and liabilities (continued)

(f) Recognised fair value measurements

The Group uses valuation techniques and hierarchy levels to determine the value of its financial instruments measured at fair value. Three classification levels are used. There were no transfers between levels for recurring fair value measurements during the year.

Level 1**:** This includes instruments for which the valuation is based on quoted market prices.

Level 2**:** This includes instruments that do not have quoted market prices, where observable market data is used to determine fair value.

Forward exchange contracts are valued using forward pricing valuation techniques. The fair value is determined using quoted forward exchange rates at the reporting date and present value calculations based on high credit quality yield curves in the respective currencies.

Interest rate swaps are valued using swap models. The fair value is calculated as the present value of the estimated future cash flows. Estimates of future floating-rate cash flows are based on quoted swap rates, future prices and interbank borrowing rates. Estimated cash flows are discounted using a yield curve constructed from similar sources and which reflects the relevant benchmark interbank rate used by market participants for this purpose when pricing interest rate swaps. The fair value estimate is subject to a credit risk adjustment that reflects the credit risk of the Group and of the counterparty; this is calculated based on credit spreads derived from current credit default swap or bond prices.

Level 3: This category level has no observable market data inputs.

The Group had one equity investment within this level in 2017, where the comparative fair value has been deemed to be cost, being the date the fair value could be reliably measured.

3.1 Financial assets and liabilities (continued)

(g) Recurring fair values

At 31 December 2018	Notes	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Financial assets					
Derivative financial assets					
Derivatives used for hedging - interest rate swaps	3.1(d)	**-**	**26**	**-**	**26**
Derivatives used for hedging - foreign exchange contracts	3.1(d)	**-**	**350**	**-**	**350**
Financial assets designated at FVOCI					
Total financial assets		**-**	**376**	**-**	**376**
Financial Liabilities					
Derivatives used for hedging - interest rate swaps	3.1(d)	**-**	**4,426**	**-**	**4,426**
Total financial liabilities		**-**	**4,426**	**-**	**4,426**
At 31 December 2017					
Financial assets					
Derivative financial assets					
Derivatives used for hedging - interest rate swaps	3.1(d)	-	1,477	-	1,477
Financial assets designated as Available-for-sale					
Other financial assets		-	-	2,400	2,400
Total financial assets		-	1,477	2,400	3,877
Financial Liabilities					
Derivative financial liabilities					
Derivatives used for hedging - interest rate swaps	3.1(d)	-	1,184	-	1,184
Derivatives used for hedging - foreign exchange contracts	3.1(d)	-	139	-	139
Total financial liabilities		-	1,323	-	1,323

The table shows the fair values of financial assets and financial liabilities, including their levels in the fair value hierarchy. It does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value.

(h) Level 3 fair values

Reconciliation from the opening balance to the closing balance for level 3 fair values:

	2018 $'000	2017 $'000
Other financial assets:		
Balance 1 January	**2,400**	2,400
Loss included in OCI		
Net change in fair value - unrealised	**(2,400)**	-
Balance 31 December	**-**	2,400

Prior to 1 January 2018, an equity investment was classified as AFS in accordance with IAS 39. From 1 January 2018 it is classified as FVOCI in accordance with IFRS 9.

3.2 Financial risk management

The main risks arising from the Group's financial instruments are credit risk, liquidity risk, interest rate risk and foreign currency risk.

The Group has established risk management processes and has an enterprise risk management framework in place that aims to ensure enterprise risks are effectively identified, measured, monitored and managed. The Group operates under a governance and risk management culture, managed ultimately by a Board Risk Committee, responsible for all enterprise risk. Risk management is cascaded to the business through approved strategies and policies, risk appetite statements and operating procedures that establish appropriate limits and controls to monitor and manage the level of risk exposure. The management committees supporting risk governance include the Asset and Liability Committee, who manage funding, liquidity and market risks, and the Risk Management Committee who manage strategic, credit, operational and financial risks. A 'three-line' of defence model is operated to comply with the risk management framework. Separate Committees govern the Australian Hallmark Insurance business, including for risk and compliance.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer fails to meet their contractual obligations, arising principally from the Group's loans to customers. The maximum exposure of the Group is represented by the carrying amount of loans and advances in the combined balance sheet.

Risk management
The Group has strategies in place to minimise future losses including the assessment of acceptable concentration of risk. New strategies are implemented to take appropriate action if adverse trends occur.

Impairment model
IFRS 9 introduced a new forward looking expected loss impairment model, replacing the IAS 39 incurred loss model that recognised impairment where there was objective evidence of default.

On transition to IFRS 9 at 1 January 2018, the provision for impairment losses, originally measured as $286.7 million at 31 December 2017 under IAS 39, has been remeasured to $311.0 million.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

3.2 Financial risk management (continued)

Exposure

(a) Total undrawn exposure of loans and advances to credit risk by credit risk rating grades (IFRS 9)

2018 Loans and advances undrawn	12-month ECL $'000	Lifetime ECL not credit impaired $'000	Lifetime ECL credit impaired, not POCI^ $'000	Lifetime ECL credit impaired, POCI^ $'000	Total $'000
Very low risk	8,015,719	-	-	2,307	8,018,026
Low risk	875,446	-	-	1,041	876,487
Medium risk	330,093	-	-	598	330,691
Moderate risk	63,028	-	-	132	63,160
High risk	59,071	-	-	30	59,101
Unrated	-	-	-	-	-
Total	9,343,357	-	-	4,108	9,347,465

^POCI: Purchased or Originated Credit Impaired

Credit risk rating

(b) Loans and advances by credit risk rating grades (IFRS 9)

2018 Gross loans and advances	12-month ECL $'000	Lifetime ECL not credit impaired $'000	Lifetime ECL credit impaired, not POCI^ $'000	Lifetime ECL credit impaired, POCI^ $'000	Total $'000
Very low risk	2,335,814	1,270	-	2,342	2,339,426
Low risk	2,026,569	4,772	-	6,228	2,037,569
Medium risk	1,560,285	6,702	-	10,719	1,577,706
Moderate risk	583,960	5,329	-	6,215	595,504
High risk	561,144	153,807	241,395	26,465	982,811
Unrated	35,426	6,016	997	-	42,439
Total	7,103,198	177,896	242,392	51,969	7,575,455

^POCI: Purchased or Originated Credit Impaired

The credit risk grade scale is used to summarise the risk distribution of the portfolio, based on the probability of an account going to default as determined by behavioural scorecards.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

3.2 Financial risk management (continued)

Credit quality

The ageing of loans and advances based on both the new impairment model under IFRS 9 and the number of days under IFRS 9 and IAS 39 is shown below:

(c) Loans and advances by credit quality (IFRS 9)

Gross loans and advances	**2018** **$'000**
Neither past due or impaired (not POCI^)	**6,267,530**
Past due but not impaired (not POCI^)	**1,013,564**
Impaired (not POCI^)	**242,392**
POCI^	**51,969**
Total	**7,575,455**

^POCI: Purchased or Originated Credit Impaired

(d) Loans and advances by credit quality (IAS 39)

Loans and advances past due but not impaired	**2017** **$'000**
Up to 3 months	1,113,392
3 to 6 months	53,942
	1,167,334

Past due loans are defined as loans and advances where the contractual interest or principal repayments have not been met by the contractual due date. Customer delinquency status is based on the cumulative number of contractual payments outstanding. A loan that is past due may return to current status where certain conditions have been satisfied.

