MACQUARIE FINANCIAL HOLDINGS LIMITED AND ITS SUBSIDIARIES

ACN 124 071 398

DIRECTORS' REPORT AND FINANCIAL REPORT
YEAR ENDED 31 MARCH 2012

MACQUARIE

The Company's registered office is:
C/- Company Secretarial
Mezzanine Level
No.1 Martin Place
Sydney, NSW 2000.

Directors' Report
for the financial year ended 31 March 2012

In accordance with a resolution of the Voting Directors (the Directors) of Macquarie Financial Holdings Limited (the Company or MFHL), the directors submit herewith the financial statements of the Company and report as follows:

Directors

At the date of this report, the Directors of MFHL are:

- M. Ferrier
- C.T, Lynam
- R.N. Upfold
- K. Bennett (resigned 21 October 2010)

Principal activities

The principal activity of the Company is to act as the holding company of the Non-Banking Group within the Macquarie Group. The Non-Banking Group comprises mostly of the activities of the Macquarie Capital Group and certain Macquarie Securities Group, Macquarie Funds Group, Fixed Income, Currencies and Commodities Group and Corporate activities.

Result

The consolidated profit after income tax attributable to ordinary equity holders, under Australian Accounting Standards, for the financial year ended 31 March 2012 was $261 million (2011: $168 million).

Dividends and distributions

There were no dividends or distributions paid or provided for during the financial year.

State of Affairs

In the opinion of the Directors, there were no significant changes in the state of affairs of the Company that occurred during the financial year under review not otherwise disclosed in this report.

Review of operations

The revenues and results of the Company and its subsidiaries (Consolidated Entity) during the financial year were:

	2012 $m	2011 $m
Net operating income	**2,341**	2,712
Profit attributable to ordinary equity holders of Macquarie Financial Holdings Limited	**261**	168

Events subsequent to balance date

At the date of this report, the Directors are not aware of any matter or circumstance which has arisen that has significantly affected or may significantly affect the operations of the Company, the results of those operations or the state of affairs of the Company in the financial years subsequent to 31 March 2012 not otherwise disclosed in this report.

Likely developments, business strategies and prospects

Disclosure of information relating to the future developments in the operations, business strategies and prospects for future financial years of the Company have not been included in the report because the Directors believe it may result in unreasonable prejudice to the Company.

Directors' indemnification

Under the Company's Constitution, the Company indemnifies all past and present Directors and Secretaries of the Company, including at this time the Directors named in this report and the Secretary or Secretaries, against every liability incurred by them in, and all legal costs incurred in defending or resisting (or otherwise in connection with) proceedings in which they become involved because of, their respective capacities unless:

- the liability is owed to the Company or to a related body corporate;
- the liability did not arise out of the conduct of good faith;
- the liability is for a pecuniary penalty order or a compensation order under the *Corporations Act 2001 (Cth)* (the Act);
- in the case of legal costs, the costs are incurred in defending or resisting a liability excluded above, criminal proceedings in which the person is found guilty or proceedings brought by the Australian Securities & Investments Commission or a liquidator where grounds for a court order are established (but excluding costs relating to investigations before commencement of proceedings for the court order), or the costs are incurred in relation to proceedings for relief to the person under the Act in which the court denies relief;
- the Company is forbidden by statute to indemnify the person against the liability or legal costs, or
- an indemnity by the Company of the person against the liability or legal costs would, if given, be made void by statute.

Each of the Directors and Secretaries having the benefit of the indemnity provisions under the Company's Constitution, agreed by deed poll that those indemnities would not apply to the extent to which an indemnity for any liability or legal costs is forbidden by Australian statute or would, if given, be made void by Australian statute. These limitations on the indemnities have subsequently been adopted into the indemnity provisions of the Company's Constitution with the effect that these limitations now apply directly to the Directors and Secretaries.

Directors' Report
for the financial year ended 31 March 2012
continued

Environmental regulations

The Company has policies and procedures in place that are designed to ensure that, where operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory, those obligations are identified and appropriately addressed.

The Directors have determined that there has not been any material breach of those obligations during the financial year.

Auditor's Independence Declaration

A copy of the Auditor's Independence Declaration, as required under section 307C of the Act, is set out on page 3 of this report.

This report is made in accordance with a resolution of the Directors.

Rounding

The Company is of a kind referred to in *Australian Securities and Investments Commission Class Order 98/0100* (as amended), relating to the rounding off of amounts in the financial report. Amounts in the financial report have been rounded off in accordance with that Class Order to the nearest million dollars unless otherwise indicated.

Company disclosures

All amounts relate to the Consolidated Entity unless otherwise stated.

Robert Upfold
Director

Sydney
31 May 2012

Auditor's Independence Declaration for the financial year ended 31 March 2012

pwc

Auditor's Independence Declaration

As lead auditor for the audit of Macquarie Financial Holdings Limited for the year ended 31 March 2012, I declare that to the best of my knowledge and belief, there have been:

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

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

This declaration is in respect of Macquarie Financial Holdings Limited and the entities it controlled during the financial year.

DH Armstrong
Partner
PricewaterhouseCoopers

Sydney
31 May 2012

Liability is limited by a scheme approved under Professional Standards Legislation

Macquarie Financial Holdings Limited
2012 Financial Report

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Macquarie Financial Holdings Limited
2012 Financial Report
Contents

The Financial Report was authorised for issue by the Directors on 30 May 2012.
The Consolidated Entity has the power to amend and reissue the Financial Report.

Consolidated income statement for the financial year ended 31 March 2012

	Notes	2012 $m	2011 $m
Interest and similar income		**378**	445
Interest expense and similar charges		**(557)**	(745)
Net interest expense	2	**(179)**	(300)
Fee and commission income	2	**1,936**	2,481
Net trading income	2	**103**	150
Share of net profits of associates and joint ventures accounted for using the equity method	2	**65**	126
Other operating income and charges	2	**416**	255
Net operating income		**2,341**	2,712
Employment expenses	2	**(1,334)**	(1,573)
Brokerage, commission and trading-related expenses	2	**(113)**	(116)
Occupancy expenses	2	**(212)**	(226)
Non-salary technology expenses	2	**(109)**	(117)
Other operating expenses	2	**(208)**	(493)
Total operating expenses		**(1,976)**	(2,525)
Operating profit before income tax		**365**	187
Income tax expense	3	**(102)**	(16)
Profit after income tax		**263**	171
Profit attributable to non-controlling interests		**(2)**	(3)
Profit attributable to ordinary equity holders of Macquarie Financial Holdings Limited		**261**	168

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

Consolidated statement of comprehensive income for the financial year ended 31 March 2012

	Notes	2012 $m	2011 $m
Profit after income tax for the financial year		**263**	171
Other comprehensive (expense)/income:			
Available for sale investments, net of tax	26	**(65)**	141
Cash flow hedges, net of tax	26	**6**	(42)
Share of other comprehensive (expense)/income of associates and joint ventures, net of tax	26	**(17)**	24
Exchange differences on translation of foreign operations, net of tax		**69**	(98)
Total other comprehensive (expense)/income for the financial year		**(7)**	25
Total comprehensive income for the financial year		**256**	196
Total comprehensive income for the financial year is attributable to:			
Ordinary equity holders of Macquarie Financial Holdings Limited		**257**	191
Non-controlling interests		**(1)**	5
Total comprehensive income for the financial year		**256**	196

The above consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

Consolidated statement of financial position as at 31 March 2012

	Notes	2012 $m	2011 $m
Assets			
Receivables from financial institutions	4	**2,583**	2,183
Cash collateral on securities borrowed and reverse repurchase agreements	5	**574**	1,372
Trading portfolio assets	6	**633**	475
Derivative assets		**126**	37
Investment securities available for sale	7	**2,024**	2,140
Other assets	8	**6,581**	5,759
Loan assets held at amortised cost	9	**1,122**	629
Other financial assets at fair value through profit or loss	11	**630**	958
Due from related body corporate entities	28	**2,131**	5,419
Property, plant and equipment	12	**230**	2,427
Interests in associates and joint ventures accounted for using the equity method	13	**1,959**	1,875
Intangible assets	14	**464**	448
Deferred tax assets	15	**897**	720
Non-current assets and assets of disposal groups classified as held for sale	16	**134**	79
Total assets		**20,088**	24,521
Liabilities			
Cash collateral on securities lent and repurchase agreements	17	**47**	514
Trading portfolio liabilities	18	**108**	75
Derivative liabilities		**125**	117
Deposits		**104**	183
Current tax liabilities		**52**	31
Other liabilities	19	**6,838**	6,478
Payables to financial institutions	20	**327**	1,778
Other financial liabilities at fair value through profit or loss	21	**1,081**	1,488
Due to related body corporate entities	28	**7,003**	9,053
Debt issued at amortised cost	22	**39**	11
Provisions	23	**64**	65
Deferred tax liabilities	15	**109**	31
Total liabilities excluding loan capital		**15,897**	19,824
Loan capital			
Macquarie Convertible Preference Securities		**617**	600
Subordinated debt at amortised cost		**405**	407
Total loan capital	24	**1,022**	1,007
Total liabilities		**16,919**	20,831
Net assets		**3,169**	3,690

	Notes	2012 $m	2011 $m
Equity			
Contributed equity	25	**1,709**	16,518
Reserves	26	**(133)**	(14,155)
Retained earnings	26	**1,523**	1,262
Total capital and reserves attributable to ordinary equity holders of Macquarie Financial Holdings Limited		**3,099**	3,625
Non-controlling interests	26	**70**	65
Total equity		**3,169**	3,690

The above consolidated statement of financial position should be read in conjunction with the accompanying notes.

Consolidated statement of changes in equity for the financial year ended 31 March 2012

	Notes	Contributed equity $m	Reserves $m	Retained earnings $m	Total $m	Non-controlling interests $m	Total equity $m
Balance at 1 April 2010		17,022	(14,177)	1,094	3,939	61	4,000
Total comprehensive income for the financial year		–	23	168	191	5	196
Transactions with equity holders in their capacity as equity holders:							
Contributions of equity, net of transaction costs	25	12	–	–	12	–	12
Reduction of capital	25	(550)	–	–	(550)	–	(550)
Contributions from ultimate parent entity in relation to share-based payments	25	34	–	–	34	–	34
Reserves arising from group restructure of combining entities under common control	26	–	(1)	–	(1)	–	(1)
Non-controlling interests:							
Loss attributable to non-controlling interests		–	–	–	–	(1)	(1)
		(504)	(1)	–	(505)	(1)	(506)
Balance at 31 March 2011		**16,518**	**(14,155)**	**1,262**	**3,625**	**65**	**3,690**
Total comprehensive (expense)/ income for the financial year		**–**	**(4)**	**261**	**257**	**(1)**	**256**
Transactions with equity holders in their capacity as equity holders:							
Contributions of equity, net of transaction costs	25	**7**	–	–	**7**	–	**7**
Reduction of capital	25	**(800)**	–	–	**(800)**	–	**(800)**
Contributions from ultimate parent entity in relation to share-based payments	25	**7**	–	–	**7**	–	**7**
Reserves arising from group restructure of combining entities under common control	26	–	**3**	–	**3**	–	**3**
Non-controlling interests:							
Distributions of equity, net of transaction cost		–	–	–	–	**(2)**	**(2)**
Profit attributable to non-controlling interests		–	–	–	–	**8**	**8**
Other equity movements							
Transfer from reserves arising from group restructure of combining entities under common control to contributed equity	26	**(14,023)**	**14,023**	–	–	–	–
		(14,809)	**14,026**	–	**(783)**	**6**	**(777)**
Balance at 31 March 2012		**1,709**	**(133)**	**1,523**	**3,099**	**70**	**3,169**

The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes.