(e) Loans and advances past due (IFRS 9 (2018) and IAS 39 (2017))

Gross loans and advances	**2018** **$'000**	**2017** **$'000**
Current	**6,419,235**	5,847,994
Past due 1-29 days	**874,307**	923,347
Past due 30-89 days	**200,953**	201,255
Past due > 90 days	**80,960**	78,364
	7,575,455	7,050,960

Counterparty risk

The Group is exposed to counterparty risk by holding cash and cash equivalents, and entering into derivatives with financial institutions. Their credit quality can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates:

Notes to the Combined Financial Statements

For the year ended 31 December 2018

3.2 Financial risk management (continued)

(f) Counterparty risk

	2018 $'000	2017 $'000
Cash and cash equivalents		
AA-	**518,604**	439,690
Derivative financial assets		
AA-	**376**	1,477

Other financial assets held by the Group are with counterparties with no external credit rating.

Provision for impairment losses

(g) Movements in the provision for impairment of loans and advances (IFRS 9)

Movements in the provision for impairment of loans and advances that are assessed for impairment collectively under IFRS 9 are shown below. This includes transition between stages of loans considered modified.

	Collective provision 12-month ECL	Collective provision lifetime ECL not credit impaired	Collective provision lifetime ECL credit impaired, not POCI^	Collective provision lifetime ECL credit impaired, POCI^	Collective provision Total
	$'000	$'000	$'000	$'000	$'000
At 1 January 2018 IAS 39					**286,742**
Transitional adjustment on adoption of IFRS 9					24,253
At 1 January 2018 remeasured	**222,982**	**12,664**	**66,020**	**9,329**	**310,995**
Effects of exchange rate on translation	1,548	88	458	65	2,159
Changes in the loss allowance contributed to by changes in the gross carrying amount of financial instruments, due to:					
i) financial instruments originated during the reporting period	71,360	1,077	5,074	-	77,511
ii) derecognition of financial instruments during the reporting period	(34,346)	(2,562)	(23,798)	(1,365)	(62,071)
iii) change in balance during reporting period	(18,359)	(68)	(2,129)	(1,366)	(21,922)
iv) transfers between stages	(6,215)	864	30,100	251	25,000
ECL calculation impact	(896)	245	(5,770)	(454)	(6,875)
Other	(149)	(320)	1,244	(705)	70
At 31 December 2018	**235,925**	**11,988**	**71,199**	**5,755**	**324,867**

^POCI: Purchased or Originated Credit Impaired

3.2 Financial risk management (continued)

(h) Movements in the provision for impairment of loans and advances (IAS 39)

	2017 $'000
At 1 January 2017	255,932
Effects of exchange rate on translation of foreign operations	(1,846)
Charge to operating profit	254,937
Charge-offs	(317,606)
Recoveries	95,325
At 31 December 2017	286,742

Loans and advances with a contractual amount of $76.4 million (2017: $80.0 million) written off during the year are still subject to enforcement activity.

Impairment losses

(i) Losses recognised in relation to loans and advances

During the year, the following gains/(losses) were recognised:

	2018 $'000	2017 $'000
Recognised in profit or loss		
Movement in provision on loans and advances	**(11,418)**	(32,600)
Net impairment loss on loans and advances	**(241,959)**	(223,513)
	(253,377)	(256,113)

Collateral

(j) Collateral held

	2018	2017
Maximum exposure ($'000)	**7,575,455**	7,050,960
Collateral classification:		
Secured (%)	**12.5**	10.9
Unsecured (%)	**87.5**	89.1

Guarantees
The Group does not have any guarantees at 31 December 2018 (2017: $nil).

Notes to the Combined Financial Statements

For the year ended 31 December 2018

3.2 Financial risk management (continued)

Foreign exchange risk

The Group has exposures primarily due to the changes in value of non-functional currency assets and liabilities and non-functional forecasted transactions. Material currency exposures are hedged where they are highly probable.

Risk management

The Group uses forward foreign exchange contracts to manage its foreign exchange risk. These contracts are not designated as hedging instruments.

Exposure

(k) Exposure to foreign currency risk, expressed in Australian Dollars

	31 December 2018 currency risk $'000	31 December 2017 currency risk $'000
Net open position - US Dollar	**(191)**	(1,126)
Net open position - NZ Dollar	**409**	-

Foreign exchange gains or losses

(l) Gains/(losses) recognised in relation to changes in foreign exchange rates

During the year, the following gains/(losses) were recognised:

	2018 $'000	2017 $'000
Recognised in profit or loss		
Net foreign exchange gain/(loss) included in other operating income	**669**	(227)
Recognised in other comprehensive income		
Translation of entities with a non-Australian denominated functional currency recognised in foreign currency translation reserve	**1,566**	(2,623)

Sensitivity

(m) Sensitivity to changes in exchange rates to financial instruments denominated in foreign currency

	Impact on post-tax profit		Impact on other components of net investment	
Index	**2018 $'000**	**2017 $'000**	**2018 $'000**	**2017 $'000**
USD/AUD exchange rate-increase 10%	**(13)**	(79)	**-**	-
USD/AUD exchange rate-decrease 10%	**13**	79	**-**	-
NZD/AUD exchange rate-increase 10%	**29**	-	**1,432**	3,263
NZD/AUD exchange rate-decrease 10%	**(29)**	-	**(1,432)**	(3,263)

3.2 Financial risk management (continued)

Interest rate risk

The Group's main interest rate risk arises from mismatches in the interest rate characteristics of the receivable assets that yield a fixed rate return and funding that is primarily through floating rate instruments.

Risk management
The Group manages its interest rate risk based on the characteristics of the underlying receivables portfolio. Hedging is undertaken for customer receivable products that yield a fixed rate return based on the expected prepayment profiles. Interest rate swaps are used where the Group agrees with other parties to exchange, at specified intervals (mainly monthly), the difference between fixed contract rates and floating rate interest amounts calculated by reference to the agreed notional principal amounts. Swaps currently in place cover floating rate securitisation liabilities relating to fixed rate auto loans and personal loans sold into securitisation trusts. These derivatives are designated in hedging relationships to minimise profit or loss volatility.

The Group determines the existence of an economic relationship between the hedging instrument and hedged item based on the reference interest rates, tenors, repricing dates and the maturities and the notional or par amounts. The Group assesses whether the derivative designated in each hedging relationship is expected to be effective in offsetting changes in cash flows of the hedged item using the hypothetical derivative method.

In these hedge relationships the main source of ineffectiveness are differences in repricing dates between the swaps and the borrowings.

Exposure

(n) Interest rate profile

The exposure of the Group’s borrowing to interest rate changes and the contractual re-pricing dates of the interest rate borrowings at the end of the reporting period are as follows:

	2018 $'000	2017 $'000
Variable rate borrowings	**6,912,174**	6,391,317
Fixed interest rate - repricing dates:		
1 – 5 years	**907,917**	896,218
	7,820,091	7,287,535

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For the year ended 31 December 2018

3.2 Financial risk management (continued)

(o) Interest rate swaps

As at the end of the reporting period, the Group had the following interest rate swap contracts outstanding:

	31 December 2018		31 December 2017	
	Weighted average interest rate %	**Balance $'000**	**Weighted average interest rate %**	**Balance $'000**
Interest rate swaps (nominal amount)	**2.01%**	**(2,264,288)**	2.04%	(1,945,193)

Hedged items and hedging instruments

(p) Amounts relating to items designated as hedged items

Amounts at the reporting date relating to items designated as hedged items were as follows:

	Change in value used for calculating hedge ineffectiveness $'000	Cash flow hedge reserve $'000	Balances remaining in the cash flow hedge reserve from hedging relationships for which hedge accounting is no longer applied $'000
31 December 2018			
Interest rate risk			
Variable rate instruments	**(4,692)**	**(3,245)**	**-**
31 December 2017			
Interest rate risk			
Variable rate instruments	591	216	-

(q) Amounts relating to items designated as hedging instruments and hedge ineffectiveness

	Nominal amount $'000	Carrying amount Assets $'000	Carrying amount Liabilities $'000	Changes in the value of the hedging instrument recognised in OCI $'000	Hedge ineffective-ness recognised in profit or loss $'000	Amount reclassified from hedging reserve to profit or loss $'000
2018						
Interest rate risk						
Interest rate swaps	(2,264,288)	**26**	**4,426**	**(4,714)**	**21**	**-**
2017						
Interest rate risk						
Interest rate swaps	(1,945,193)	1,477	1,184	260	331	-

3.2 Financial risk management (continued)

Fair value gains or losses

(r) Gains/(losses) recognised in relation to derivatives designated as cash flow hedges

During the year, the following gains/(losses) were recognised:

	2018 $'000	2017 $'000
Recognised in profit or loss		
Net gain/(loss) for ineffective portion of derivatives designated as cash flow hedges	**21**	331
Recognised in other comprehensive income		
(Loss)/gain recognised in other comprehensive income	**(3,461)**	46

Sensitivity

(s) Sensitivity to changes in interest rates

	Impact on post-tax profit		Impact on other components of net investment	
	2018 $'000	2017 $'000	2018 $'000	2017 $'000
Interest rates - increase by 100 basis points - Increase in profit	**52**	46	**26,605**	28,233
Interest rates - decrease by 100 basis points - Decrease in profit	**(52)**	(47)	**(27,273)**	(29,065)

The analysis above includes the assessment of cash and derivatives, excluding those within securitisation trusts. Movements in the cash rate would increase or decrease the interest income receivable on cash and receivables and increase or decrease the interest payable on borrowings within the Trusts. However, as these movements would ultimately be reflected in the distribution payable to the Trust beneficiaries, there will be no net impact on the profit or loss attributable to the owners of the Group.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

3.2 Financial risk management (continued)

Liquidity risk

The Group ensures it has access to liquidity and has the resources to meet its contractual financial obligations during the normal course of business and in periods of stress. This includes maintaining sufficient cash and other liquid assets and flexibility in funding through committed credit lines.

Risk management
Funding is monitored on a regular basis and risk management includes forecasts and modelling including stress testing scenarios.

Financing arrangements
KVD Australia Holdco Pty Ltd has access to a $15 million (2017: $15 million) bank overdraft facility and Latitude Financial Services Limited has access to a $4.7 million (2017: $4.5 million) bank overdraft facility, that may be drawn at any time and may be terminated by the bank without notice. The facilities are fixed rate facilities that expire within one year, repayable within 90 days of being drawn. As at 31 December 2018 the overdrafts had not been utilised (2017: $nil).

In addition, the Group had access to the following undrawn borrowing facilities at the end of the reporting period, relating to securitisation borrowings disclosed (refer section 3.1 as follows):

(t) Undrawn facilities

Floating rate	**2018 $'000**	**2017 $'000**
Borrowing facilities available	**8,251,940**	7,784,248
Drawn facilities	**(6,948,231)**	(6,437,852)
Undrawn facilities	**1,303,709**	1,346,396

Maturities of financial liabilities
The tables below analyse the Group's financial liabilities into relevant maturity groupings based on their contractual maturities. The amounts disclosed are the undiscounted cash flows, including both principal and associated future interest payments, but exclude transaction costs that have been set off and therefore will not agree to the carrying amounts on the balance sheet.

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3.2 Financial risk management (continued)

(u) Contractual maturities of financial liabilities

At 31 December 2018	Less than 6 months $'000	6 - 12 months $'000	Between 1-2 years $'000	Between 2-5 years $'000	Over 5 years $'000	Total contractual cash flows $'000	Carrying amount (assets)/ liabilities $'000
Non-derivatives							
Borrowings – Securitisation liabilities	**252,999**	**252,639**	**1,432,962**	**5,666,621**	**155,677**	**7,760,898**	**6,955,782**
Borrowings – Shareholder loans	**39,607**	**39,607**	**981,523**	**-**	**-**	**1,060,737**	**907,917**
Trade and other liabilities	**247,535**	**-**	**-**	**-**	**-**	**247,535**	**247,535**
Total non-derivatives	**540,141**	**292,246**	**2,414,485**	**5,666,621**	**155,677**	**9,069,170**	**8,111,234**
Derivatives							
Derivatives - interest rate swaps	**1,760**	**2,375**	**3,375**	**1,385**	**-**	**8,895**	**4,426**
Total derivatives	**1,760**	**2,375**	**3,375**	**1,385**	**-**	**8,895**	**4,426**

At 31 December 2017	Less than 6 months $'000	6 - 12 months $'000	Between 1-2 years $'000	Between 2-5 years $'000	Over 5 years $'000	Total contractual cash flows $'000	Carrying amount (assets)/ liabilities $'000
Non-derivatives							
Borrowings – Securitisation liabilities	126,843	126,843	474,067	5,640,766	1,027,165	7,395,684	6,446,083
Borrowings – Shareholder loans	39,056	39,705	78,761	972,420	-	1,129,942	899,022
Trade and other liabilities	214,122	-	-	-	-	214,122	214,122
Total non-derivatives	380,021	166,548	552,828	6,613,186	1,027,165	8,739,748	7,559,227
Derivatives							
Derivatives - interest rate swaps	1,154	389	(220)	(172)	-	1,151	1,184
Total derivatives	1,154	389	(220)	(172)	-	1,151	1,184

Notes to the Combined Financial Statements

For the year ended 31 December 2018

Section 4 - Capital Management

4.1 Commitments

(a) Non-cancellable operating leases

	2018 $'000	2017 $'000
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:		
Within one year	**10,038**	9,934
Later than one year but not later than five years	**31,505**	34,745
Later than five years	**28,664**	36,150
	70,207	80,829

	2018 $'000	2017 $'000
Rental expense relating to operating leases:		
Minimum lease payments	**13,898**	17,129

The Group leases operational sites and equipment under non-cancellable operating leases within one year to later than five years. The leases have varying terms, escalation clauses and renewal rights. On renewal, the terms of the leases are renegotiated.

(b) Other commitments

	2018 $'000	2017 $'000
Commitment to extend credit	**9,347,465**	8,898,618
Capital expenditure	**6,744**	2,198
	9,354,209	8,900,816

The Group makes commitments to extend credit facilities to its customers in the normal course of business.

The Group is investing significantly in technology developments as it transitions to a more digital business model. At the reporting date, the Group has committed expenditure in relation to a number of technology transformation programs.