Consolidated statement of cash flows for the financial year ended 31 March 2012

	Notes	2012 $m	2011 $m
Cash flows from operating activities			
Interest received		408	381
Interest and other costs of finance paid		(542)	(745)
Dividends and distributions received		446	205
Fees and other non-interest income received		2,030	2,761
Fees and commissions paid		(128)	(113)
Net receipts/(payments) for trading portfolio assets and other financial assets/liabilities		528	(102)
Payments to suppliers		(793)	(432)
Employment expenses paid		(1,478)	(1,758)
Income tax paid		(37)	(34)
Net loan assets granted		(1,172)	(2,127)
Recovery of loans previously written off		3	–
Net increase/(decrease) in amounts due to other financial institutions, deposits and other borrowings		157	(901)
Net cash flows used in operating activities	27	(578)	(2,865)
Cash flows from investing activities			
Net (payments)/proceeds from financial assets available for sale		(299)	1,462
Payment for acquisition and disposal of associates		(132)	(160)
Proceeds/(payments) for the acquisition of assets and disposal groups classified as held for sale net of cash acquired		5	(22)
Payments for the acquisition of subsidiaries and businesses, excluding disposal groups, net of cash acquired		(20)	(69)
Proceeds from the disposal of subsidiaries and businesses excluding disposal groups, net of cash deconsolidated		301	102
Payments for property, plant and equipment and leased assets		(80)	(122)
Proceeds from disposal of management rights		–	14
Net cash flows from investing activities		(225)	1,205
Cash flows from financing activities			
Payments from non-controlling interests		1	1
Return of capital to parent		(800)	(550)
Proceeds from subordinated debt		–	386
Net cash flows used in financing activities		(799)	(163)
Net decrease in cash and cash equivalents		(1,602)	(1,823)
Cash and cash equivalents at the beginning of the financial year		5,425	7,248
Cash and cash equivalents at the end of the financial year	27	3,823	5,425

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

Notes to the financial statements for the financial year ended 31 March 2012

Note 1

Summary of significant accounting policies

(i) Basis of preparation

The principal accounting policies adopted in the preparation of this financial report and that of the previous financial year are set out below. These policies have been consistently applied to all the financial years presented, unless otherwise stated.

This financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards – Reduced Disclosure Requirements (which includes Australian Interpretations by virtue of AASB 1048 *Interpretation and Application of Standards*) and the *Corporations Act 2001 (Cth)*.

Compliance with IFRS as issued by the IASB

Compliance with Australian Accounting Standards – Reduced Disclosure Requirements ensures that the financial report complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Consequently, this financial report has also been prepared in accordance with and complies with IFRS as issued by the IASB.

Historical cost convention

This financial report has been prepared under the historical cost convention, as modified by the revaluation of investment securities available for sale and certain other assets and liabilities (including derivative instruments) at fair value.

Critical accounting estimates and significant judgements

The preparation of the financial report in conformity with Australian Accounting Standards – Reduced Disclosure Requirements requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the accounting policies. The notes to the financial statements set out areas involving a higher degree of judgement or complexity, or areas where assumptions are significant to the Company and its subsidiaries (Consolidated Entity) and the consolidated financial report such as:

- fair value of financial assets and liabilities (note 36);
- impairment of loan assets held at amortised cost, investment securities available for sale, interests in associates and joint ventures and held for sale investments (notes 1(xi), 1(xii), 10 and 35.1);
- acquisitions and disposals of subsidiaries, associates and joint ventures and assets and disposal groups classified as held for sale (notes 1(ii), 1(xi), 13, 16 and 38);
- distinguishing between whether assets or a business is acquired (note 1(iii));
- determination of whether dividends and distributions received are recognised as income or a return of capital (note 1(v))
- recoverability of deferred tax assets and measurement of current and deferred tax liabilities (notes 1(vi), 3 and 15); and
- the impairment of goodwill and other identifiable intangible assets with indefinite useful lives (notes 1(xiv) and 14).

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including reasonable expectations of future events.

Management believes the estimates used in preparing the financial report are reasonable. Actual results in the future may differ from those reported and therefore it is reasonably possible, on the basis of existing knowledge, that outcomes within the next financial year that are different from our assumptions and estimates could require an adjustment to the carrying amounts of the assets and liabilities reported.

New Accounting Standards and amendments to Accounting Standards and Interpretations that are effective in the current financial year

AASB 2010-3 and AASB 2010-4 Amendments to *Australian Accounting Standards arising from the Annual Improvements Project* were issued in June 2010 and became applicable in the current financial year.

AASB 2010-3 amendments confirm that:

- contingent consideration arising in a business combination that had been accounted for in accordance with AASB 3 (2004) that has not been settled or otherwise resolved at the adoption date of AASB 3 (2008) continues to be accounted for in accordance with AASB 3 (2004);
- the accounting policy choice to measure non-controlling interests (NCI) upon initial recognition either at fair value or at the NCI's proportionate share of the acquiree's identifiable net assets is limited to instruments that give rise to a present ownership interest and which currently entitle the holder to a share of net assets in the event of liquidation. The accounting policy choice does not apply to other instruments, such as written options classified as equity instruments or options granted under share-based payment arrangements – these are generally measured at fair value or otherwise in accordance with the relevant Standards;
- AASB 3 (2008) application guidance applies to unreplaced and voluntarily replaced share-based payment awards; and
- consequential amendments to AASB 121, AASB 128 and AASB 131 as a result of the issue of AASB 127 (2008) relating to disposals of all or part of a foreign operation and accounting for a loss of significant influence/joint control is applied prospectively.

AASB 2010-4 makes amendments to various disclosure requirements relating to AASB 7 *Financial Instruments: Disclosures*, AASB 101 *Presentation of Financial Statements* and AASB 134 *Interim Financial Reporting*.

The application of these amendments in the current year has had an immaterial impact.