Section 5 - Other Assets and Liabilities

Accounting Policy

Goodwill

Goodwill on acquisitions of subsidiaries is included in intangible assets and represents the excess of the cost paid over the fair value of the net identifiable assets acquired at the date of acquisition.

Customer relationships and distribution agreements

Separately acquired customer contracts and distribution agreements are shown at historical cost. Those acquired in a business combination are recognised at fair value at the acquisition date. They have a finite useful life and are subsequently carried at cost less accumulated amortisation and impairment losses. Customer contracts are amortised on a straight-line basis over 5-9 years and distribution agreements are amortised on a straight-line basis over 1-9 years.

Software

Software relates to IT projects and associated system expenditure that does not result in the acquisition of physical hardware, including software licence acquisitions, upgrades to software platforms, applications and internal functions and network configuration, including internally generated development costs. Software is amortised on a straight-line basis over 1-5 years, or in the case of a licenced intangible, straight line over the licence period.

An intangible asset is recognised if it is probable that the associated future economic benefits will flow to the Group and the cost can be measured reliably where the following criteria are met: it is technically feasible to complete the software so that it will be available for use; it can be demonstrated how the software will generate probable future economic benefits; adequate technical, financial and other resources to complete the development and to use or sell the software are available, and the expenditure attributable to the software during its development can be reliably measured. Any other costs associated with maintaining software are recognised as an expense as incurred.

Development Activities

Capitalised development costs are recorded as software intangible assets and amortised on a straight-line basis from the point at which the asset is ready for use, over the useful life of the intangible. Each phase of a project is considered separately to determine the useful life of the project. Development expenses that do not meet the criteria as software above is recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Impairment of assets

Goodwill and intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value-in-use. For the purposes of assessing impairment, assets are

Section 5 - Other Assets and Liabilities (continued)

grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting period.

Leases

Leases in which a significant portion of the risks and rewards of ownership are not transferred to the Group as lessee are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognised for future operating losses. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small. Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The discount rate used to determine the present value is a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The increase in the provision due to the passage of time is recognised as interest expense.

Employee benefit obligations

Short-term obligations: Liabilities for wages and salaries, including non-monetary benefits that are expected to be settled wholly within 12 months after the end of the period in which the employees render the related service are recognised in respect of employees' services up to the end of the reporting period and are measured at the amounts expected to be paid when the liabilities are settled. The liabilities are presented as current employee benefit obligations in the balance sheet.

Other long-term employee benefit obligations - Long service leave: These are measured as the present value of expected future payments to be made in respect of services provided by employees up to the end of the reporting period using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service.

Expected future payments are discounted using market yields at the end of the reporting period of government bonds with terms and currencies that match, as closely as possible, the estimated future cash outflows. Remeasurements as a result of experience adjustments and changes in actuarial assumptions are recognised in profit or loss. The obligations are presented as current liabilities in the combined balance sheet if the entity does not have an unconditional right to defer settlement for at least 12 months after the reporting date, regardless of when the actual settlement is expected to occur.

Section 5 - Other Assets and Liabilities (continued)

Equity-based payments

The fair value of units granted under equity based compensation benefits is recognised as employment expenses in the combined income statement with a corresponding increase in net investment. The fair value is recognised at grant date and recognised over the period during which the party becomes unconditionally entitled to the instruments. The fair value is independently determined using an option-granting model as measured at the grant date which includes the terms and conditions of the instruments. The fair value of the instruments granted is adjusted to reflect market vesting conditions, but excludes the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number and value of instruments that are expected to become exercisable. The equity-based payment expense recognised each year takes into account the most recent estimate.

Insurance liabilities

Profits of the Insurance business are brought to account on a margin on services ('MoS') basis. Under MoS, profit (the excess of premium received and investment earnings over claims and expenses including amortised acquisition costs) is recognised as fees are received and services are provided to policyholders. Profit is deferred to the balance sheet when fees have been received but the service has not been provided. Costs associated with the acquisition of policies are deferred on the balance sheet and charged to the profit or loss over the period that the policy will generate profits. Insurance contract liabilities are valued using a method that approximates to the projection method and the liability for outstanding claims is subject to an annual actuarial review.

Insurance claims

Claims incurred relate to the provision of services and bearing of risks and is treated as an expense. The liability for outstanding claims covers the expected future payments for claims including IBNR and IBNER claims and the anticipated direct and indirect costs of settling these claims. Actuarial methods are used by a qualified person to estimate the value of outstanding claims where generally, this involves analysing available past experience to determine expected future payments. The provision for the outstanding claims liability also contains a risk margin to reflect the inherent uncertainty in the central estimate. The risk margin increases the probability that the net liability is adequately provided for to a 90% confidence level.

Outward reinsurance and reinsurance recoveries

Premium ceded to reinsurers is recognised as an expense in accordance with the pattern of reinsurance service received. Accordingly, a portion of outwards reinsurance premium is treated at the reporting date as deferred reinsurance expense. Reinsurance recoveries and other recoveries receivable on paid claims, reported claims not yet paid and IBNR's are recognised as revenue.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

Section 5 - Other Assets and Liabilities (continued)

Assets backing insurance liabilities

The Insurance business has established a target capital to ensure assets are available to meet insurance liabilities. Financial assets designated at fair value through profit or loss are initially recognised at fair value, excluding transaction costs, which are expensed in the combined income statement in the period in which they arise. Financial assets are subsequently measured at fair value at each reporting date with realised and unrealised gains and losses arising from changes in the fair value recognised in the combined income statement in the period in which they arise. Short term deposits are carried at the face value of the amounts deposited as their carrying amounts approximate their fair value. Unlisted fixed interest securities are recorded at amounts based on valuations using rates of interest equivalent to the yields obtainable on comparable investments at the end of the reporting period.

Unexpired risk liability

Provision is made for unexpired risks arising from general insurance business where the expected value of claims and expenses attributed to the unexpired periods of policies in force at the end of the reporting period exceeds the unearned premiums provision in relation to such policies after the deduction of any deferred acquisition costs. The provision for unexpired risk is calculated separately by reference to separate classes of business, which are managed together, after taking into account the relevant investment return. Unexpired risk liability, if any, remaining after writing off deferred acquisition costs is recognised immediately in the combined income statement.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

5.1 Other Assets and Liabilities

(a) Intangible assets

	Goodwill $'000	Distribution agreements $'000	Customer contracts $'000	Software $'000	Capital works in progress $'000	Trade-mark $'000	Total $'000
At 1 January 2018							
Cost	517,954	161,316	264,776	93,431	32,840	-	1,070,317
Accumulation amortisation	-	(38,671)	(66,990)	(50,139)	-	-	(155,800)
Net book amount	517,954	122,645	197,786	43,292	32,840	-	914,517
Year ended 31 December 2018							
Opening net book amount	517,954	122,645	197,786	43,292	32,840	-	914,517
Effects of exchange rate differences on translation of foreign operations	4,858	429	1,251	68	-	-	6,606
Additions	-	-	1,595	5,489	51,946	166	59,196
Disposals	-	-	-	(457)		-	(457)
Amortisation charge	-	(18,432)	(31,798)	(18,904)	-	(3)	(69,137)
Amortisation on disposals	-	-	-	321	-	-	321
Impairment loss	-	-	-	-	(14,326)	-	(14,326)
Transfers	-	-	-	18,232	(20,422)	-	(2,190)
Closing net book amount	522,812	104,642	168,834	48,041	50,038	163	894,530
At 31 December 2018							
Cost	522,812	161,807	267,812	116,852	50,038	166	1,119,487
Accumulation amortisation	-	(57,165)	(98,978)	(68,811)	-	(3)	(224,957)
Net book amount	522,812	104,642	168,834	48,041	50,038	163	894,530
Year ended 31 December 2017							
Opening net book amount	524,140	141,649	230,083	38,267	24,157	-	958,296
Effects of exchange rate differences on translation of foreign operations	(6,186)	(659)	(1,920)	(253)	(1)	-	(9,019)
Additions	-	-	905	-	39,863	-	40,768
Disposals	-	-	-	(1,113)	(206)	-	(1,319)
Amortisation charge	-	(18,345)	(31,282)	(24,451)	-	-	(74,078)
Amortisation on disposals	-	-	-	669	-	-	669
Transfers	-	-	-	30,173	(30,973)	-	(800)
Closing net book amount	517,954	122,645	197,786	43,292	32,840	-	914,517
At 31 December 2017							
Cost	517,954	161,316	264,776	93,431	32,840	-	1,070,317
Accumulation amortisation	-	(38,671)	(66,990)	(50,139)	-	-	(155,800)
Net book amount	517,954	122,645	197,786	43,292	32,840	-	914,517

As a result of the investment in digital capability as described a number of legacy assets classified as Capital works in progress have had their useful life reduced, leading to impairment charges in 2018. Capital works in progress are impaired when they no longer meet capitalisation criteria. Distribution agreements and customer contracts recognised as part of a business combination in 2015 have remaining amortisation periods of 6 years in Australia and 4 years in New Zealand at 31 December 2018 (2017: 7 years in Australia and 5 years in New Zealand).

5.1 Other Assets and Liabilities (continued)

Impairment testing for cash-generating units containing goodwill

(b) Goodwill allocation

Goodwill arises on the acquisition of entities and is allocated to the Group's cash-generating units (CGU's). Goodwill is subject to impairment testing on an annual basis.

	2018 $'000	2017 $'000
Australia	**396,071**	396,071
New Zealand	**113,137**	108,279
Insurance	**13,604**	13,604
Total goodwill	**522,812**	517,954

(c) Significant estimates: key assumptions used for value-in-use calculations

The recoverable amount of a cash generating unit (CGU) is determined based on value-in-use calculations which require the use of assumptions. The calculations use discounted cash flow projections based on financial forecasts covering a five-year period. Cash flows are extrapolated using a growth rate and a terminal value to yield value appropriate to each CGU. The following table sets out the key assumptions for those CGUs:

		Australia		New Zealand		Insurance
	2018 %	2017 %	2018 %	2017 %	2018 %	2017 %
Pre-tax discount rate	**17.5**	18.5	**16.7**	18.5	**17.5**	18.5
Terminal growth rate	**3**	1.5	**3**	1.5	**3**	1.5

(d) Trade and other liabilities

	2018 $'000	2017 $'000
Current		
Trade and other payables	**86,835**	77,652
Accrued expenses	**58,956**	51,093
Payables to related parties	**37,225**	30,735
Customer credit balances	**40,361**	36,460
Outstanding Insurance claims liability	**10,863**	11,201
	234,240	207,141
Non-Current		
Trade and other payables	**7,240**	1,732
Outstanding Insurance claims liability	**6,055**	5,249
	13,295	6,981
Total trade and other liabilities	**247,535**	214,122

The carrying amounts of trade and other liabilities approximates fair value.

5.1 Other Assets and Liabilities (continued)

(e) Provisions

			2018			2017
	Current $'000	Non-Current $'000	Total $'000	Current $'000	Non-current $'000	Total $'000
Leave obligations	**17,425**	**762**	**18,187**	16,780	1,179	17,958
Other employee benefit obligations	**18,373**	**-**	**18,373**	13,913	-	13,913
Total employee benefit obligations	**35,798**	**762**	**36,560**	30,693	1,179	31,872
Customer remediation provisions	**21,676**	**2,057**	**23,733**	13,521	-	13,521
Total provisions	**57,474**	**2,819**	**60,293**	44,214	1,179	45,393

Leave obligations represent the Group's liability for long service leave and annual leave. The current portion of this liability includes all of the accrued annual leave, the unconditional entitlements to long service leave where employees have completed the required period of service and also those where employees are entitled to pro-rata payments in certain circumstances. Other employee benefit obligations cover the Group's liability for other employee benefit obligations such as bonus payments.

(f) Gross insurance policy liabilities

	2018 $'000	2017 $'000
Current	**45,583**	48,778
Non-current	**37,387**	42,062
Total gross insurance policy liabilities	**82,970**	90,840

5.2 Summary of Hallmark life and general actuarial assumptions and methods

Contracts under which the Insurance group accepts significant insurance risk from the policyholder, or another party, by agreeing to compensate the policyholder, or other beneficiary, if a specified uncertain future event adversely affects the policyholder or other beneficiary, are classified as insurance contracts. Any products sold that do not meet the definitions of a life insurance contract are classified as life investment contracts. The Insurance business has no life investment contracts.

Insurance risk is defined as significant if and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e. have no discernible effect on the economics of the transaction). Insurance contracts include those where the insured benefit is payable on the occurrence of a specified event such as death, injury or disability caused by accident or illness. The insured benefit is either not linked or only partly linked to the market value of the investments held by the Insurance group, and the financial risks are substantially borne by the Insurance group.

The life insurance operations of the Insurance group are conducted within separate Statutory funds as required by the *Life Insurance Act 1995* and are reported in aggregate with the Shareholders' fund in the statement of profit or loss and other comprehensive income, balance sheet and statement of cash flows of the Group. Monies held in the Statutory funds are subject to the distribution and transfer restrictions and other requirements of the *Life Insurance Act 1995*.

Life insurance actuarial assumptions and methods

The following section describes the process surrounding, and key factors used to estimate the policy liabilities in the actuarial report:

(a) Basis of preparation

The effective date of the actuarial report on policy liabilities and capital requirements is 31 December 2018. The actuarial report was prepared by Mr. Brendan Mark Counsell, BSc, BA, FIAA, FNSZA. The actuarial report indicates that Mr. Counsell is satisfied as to the accuracy of the data upon which policy liabilities have been determined.

The amount of policy liabilities has been determined in accordance with methods and assumptions disclosed in these financial statements and the requirements of the relevant accounting standards (which may differ from the requirements of the Life Insurance Act 1995).

Policy Liabilities for Insurance Contracts

Policy liabilities for insurance contracts have been calculated in accordance with Prudential Standard LPS 340 Valuation of Policy Liabilities issued by APRA under subsection 230A(1) of the Life Insurance Act 1995. The Prudential Standard requires the policy liabilities to be calculated in a way which allows for the systematic release of planned margins as services are provided to policy owners.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

The profit carriers used for the major product groups in order to achieve the systematic release of planned margins are as follows:

Product group	Method (projection or other)	Profit carrier
Lump sum risk	Accumulation (2017: Accumulation)	Claims (implied)
Disability and involuntary unemployment income	Accumulation (2017: Accumulation)	Claims (implied)

Policy liabilities have been calculated as the provision for unearned premium, less a deferred acquisition cost item. The recognition rate of premium has been chosen to approximate the planned margin release that would be achieved through use of the projection method.