New Accounting Standards and amendments to Accounting Standards and Interpretations that are not yet effective

When a new Accounting Standard is first adopted, any change in accounting policy is accounted for in accordance with the specific transitional provisions (if any), otherwise retrospectively.

The Company's and Consolidated Entity's assessment of the impact of the key new Accounting Standards and Interpretations and amendments to Accounting Standards is set out below:

AASB 2010-6 ***Amendments to Australian Accounting Standards – Disclosures on Transfers of Financial Assets***

AASB 2010-6 was issued by the AASB in November 2010 and is effective for annual reporting periods beginning on or after 1 July 2011. The Standard adds and amends disclosure requirements about transfers of financial assets. The standard requires disclosures to be made of transfers of financial assets that are either not derecognised in their entirety, or for which a continuing involvement is retained. The Consolidated Entity will first apply the Standard in the financial year beginning 1 April 2012. Comparative information is not required.

Whilst the new standard will not affect any of the amounts recognised in the financial statements, it will increase disclosures of transferred assets.

AASB 2010-7 ***Amendments to Australian Accounting Standards arising from AASB 9***

In December 2010, the AASB re-issued AASB 9 *Financial Instruments*, which is effective for annual reporting periods beginning on or after 1 January 2015. Early adoption is permitted if all the requirements are applied at the same time. The revised AASB 9 includes the classification and measurement requirements for financial liabilities, and the recognition and derecognition requirements for financial instruments, in addition to the classification and measurement requirements for financial assets that appeared in the December 2009 version of the Standard.

Under the new guidance, a financial asset is to be measured at amortised cost only if it is held within a business model whose objective is to collect contractual cash flows and the contractual terms of the asset give rise to cash flows on specified dates that are payments solely of principal and interest (on the principal amount outstanding). All other financial assets are to be measured at fair value.

Changes in the fair value of investments in equity securities that are not part of a trading activity may be reported directly in other comprehensive income (OCI), but upon realisation those accumulated changes in value are not recycled to the income statement. Dividends on such investments are recognised in profit or loss, rather than OCI, unless they clearly represent a recovery of the cost of the investment. Changes in the fair value of all other financial assets carried at fair value are reported in the income statement. The Consolidated Entity is currently assessing the impact of the new Standard, and it is likely that some financial assets:

- carried at fair value through profit or loss (e.g. quoted bonds outside of trading book) will change to be carried at amortised cost;
- carried at amortised cost (e.g. beneficial interests) will change to be carried at fair value through profit or loss; and
- containing embedded derivatives (e.g. capital protected products) will no longer be separated, and the entire product will change to be carried at fair value through profit or loss.

In respect of financial liabilities, the change in fair value (for financial liabilities designated at fair value through profit or loss) due to changes in an entity's own credit risk is to be presented in OCI, unless such presentation would create an accounting mismatch. If a mismatch is created or enlarged, all changes in fair value (including the effects of changes in the credit risk of the liability) are presented in the income statement. All other key requirements for classification and measurement of financial liabilities have been carried forward unamended from AASB 139 *Financial Instruments: Recognition and Measurement*. The recognition and derecognition requirements in AASB 139 have also been retained and relocated to the revised AASB 9 unamended. The Consolidated Entity will first apply AASB 9 in the financial year beginning 1 April 2015. The impact of AASB 9 on the Consolidated Entity's financial statements on initial application has not yet been assessed.

AASB 2011-4 ***Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements***

The AASB has decided to remove the individual Key Management Personnel (KMP) disclosure requirements from AASB 124 *Related Party Disclosures*. While this will reduce the disclosures that are currently required in the notes to the financial statements, it will not affect any of the amounts recognised in the financial statements. The amendments are effective for annual reporting periods on or after 1 July 2013 and cannot be adopted early.

AASB 2011-9 ***Amendments to Australian Accounting Standards - Presentation of Items of Other Comprehensive Income.***

The amendment requires items in other comprehensive income to be segregated into two categories, based on whether they may be recycled to income statement in the future. Items that will never recycle (such as revaluation reserve) will be presented separately from items that may recycle in the future (such as cash flow hedge reserves and the foreign currency translation reserve). The amendments are effective for annual periods beginning on or after 1 July 2012.

Notes to the financial statements for the financial year ended 31 March 2012

Note 1

Summary of significant accounting policies continued

AASB 10 *Consolidated Financial Statements,* AASB 11 *Joint Arrangements,* AASB 12 *Disclosure of Interests in Other Entities and revised* AASB 127 *Separate Financial Statements and* AASB 128 *Investments in Associates and Joint Ventures*

The AASB has issued a suite of five new and amended standards which address the accounting for joint arrangements, consolidated financial statements and associated disclosures.

These new standards are effective for annual periods beginning on or after 1 January 2013 and are applied on a modified retrospective basis. Early adoption is permitted, however these standards must be adopted as a package, that is, all as of the same date, except that an entity may early adopt the disclosure provisions for AASB 12 (without adopting the other new standards). The Consolidated Entity currently intends to first apply these Standards in the financial year beginning 1 April 2013.

AASB 10 replaces the guidance on control and consolidation in AASB 127 *Consolidated and Separate Financial Statements*, and Interpretation 112 *Consolidation – Special Purpose Entities*. The core principle that a Consolidated Entity presents a parent and its subsidiaries as if they are a single economic entity remains unchanged, as do the mechanics of consolidation. However the standard introduces a single definition of control that applies to all entities. It focuses on the need to have power, rights or exposure to variable returns and ability to use the power to affect the returns. Power is the current ability to direct the activities that significantly influence returns. Returns must vary and can be positive, negative or both. There is also new guidance on participating and protective rights, de-facto control and on agent versus. principal relationships. The impact of AASB 10 on the Consolidated Entity's financial statements on initial application is being assessed.