(b) Disclosure of assumptions

Assumptions are required to establish recoverability of acquisition costs. Key assumptions are listed below:

(i) Discount rates

The gross interest rates used are the gross yield to redemption of benchmark government securities. For the current valuation, these are:

90 days: Australia 2.09% (2017: 1.80%), New Zealand 1.97% (2017: 1.88%)

5 years: Australia 1.99% (2017: 2.34%), New Zealand 1.85% (2017: 2.26%)

(ii) Inflation rates

Allowance for future inflation:

Australia 2.5%. (2017: 2.5% p.a.) where future inflation assumption is based on the long-term target range of the Reserve Bank of Australia of 2% - 3%.

New Zealand 2.0% (2017: 2.0% p.a.) where future inflation assumption is based on the medium-term target range of the Reserve Bank of New Zealand of 1% - 3%.

(iii) Future expenses and indexation

Maintenance expense assumptions have been based on the experience in the current year and budgeted expenses for the 2019 year. Inflation adjustments are consistent with the inflation assumption.

(iv) Mortality and morbidity

Mortality rates for risk products have been based on experience over recent years. A loss ratio approach (applied to earned premium) was adopted. The loss ratios used have not varied significantly from those used in 2017.

(v) Disability and involuntary unemployment

The general approach to actuarial estimation of disability and involuntary unemployment liabilities (in the New Zealand statutory fund) is to analyse all available past experience. This analysis allows patterns to be identified in the past experience. Based on this, development patterns associated with the run-off of outstanding claims at the balance date can be

5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

estimated. The estimate of the outstanding claims includes an allowance for claims incurred but not reported ("IBNR") and the further development of reported claims, a risk margin and claims handling expense provision. Actuarial methods such as payment per claim incurred (PPCI), Payment Chain Ladder ("PCL") and Bornheutter Ferguson ("BF") are adopted to estimate the outstanding claims.

The key actuarial assumptions for the determination of the outstanding claims liabilities are average claim size (Disability = NZ$1801, Unemployment = NZ$598), a claims handling expense rate of 13.5% of the projected gross claim payments (based on expense investigation) and a discount rate of 1.71% (based on the yield of 1 year and 2 year New Zealand Government bond yield as at 31 December 2018). Across all classes, changes to the claim termination and average claim size assumptions would cause the most significant change to the liability estimate.

(vi) Voluntary discontinuance

Voluntary discontinuance rates vary by product and have been based on the Group's recent discontinuance experience.

For the major classes of Australian business, the assumed aggregate rates of discontinuance are:
Consumer credit insurances - 35% p.a.(2017: 34% p.a.)
Regular premium term life insurances - 18% p.a.(2017: 17% p.a.)

For the major classes of New Zealand business, the assumed aggregate rates of discontinuance are:
Consumer credit insurances - 40% p.a.(2017: 42% p.a.)
Single premium term life insurances - <1% p.a.(2017: <1% p.a.)

(vii) Capital requirements

The Group is required to hold prudential reserves, over and above the policy liabilities, as a buffer against adverse future experience and poor investment returns. The methods and bases used for determining the capital requirements were in accordance with the requirements of Prudential Standard *LPS 110: Capital Adequacy* as issued by APRA.

(c) Impact of changes in assumptions

The policy liabilities for insurance contracts have been calculated using the accumulation method. Under this method, changes in assumptions do not have any impact on policy liabilities in the current period, unless a product enters loss recognition. As at 31 December 2018, the assumption changes have not resulted in any of the related product groups entering loss recognition, and hence the policy liability has not been impacted by changes in assumptions.

The value of future profit margins is not explicitly calculated under the accumulation method and hence the impact of any change in assumptions on the value of future profit margins is not determined.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

(d) Sensitivity analysis

Movements in key variables such as mortality experience, lapse rates and expenses will have an impact on the future cash flows, performance and net assets of the business.

As the accumulation method is used to determine policy liabilities for insurance contracts, changes in the assumptions around these key variables do not have any impact on the policy liability or retained profits at the current balance date, unless a product group enters loss recognition. An alternate approach to demonstrating the sensitivity to changes in variables is to consider the impact on profit and net investment at the current balance date if the experience over the current financial period varied under certain scenarios. The table below considers a number of changes in variables, and shows the impact on the profit and net investment if that change had been experienced during the financial reporting period.

31/12/2018 ($'000) Australia	**Percentage change in Assumptions**	**Impact on 2018 income statement**		**Impact on 2018 net investment**	
		Gross of Reinsurance	Net of Reinsurance	Gross of Reinsurance	Net of Reinsurance
Mortality/morbidity	Worsening by 5%	(144)	(119)	(144)	(119)
	Improving by 5%	144	119	144	119
Lapse rates	Worsening by 5%	32	32	32	32
	Improving by 5%	(32)	(32)	(32)	(32)
Expenses	Worsening by 5%	(169)	(169)	(169)	(169)
	Improving by 5%	169	169	169	169

31/12/2018 ($'000) New Zealand	**Percentage change in variables**	**Impact on 2018 income statement**		**Impact on 2018 net investment**	
		Gross of Reinsurance	Net of Reinsurance	Gross of Reinsurance	Net of Reinsurance
Mortality/morbidity	Worsening by 5%	(41)	(41)	(41)	(41)
	Improving by 5%	41	41	41	41
Lapse rates	Worsening by 5%	11	11	11	11
	Improving by 5%	(11)	(11)	(11)	(11)
Expenses	Worsening by 5%	(43)	(43)	(43)	(43)
	Improving by 5%	43	43	43	43

General insurance actuarial assumptions and methods

The Group writes consumer credit insurances across Australia and New Zealand, including involuntary unemployment, disability, merchandise and price protection and stolen card cover.

5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

(e) Process used to determine outstanding claims liabilities (actuarial methods)

The general approach to the estimation of Outstanding Claims Liabilities is to analyse all available past experience, including the number of reported and finalised claims, timing and amounts of claim payments. This analysis allows patterns to be identified in the past experience. Based on this, development patterns associated with the run-off of outstanding claims and premium liabilities at the balance date can be estimated. Claims incurred all relate to providing services, including the bearing of risk, and are accordingly treated as expenses in the income statement. Claims expenses represent total claim payments made during the year adjusted for the movement in the outstanding claims liability. The determination of the outstanding claims liabilities involves two steps:

Notes to the Combined Financial Statements

For the year ended 31 December 2018

5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

1. The determination of the central estimate of outstanding claims at the balance date. The central estimate of outstanding claims includes an allowance for claims incurred but not reported ("IBNR") and the further development of reported claims, also known as incurred but not enough reported ("IBNER"). The central estimate has no deliberate bias towards either over or under estimation. This means that the central estimate is assessed to have approximately 50% probability of adequacy.

2. The determination of a risk margin and claims handling expense provision to be added to the central estimates of outstanding claims. The risk margin is intended to achieve a 90% probability of adequacy at an aggregate level. The estimation of the outstanding claims liabilities involves the use of the following standard aggregate projection methods: Payment Chain Ladder ("PCL"); Payment Per Claim Incurred ("PPCI"); Payment Per Claim Finalised ("PPCF"); Payment Per Claim Handled ("PPCH") and Bornheutter Ferguson ("BF"). A blend of the projection methods is adopted based on the nature of the claims within each portfolio to estimate the appropriate outstanding claims.