AASB 11 introduces a principles based approach to accounting for joint arrangements. The focus is no longer on the legal structure, but rather on how rights and obligations are shared by the parties to the joint arrangement. Based on the assessment of rights and obligations, a joint arrangement will be classified as either a joint operation or joint venture. Joint ventures are accounted for using the equity method, and the choice to proportionately consolidate will no longer be permitted. Parties to a joint operation will account their share of revenues, expenses, assets and liabilities in much the same way as under the previous standard. AASB 11 also provides guidance for parties that participate in joint arrangements but do not share joint control. The impact of AASB 11 on the Consolidated Entity's financial statements on initial application is being assessed.

AASB 12 sets out the required disclosures for interests in entities that are subsidiaries, associates, joint ventures and unconsolidated structured entities. Application of this standard by the Consolidated Entity will not affect any of the amounts recognised in the financial statements, but will impact the type of information disclosed in relation to the Consolidated Entity's investments. Systems may need to be developed to capture all the necessary information.

Whilst the new standard will not affect any of the amounts recognised in the financial statements, it will require additional disclosures of interests in subsidiaries, associates, joint ventures and unconsolidated structured entities.

AASB 127 is renamed Separate Financial Statements and now deals solely with separate financial statements. Initial application of this standard by the Consolidated Entity and the Company is not expected to result in any material impact.

Amendments to AASB 128 clarify that an entity continues to apply the equity method for its retained interest where on a change of ownership a joint venture becomes an associate, and vice versa. The amendments also clarify that where part of an associate or joint venture is to be sold, an entity accounts for the part to be sold under AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*, and continues to apply the equity method on the retained portion until the portion held for sale is sold. The Consolidated Entity is still assessing the impact of these amendments, although it is not expected to result in any material impact.

AASB 13 Fair Value Measurement

AASB 13 has been issued by the AASB and is effective for annual reporting periods beginning on or after 1 January 2013.

AASB 13 explains how to measure fair value and aims to enhance fair value disclosures. The impact of AASB 13 on the Consolidated Entity's financial statements on initial application has not yet been assessed.

The Consolidated Entity intends to first apply the Standard prospectively from 1 April 2013.

(ii) Principles of consolidation

Subsidiaries

The consolidated financial report comprises the financial report of the Consolidated Entity. Subsidiaries are all those entities (including SPEs) over which the Company has the power to govern (directly or indirectly) decision-making in relation to financial and operating policies, so as to require that entity to conform to the Company's objectives. The effects of all transactions between entities in the Consolidated Entity are eliminated in full. NCI in the results and equity of subsidiaries, where the Company owns less than 100 per cent of the issued capital, are shown separately in the consolidated income statement, consolidated statement of comprehensive income and consolidated statement of financial position, respectively.

Where control of an entity was obtained during the financial year, its results are included in the consolidated income statement from the date on which control commenced. Where control of an entity ceased during the financial year, its results are included for that part of the financial year during which control existed.

The Company and Consolidated Entity determine the dates of obtaining control (i.e. acquisition date) and losing control (i.e. disposal date) of another entity based on an assessment of all pertinent facts and circumstances that affect the ability to govern the financial and operating policies of that entity. Facts and circumstances that have the most impact include the contractual arrangements agreed with the counterparty, the manner in which those arrangements are expected to operate in practice and whether regulatory approval is required to complete. The acquisition or disposal date does not necessarily occur when the transaction is closed or finalised under law.

Subsidiaries held by the Company are carried in its separate financial statements at cost less impairment in accordance with AASB 127 *Consolidated and Separate Financial Statements.*

Impairment of subsidiaries

Investments in subsidiaries are reviewed annually for indicators of impairment, or more frequently if 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 investment's carrying amount exceeds its recoverable amount (which is the higher of fair value less costs to sell and value in use). At each balance date, investments in subsidiaries that have been impaired are reviewed for possible reversal of the impairment.

Interests in associates and joint ventures accounted for using the equity method

Associates and joint ventures are entities over which the Consolidated Entity has significant influence or joint control, but not control, and are accounted for under the equity method except those which are classified as held for sale (see note 1(xi)). The equity method of accounting is applied in the consolidated financial report and involves the recognition of the Consolidated Entity's share of its associates' and joint ventures' post-acquisition profits or losses in the consolidated income statement, and its share of post-acquisition movements in reserves.

The Company and Consolidated Entity determine the dates of obtaining or losing significant influence or joint control of another entity based on an assessment of all pertinent facts and circumstances that affect the ability to significantly influence or jointly control the financial and operating policies of that entity. Facts and circumstances that have the most impact include the contractual arrangements agreed with the counterparty, the manner in which those arrangements are expected to operate in practice, and whether regulatory approval is required to complete. The acquisition or disposal date does not necessarily occur when the transaction is closed or finalised under law.

Associates and joint ventures held by the Company are carried in its separate financial statements at cost in accordance with AASB 127 *Consolidated and Separate Financial Statements.*

(iii) Business combinations

The purchase method of accounting is used to account for all business combinations (excepting business combinations involving entities or businesses under common control) which occurred before 1 April 2010. From 1 April 2010, business combinations are accounted for using the acquisition method. Cost is measured as the aggregate of the fair values (at the date of exchange) of assets acquired, equity instruments issued or liabilities incurred or assumed at the date of exchange plus, for business combinations occurring before 1 April 2010, any costs directly attributable to the acquisition. Transaction costs arising on the issue of equity instruments are recognised directly in equity, and those arising on borrowings are capitalised and included in interest expense using the effective interest method.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at their fair value on the acquisition date. The Consolidated Entity can elect, on a transaction-by-transaction basis, to measure any NCI either at fair value or at the NCI's proportionate share of the fair value of the identifiable assets and liabilities. The excess of the cost of acquisition over the fair value of the Consolidated Entity's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the Consolidated Entity's share of the fair value of the identifiable net assets of the business acquired, the difference is recognised directly in the consolidated income statement, but only after a reassessment of the identification and measurement of the net assets acquired. For contingent consideration given in business combinations occurring from 1 April 2010, the amount is subsequently remeasured to its fair value with changes recognised in the consolidated income statement.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present values as at the date of exchange. The discount rate used is the entity's incremental borrowing rate, being the rate at which a similar borrowing could be obtained from an independent financier under comparable terms and conditions.

Notes to the financial statements for the financial year ended 31 March 2012

Note 1

Summary of significant accounting policies continued

Distinguishing between whether assets or a business is acquired involves judgement. Some of the factors that the Consolidated Entity uses in identifying a business combination are:

- the nature of the Consolidated Entity's industry and business model, which affects the nature of an input, process or output;
- whether the acquisition included at least a majority of the critical inputs (e.g. tangible or intangible assets, and intellectual property) and a majority of the critical processes (e.g. strategic processes, skilled and experienced workforce);
- the relative ease of replacing the critical processes not acquired by either integrating within the Consolidated Entity's existing processes or sub-contracting them to third parties; and
- the presence of goodwill.

Combinations between entities or businesses under common control

Combinations between entities under common control are business combinations in which all of the combining entities or businesses ultimately are controlled by the same party or parties both before and after the combination and that control is not transitory. In the consolidated financial statements of the Company, assets and liabilities of the acquired entities are measured at the carrying amounts recognised previously in the seller's consolidated financial statements at the date of the combination. In the separate financial statements of the Company, assets and liabilities of the acquired businesses are measured at the carrying amounts recognised previously in the seller's financial statements at the date of the combination. Any difference between the fair value of the consideration given over the carrying amounts recognised is recorded directly in equity.

(iv) Foreign currency translation

Functional and presentation currency

Items included in the financial statements of foreign operations are measured using the currency of the primary economic environment in which the foreign operation operates (the functional currency). The Company's and Consolidated Entity's financial statements are presented in Australian dollars (the presentation currency), which is also the Company's functional currency.

Transactions and balances

Foreign currency transactions are recorded in 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 year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in OCI as a result of meeting cash flow hedge or net investment hedge accounting requirements (see note 1(x)).

Translation differences on non-monetary items (such as equities) held at fair value through profit or loss, are reported as part of the fair value gain or loss in the income statement. Translation differences on non-monetary items (such as equities) classified as available for sale financial assets are included in the available for sale reserve in equity, unless they form part of fair value hedge relationships in which case the translation differences are recognised in the income statement (see note 1(x)).

Subsidiaries and other entities

The results and financial position of all foreign operations that have a functional currency other than Australian dollars are translated into Australian dollars as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing exchange rate at the date of that statement of financial position;
- income and expenses for each income statement are translated at actual exchange rates at the dates of the transactions; and
- all resulting exchange differences are recognised in OCI within a separate component of equity – the foreign currency translation reserve.

On consolidation, exchange differences arising from the translation of any net investment in foreign operations and of borrowings and other foreign currency instruments designated as hedges of such investments, are taken to the foreign currency translation reserve through OCI. When a foreign operation is disposed of or any borrowings forming part of the net investment are repaid, such exchange differences are recognised in the income statement as part of the gain or loss on disposal.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

(v) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Revenue is recognised for each major revenue stream as follows:

Interest income

Interest income is brought to account using the effective interest method. The effective interest method calculates the amortised cost of a financial instrument and allocates the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash receipts or payments through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or liability. Fees and transaction costs associated with loans are capitalised and included in the effective interest rate and recognised in the income statement over the expected life of the instrument.

Interest income on finance leases is brought to account progressively over the life of the lease consistent with the outstanding investment balance.

Fee and commission income

Fee and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are capitalised and included in the effective interest rate and recognised in the income statement over the expected life of the instrument.

Other fee and commission income, including fees from fund management, brokerage, account servicing, corporate advisory, underwriting and securitisation arrangements is recognised as the related services are performed. Where commissions and fees are subject to clawback or meeting certain performance hurdles, they are recognised as income at the point when those conditions can no longer affect the outcome.

Fees charged for performing a significant act in relation to funds managed by the Consolidated Entity are recognised as revenue when that act has been completed.

Net trading income

Net trading income comprises gains and losses related to trading assets and liabilities and include all realised and unrealised fair value changes, dividends and foreign exchange differences.

Dividends and distributions

Dividends and distributions are recognised as income when the Consolidated Entity becomes entitled to the dividend or distribution. Dividends from subsidiaries, associates and joint ventures are recognised in the income statement when the Company's right to receive the dividend is established.

When accounting for a dividend or distribution, judgement is required about whether it is recognised as income or a return of capital. The range of factors that are considered include:

- whether the payment follows a legal process to reduce either the number of outstanding shares or the amount of share capital;
- whether evidence exists clearly demonstrating that the distribution is a return of capital originally invested by the investor (e.g. the timing of a distribution relative to the acquisition of the investment);
- the substance of the payment, including the existence of non-discretionary evidence, that may identify its nature. A director declaration of the nature is given a low weighting in the analysis;
- other transactions occur with the same counterparty at the same time as, or in contemplation of, the payment;
- whether the payment is from profits in proportion to the investors' particular class of capital;
- when a dividend is paid in the form of additional equity of the investee, whether all investors retain their same relative ownership interest in the investee;
- whether the criteria for derecognising part, or all, of an investment in a financial asset under AASB139 *Financial Instruments: Recognition and Measurement* are met, and in particular if substantially all the risks and rewards of ownership have transferred; and
- the basis for the amendment in May 2008 to the 'cost method' description in AASB 127 *Consolidated and Separate Financial Statements* so as to remove an approach solely relying upon determining post-acquisition retained earnings.

(vi) Income tax

The income tax expense for the financial year is the tax payable on the current period's taxable income based on the national income tax rate for each jurisdiction, adjusted for changes in deferred tax assets and liabilities and unused tax losses.

Deferred tax assets are recognised when temporary differences arise between the tax base of assets and liabilities and their respective carrying amounts which give rise to a future tax benefit, or where a benefit arises due to unused tax losses. In both cases, deferred tax assets are recognised only to the extent that it is probable that future taxable amounts will be available to utilise those temporary differences or tax losses. Deferred tax liabilities are recognised when such temporary differences will give rise to taxable amounts being payable in future periods. Deferred tax assets and liabilities are recognised at the tax rates expected to apply when the assets are recovered or the liabilities are settled under currently enacted tax law.