(f) Actuarial assumptions

The key actuarial assumptions for the determination of the outstanding claims liabilities of the consumer credit insurance portfolios are as follows:

2018	**Disability (Personal Loans)**	**Unemployment (Personal Loans)**	**Disability (Credit Cards)**	**Unemployment (Credit Cards)**	**Protection^**
Australia:					
Number of future finalisations	688	238	388	363	733
Discounted loss ratio	36%	18%	12%	17%	13%
Expense rate	13.5%	13.5%			
Discount rate	1.8%pa-3.2%pa	1.8%pa-3.2%pa			
New Zealand:					
Number of future finalisations	211	89	79	47	58
Discounted loss ratio	27%	7%	18%	10%	6%
Expense rate	13.5%	13.5%			
Discount rate	1.71%	1.71%			

Notes to the Combined Financial Statements

For the year ended 31 December 2018

5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

2017	Disability (Personal Loans)	Unemployment (Personal Loans)	Disability (Credit Cards)	Unemployment (Credit Cards)	Protection^
Australia:					
Number of future finalisations	705	245	392	354	681
Discounted loss ratio	35%	18%	14%	17%	13%
Expense rate	11.50%	11.50%			
Discount rate	1.8%pa-3.9%pa	1.8%pa-3.9%pa			
New Zealand:					
Number of future finalisations	233	94	130	91	73
Discounted loss ratio	30%	9%	22%	14%	8%
Expense rate	11.50%	11.50%			
Discount rate	1.89%	1.89%			

^ Merchandise protection, price protection and stolen cards (credit cards)

The above key actuarial assumptions were based on the following:

- Future finalisations - based on an analysis of historical claim reports and finalisation rates, enabling the future numbers of reports, handled claims and finalisations to be projected.
- Adopted average claim size - based on historic ratios of claim payments to factors such as number of claims reported, handled or finalised.
- Adopted claims handling expense rate – determined based on the results of an expense allocation carried out during the 2018 valuation.
- Central estimates of the outstanding claims liabilities - discounted to allow for future investment income attributable to the liabilities during the run off period. The discount factor is based on annual risk-free rates of return, derived from Government bond yield curves as published by the Reserve Bank of Australia.
- Other assumptions - the outstanding claims provision for disability (Personal Loans) includes an additional 1.3% for medical expenses, with a prudential margin calculated at a 90% probability of adequacy.

(g) Sensitivity analysis

The outstanding claims liabilities included in the reported results are calculated based on the key actuarial assumptions as disclosed above. The movements in any of the above key actuarial assumptions will impact the performance and net investment of the Company. The table below describes how a change in each of the assumptions will affect the outstanding claims liabilities.

Notes to the Combined Financial Statements

For the year ended 31 December 2018

5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

Key actuarial assumptions 2018	Changes	Impact on net outstanding claims liabilities ($'000's)	Impact on total outstanding claims liabilities (%)
Australia:			
Reported claims chain ladder factor	Increase the chain ladder factor by 10%	+249	+2.0
Discount rate	Decrease discount rate by 1%	+136	+1.1
Claims handling expense rate	Increase claims handling expense rate by 4%	+477	+3.8
New Zealand:			
Chain ladder factor	Increase the chain ladder factor by 10%	+30	+1.12
Discount rate	Decrease discount rate by 1%	+23	+0.87
Claims handling expense rate	Increase claims handling expense rate by 4%	+107	+3.98
Key actuarial assumptions 2017	**Changes**	**Impact on net outstanding claims liabilities ($'000's)**	**Impact on total outstanding claims liabilities (%)**
Australia:			
Reported claims chain ladder factor	Increase the chain ladder factor by 10%	+249	+2.1
Discount rate	Decrease discount rate by 1%	+119	+1.0
Claims handling expense rate	Increase from claims handling expense rate by 4%	+457	+3.9
New Zealand:			
Chain ladder factor	Increase the chain ladder factor by 10%	+40	+1.65
Discount rate	Decrease discount rate by 1%	+19	+0.79
Claims handling expense rate	Increase from claims handling expense rate by 4%	+99	+4.06

Section 6 - Other Disclosures

6.1 Interests in other entities

(a) Material subsidiaries

The Group's principal subsidiaries at 31 December 2018 are set out below. Unless otherwise stated, they have share capital consisting solely of ordinary shares that are held directly by the Group, and the proportion of ownership interests held equals the voting rights held by the Group. The country of incorporation or registration for all entities is Australia or New Zealand, which is also their principal place of business.

Name of entity	Ownership held by Group		Ownership held by NCI		Principal activities
	2018	2017	2018	2017	
	%	%	%	%	
Country of incorporation - Australia:					
KVD Australia Pty Ltd*	**100**	100	**-**	-	Group financier
Latitude Financial Services Australia Holdings Pty Ltd*	**100**	100	**-**	-	Employer/servicer
Latitude Finance Australia*	**100**	100	**-**	-	Sales finance/credit cards
Latitude Automotive Financial Services*	**100**	100	**-**	-	Automotive lending
Latitude Personal Finance Pty Ltd*	**100**	100	**-**	-	Personal lending
Latitude Finance JV HoldCo Pty Ltd*	**100**	100	**-**	-	Dormant
Hallmark Life Insurance Company Ltd	**100**	100	**-**	-	Life insurer
Hallmark General Insurance Company Ltd	**100**	100	**-**	-	General insurer
KVD TM Pty Ltd	**100**	100	**-**	-	Trust manager
Latitude Insurance Holdings Pty Ltd	**100**	100	**-**	-	Holding company
Australian Sales Finance and Credit Cards Trust	**-**	-	**100**	100	Securitisation of receivables
Australian Personal Loans Trust	**-**	-	**100**	100	Securitisation of receivables
Australian Auto Loans Trust	**-**	-	**100**	100	Securitisation of receivables
Australian Secured Personal Loans Trust	**-**	-	**100**	100	Securitisation of receivables
Australian Sales Finance and Credit Cards Trust No.2	**-**	-	**100**	100	Securitisation of receivables
Latitude Australia Credit Card Master Trust	**-**	-	**100**	100	Securitisation of receivables
Latitude Australia Credit Card Loan Note Trust	**-**	-	**100**	100	Securitisation of receivables
Latitude Australia Personal Loans Series 2017-1 Trust	**-**	-	**100**	100	Securitisation of receivables
Latitude Investment Holdings Pty Ltd	**100**	100	**-**	-	Trust management
Latitude Investment Holdings No.1 Pty Ltd	**100**	100	**-**	-	Trust management
Latitude Investment Trust	**-**	-	**100**	100	Investment Trust
Latitude Investment Sub-Trust 1	**-**	-	**100**	100	Investment Trust
Latitude Investment Sub-Trust 2	**-**	-	**100**	100	Investment Trust
Latitude Investment Sub-Trust 3	**-**	-	**100**	100	Investment Trust
Latitude Investment Sub-Trust 4	**-**	-	**100**	100	Investment Trust
Country of incorporation - New Zealand:					
New Zealand Sales Finance and Credit Cards Trust	**-**	-	**100**	100	Securitisation of receivables
New Zealand Personal Loans Trust	**-**	-	**100**	100	Securitisation of receivables
Latitude New Zealand Credit Card Master Trust	**-**	-	**100**	-	Securitisation of receivables
Latitude Innovation Holdings Limited^	**100**	-	**-**	-	Payment platform

* These subsidiaries have been granted relief from the necessity to prepare financial reports in accordance with Instrument 2016/785 issued by the Australian Securities and Investments Commission. KVD Australia Holdco Pty Ltd, the holding entity and these subsidiaries, are party to a closed group within a deed of cross guarantee.