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 either settle on a net basis, or realise the asset and settle the liability simultaneously. Current and deferred taxes attributable to amounts recognised directly in equity are also recognised directly in equity.

The Company and Consolidated Entity exercise judgement in determining whether deferred tax assets, particularly in relation to tax losses, are probable of recovery. Factors considered include the ability to offset tax losses within the tax consolidated group in Australia or groups of entities in overseas jurisdictions, the nature of the tax loss, the length of time that tax losses are eligible for carry forward to offset against future taxable profits and whether future taxable profits are expected to be sufficient to allow recovery of deferred tax assets.

The Consolidated Entity undertakes transactions in the ordinary course of business where the income tax treatment requires the exercise of judgement. The Consolidated Entity estimates its tax liability based on its understanding of the tax law.

Tax consolidation

All eligible Australian resident wholly-owned subsidiaries of the Macquarie Group represent a tax consolidated group, with Macquarie Group Limited (MGL) as the head entity. As a consequence, the Company and the relevant subsidiaries are not liable to make income tax payments and do not recognise any current tax balances or any deferred tax assets arising from unused tax losses. Under the terms and conditions of a tax funding agreement, MGL charges each subsidiary for all current tax liabilities incurred in respect of their activities and reimburses each subsidiary for any tax assets arising from unused tax losses.

Notes to the financial statements for the financial year ended 31 March 2012

Note 1

Summary of significant accounting policies continued

(vii) Cash collateral on securities borrowed/lent and reverse repurchase/repurchase agreements

As part of its trading activities, the Consolidated Entity borrows and lends securities on a collateralised basis. The securities subject to the borrowing or lending are not derecognised from the statements of financial position of the relevant parties, as the risks and rewards of ownership remain with the initial holder. Where cash is provided as collateral, the cash paid to third parties on securities borrowed is recorded as a receivable, while cash received from third parties on securities lent is recorded as a borrowing.

Reverse repurchase transactions, where the Consolidated Entity purchases securities under an agreement to resell, and repurchase transactions, where the Consolidated Entity sells securities under an agreement to repurchase, are also conducted on a collateralised basis. The securities subject to the reverse repurchase and repurchase agreements are not derecognised from the statements of financial position of the relevant parties, as the risks and rewards of ownership remain with the initial holder. Where cash is provided as collateral, the cash paid to third parties on the reverse repurchase agreement is recorded as a receivable, while cash received from third parties on the repurchase agreement is recorded as a borrowing.

The Consolidated Entity continually reviews the fair values of the securities on which the above transactions are based and, where appropriate, requests or provides additional collateral to support the transactions, in accordance with the underlying agreements.

(viii) Trading portfolio assets and liabilities

Trading portfolio assets (long positions) comprise debt and equity securities, bank bills, treasury notes, bullion and commodities purchased with the intent of being actively traded. Trading portfolio liabilities (short positions) comprise obligations to deliver assets across the same trading categories, which the Consolidated Entity has short-sold and are actively traded.

Assets and liabilities included in the trading portfolio are carried at fair value (see note 36). Realised gains and losses, and unrealised gains and losses arising from changes in the fair value of the trading portfolio are recognised as net trading income in the income statement in the period in which they arise. Dividend income or expense on the trading portfolio is recognised in the income statement as net trading income.

The Consolidated Entity uses trade date accounting when recording regular way purchases and sales of financial assets. At the date the transaction is entered into (trade date), the Consolidated Entity recognises the resulting financial asset or liability and any subsequent unrealised profits or losses arising from revaluing that contract to fair value in the income statement. When the Consolidated Entity becomes party to a sale contract of a financial asset, it derecognises the asset and recognises a trade receivable from trade date until settlement date.

(ix) Derivative instruments

Derivative instruments entered into by the Company and Consolidated Entity include futures, forwards and forward rate agreements, swaps and options in the interest rate, foreign exchange, commodity and equity markets. These derivative instruments are principally used for the risk management of existing financial assets and financial liabilities.

All derivatives, including those used for statement of financial position hedging purposes, are recognised on the statement of financial position and are disclosed as an asset where they have a positive fair value at balance date or as a liability where the fair value at balance date is negative.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and subsequently re-measured to their fair value. Fair values are obtained from quoted market prices in active markets including recent market transactions, and valuation techniques including discounted cash flow models and option pricing models, as appropriate. Movements in the carrying amounts of derivatives are recognised in the income statement in net trading income, unless the derivative meets the requirements for hedge accounting.

The best evidence of a derivative's fair value at initial recognition is its transaction price, unless its fair value is evidenced by comparison with other observable current market transactions in the same instrument, or based on a valuation technique for which variables include only data from observable markets. Where such alternative evidence exists, the Company and Consolidated Entity recognises profits or losses immediately when the derivative is recognised.

(x) Hedge accounting

The Consolidated Entity designates certain derivatives or financial instruments as hedging instruments in qualifying hedge relationships. On initial designation of the hedge, the Consolidated Entity documents the hedge relationship between hedging instruments and hedged items, as well as its risk management objectives and strategies. The Consolidated Entity also documents its assessment, both at hedge inception and on an ongoing basis, of whether hedging relationships have been and will continue to be highly effective. Derivatives or financial instruments can be designated in one of three types of hedge relationships:

Cash flow hedges

For a derivative or financial instrument designated as hedging the variability in cash flows attributable to a particular risk associated with a recognised asset or liability (or a highly probable forecast transaction), the gain or loss on the derivative or financial instrument associated with the effective portion of the hedge is initially recognised in OCI in the cash flow hedging reserve and subsequently released to the income statement when the hedged item affects the income statement. The gain or loss relating to the ineffective portion of the hedge is recognised immediately in the income statement.