^ The Group acquired the assets and business of Genoapay Limited on 4 December 2018. Total consideration was NZD $5,502,350 in cash and NZD $697,650 to be held in escrow. The main asset acquired was a software intangible for the payment platform. Latitude Innovation Holdings Limited is a new legal entity to hold the acquired assets.

6.1 Interest in other entities (continued)

(b) Structured entities

A structured entity is one that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. The Group uses structured entities to support its loan securitisation program. They are consolidated by the Group as it is exposed to variable returns from the securitised entities and it has the ability to affect those returns through its power over the activities of the structured entities.

6.2 Contingent liabilities and contingent assets

Latitude is subject to a number of obligations which, if not discharged, may give rise to potential claims. Where some loss from non-performance of an obligation is more likely than not and can be reliably estimated, provisions have been made. The Group considers that the outcome of any specific enquiry which is underway as at 31 December 2018, and has not been provided for, is not likely to affect its financial position in any material way, either individually or in aggregate. The tax affairs of the Group are subject to review by the Australian Taxation Office ("ATO") as well as the Revenue Offices of the various Australian States and Territories from time to time. In particular, the ATO is completing assurance reviews of the top 1000 companies in Australia. In February 2019, the ATO completed an assurance review of the Group and provided an assurance report which raised a number of matters that the ATO may consider further. As yet, the ATO has not sought further engagement on these matters. Accordingly, any potential outcomes and total costs associated with any such activities remain uncertain at this time. One of these matters relates to the pre-Restructure ownership of the Group and distributions made as part of that ownership. Should the Group be subject to a future tax obligation arising from those distributions, the Selling Shareholders have agreed to an effective sales proceeds adjustment, backed by cash or cash equivalent security, to reduce the Group's possible exposure to that issue to an immaterial amount. The Group considers that the residual risk stemming from the items raised in the report, is not likely to materially affect its financial position, either individually or in aggregate.

6.3 Events occurring after the reporting period

No events have occurred since 31 December 2018 that have significantly affected the Group's operations or results.

6.4 Related party transactions

(a) Parent entity

KVD Singapore Pte. Ltd, a company incorporated in Singapore has 100% ownership interest (2017: 100%) in KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited and is the ultimate owner of the Group.

(b) Subsidiaries

Interests in subsidiaries are set out in Section 6.1.

6.4 Related party transactions (continued)

(c) Key management personnel compensation

The following compensation is paid to Key Management Personnel (KMP) covering Latitude Financial Services Group and any Australian and New Zealand related party entities:

	2018 $	2017 $
Short-term employee benefits	**7,170,998**	6,213,915
Long-term benefits	**28,235**	43,084
Post-employment benefits	**387,053**	332,547
Termination benefits	**150,402**	326,807
Share based payments	**4,861,508**	6,885,786
	12,598,196	13,802,139

At 31 December 2018 KMP had outstanding balances payable totalling $37,903 (2017: $43,580) in respect of credit card products. The total available credit facility during the period was $241,219 (2017: $173,170) and the maximum drawn amount during the period was $104,935 (2017: $90,843).

Interest charged on these products issued to KMP was at normal consumer rates and under normal terms and conditions.

Compensation paid above includes share based awards that were granted to Executives during their time in a KMP role during the year, as follows:

	2018 $	2017 $
At 1 January	**5,765,785**	1,077,133
Granted	**-**	5,920,296
Equity adjustments	**(1,906,985)**	(1,231,644)
At 31 December	**3,858,800**	5,765,785

6.4 Related party transactions (continued)

(d) Transactions with other related parties

The Group's related parties are predominantly its parent and subsidiaries, KMP and parties with significant influence over the Group arising from its funding and securitisation structure. Transactions between KVD Australia Holdco Pty Ltd, Latitude Financial Services Limited, and their respective subsidiaries are eliminated on consolidation and are not disclosed in this note. Outstanding balances at year end are unsecured.

	2018 $	2017 $
Rendering and receiving of services		
Amounts paid to entities with significant influence	**(6,090,617)**	(6,023,108)
Distributions paid to entities with significant influence	**(60,482,790)**	(36,740,077)
Distributions accrued to entities with significant influence	**(71,715,932)**	(55,399,366)
Other transactions		
(Capital return)/ subscription of shares to parent	**-**	(14,600,000)

(e) Outstanding balances arising from transactions with related parties

	2018 $	2017 $
Receivables/(payables) outstanding at the end of the period:		
Entities with significant influence	**(37,225,068)**	(30,734,841)

(f) Loans to/from related parties

	2018 $	2017 $
Loans from parties with significant influence		
At 1 January	**899,010,879**	1,047,360,476
Effects of exchange rate on translation of foreign operations	**9,412,510**	(11,990,217)
Loan repayments made	**-**	(136,049,980)
Interest due to related parties	**78,665,114**	87,750,835
Interest paid	**(79,217,189)**	(88,060,235)
At 31 December	**907,871,314**	899,010,879

The loan from related parties represents a loan facility for 5 years beginning from 24 November 2015. The loan interest is charged at 8.5% in Australia and 9.5% in New Zealand. There is no allowance account for impaired receivables in relation to any outstanding balances, and no expense has been recognised in respect of impaired receivables due from related parties.

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For the year ended 31 December 2018

6.5 Share-based payments

(a) Management equity plan

The Management Equity Plan (MEP) is designed to provide an opportunity for participating people to acquire an interest at fair value in the Latitude Group. The MEP was established on 1 January 2016. Under the MEP, participants are granted an interest in KVD Australia Pty Ltd, where participation in the MEP is at the board's discretion.

The fair value of units granted is recognised at grant date and recognised over the period during which the party becomes unconditionally entitled to the instrument. The fair value of units granted has been determined using a pricing model that had regard to the following specified variables: the underlying equity value; risk-free interest rate; expected volatility of underlying equity value; dividends expected on the shares; and the estimated life.

The key terms and conditions relating to the grants under the MEP are as follows:

1. Time vesting - straight line vesting
2. KPI vesting - straight line vesting upon meeting or exceeding the adjusted profit target on an annual basis
3. Exit event vesting - exercised at the time of an exit event.

Set out below is a summary of units granted under the MEP:

	2018 $ issued	2017 $ issued
At 1 January	**10,209,885**	5,854,800
Fair value of units granted during the year	**-**	4,355,085
At 31 December	**10,209,885**	10,209,885

During the year ended 31 December 2018, units adjusted for equity changes was $9,278,691 (2017: $3,404,279). No units were exercised, none expired during the year, and no units were exercisable at year end. At 31 December 2018, 39,399,999 units were outstanding (31 December 2017: 53,649,999 units)

The total expense recognised in the profit and loss for the year ended 31 December 2018 in respect of MEP granted during the year was $1,607,081 (2017: $6,921,770).