Fair value hedges

For a derivative or financial instrument designated as hedging the change in fair value of a recognised asset or liability (or an unrecognised firm commitment), and the gain or loss on the derivative or financial instrument is recognised in the income statement immediately, together with the loss or gain on the hedged asset or liability that is attributable to the hedged risk.

Net investment hedges

For a derivative or borrowing designated as hedging a net investment in a foreign operation, the gain or loss on revaluing the derivative or borrowing associated with the effective portion of the hedge is recognised in the foreign currency translation reserve and subsequently released to the income statement when the foreign operation is disposed of. The ineffective portion is recognised in the income statement immediately.

The fair values of various financial instruments used for hedging purposes are disclosed in note 34. Movements in the cash flow hedging reserve in equity are shown in note 26.

(xi) Investments and other financial assets

With the exception of trading portfolio assets, derivatives and investments in associates and joint ventures, which are classified separately in the statement of financial position, the remaining investments in financial assets are classified into the following categories: loans and receivables (loan assets held at amortised cost, amounts due from related body corporate entities and amounts due from subsidiaries), other financial assets at fair value through profit or loss, investment securities available for sale and non-current assets and assets of disposal groups classified as held for sale. The classification depends on the purpose for which the financial asset was acquired, which is determined at initial recognition and, except for other financial assets at fair value through profit or loss, is re-evaluated at each balance date.

Loans and receivables

Loan assets held at amortised cost, amounts due from related body corporate entities and amounts due from subsidiaries are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Other financial assets at fair value through profit or loss

This category includes only those financial assets which have been designated by management as held at fair value through profit or loss on initial recognition.

The policy of management is to designate a financial asset as such if: the asset contains embedded derivatives which must otherwise be separated and carried at fair value; it is part of a group of financial assets managed and evaluated on a fair value basis; or doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise. Interest income on debt securities designated as at fair value through profit or loss is recognised in the income statement in interest income using the effective interest method as disclosed in note 1(v).

Investment securities available for sale

Investment securities available for sale comprise securities that are not actively traded and are intended to be held for an indefinite period. Such securities are available for sale and may be sold should the need arise, including purposes of liquidity, or due to the impacts of changes in interest rates, foreign exchange rates or equity prices.

Investment securities available for sale are initially carried at fair value plus transaction costs. Gains and losses arising from subsequent changes in fair value are recognised directly in the available for sale reserve in equity until the asset is derecognised or impaired, at which time the cumulative gain or loss is recognised in the income statement. Fair values of quoted investments in active markets are based on current bid prices.

If the relevant market is not considered active (or the securities are unlisted), fair value is established by using valuation techniques, including recent arm's length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants.

Interest income on debt securities available for sale is recognised in the income statement in interest income using the effective interest method as disclosed in note 1(v).

Non-current assets and disposal groups classified as held for sale

This category includes interests in associates and joint ventures for which their carrying amount will be recovered principally through a sale transaction rather than continuing use, and subsidiaries held exclusively with a view to sale. These assets are classified as held for sale when it is highly probable that the asset will be sold within 12 months subsequent to being classified as such. Where there is a planned partial disposal of a subsidiary resulting in loss of control, all of the assets and liabilities of the subsidiary are classified as held for sale.

Non-current assets and disposal groups classified as held for sale are presented separately on the face of the statement of financial position.

Non-current assets and assets of disposal groups classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell. These assets are not depreciated.

An impairment loss is recognised for any initial or subsequent write down of the asset to fair value less costs to sell. A gain is recognised for any subsequent increase in fair value less costs to sell, limited by the cumulative impairment loss previously recognised. A gain or loss not previously recognised by the date of sale is recognised at the date of sale.

(xii) Impairment

Loan assets held at amortised cost

Loan assets are subject to regular review and assessment for possible impairment. Provisions for impairment on loan assets are recognised based on an incurred loss model and re-assessed at each balance date. A provision for impairment is recognised when there is objective evidence of impairment, and is calculated based on the present

Notes to the financial statements for the financial year ended 31 March 2012

Note 1

Summary of significant accounting policies continued

value of expected future cash flows, discounted using the original effective interest rate.

Individually assessed provisions for impairment are recognised where impairment of individual loans are identified. Where individual loans are found not to be impaired, they are placed into pools of assets with similar risk profiles and collectively assessed for losses that have been incurred but are not yet specifically identifiable.

The Company and Consolidated Entity make judgements as to whether there is any observable data indicating that there is a significant decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of the borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Changes in assumptions used for estimating future cash flows could result in a change in the estimated provisions for impairment on loan assets at the end of the reporting period.

If, in a subsequent period, the amount of impairment losses decrease and the decrease can be related objectively to an event occurring after the impairment losses were recognised, the previously recognised impairment losses are reversed through the income statement to the extent of what the amortised cost would have been had the impairment not been recognised.

Investment securities available for sale

The Company and Consolidated Entity perform an assessment at each balance date to determine whether there is any objective evidence that available for sale financial assets have been impaired. Impairment exists if there is objective evidence of impairment as a result of one or more events (loss event) which have an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

For equity securities classified as available for sale, the main indicators of impairment are: significant changes in the market, economic or legal environment and a significant or prolonged decline in fair value below cost.

In making this judgement, the Consolidated Entity evaluates among other factors, the normal volatility in share price and the period of time for which fair value has been below cost.

In the case of debt securities classified as available for sale, observable data that relates to loss events are considered, including adverse changes in the payment status of the issuer and national or local economic conditions that correlate with defaults on those assets.

In addition, impairment may be appropriate when there is evidence of deterioration in the financial condition of the investee, industry and sector performance, operational and financing cash flows or changes in technology.

When the fair value of an available for sale financial asset is less than its initial carrying amount and there is objective evidence that the asset is impaired, the cumulative loss recognised directly in OCI is removed from equity and recognised in the income statement.

Impairment losses recognised in the income statement for equity securities classified as available for sale are not subsequently reversed through the income statement. However impairment losses recognised for debt investment securities classified as available for sale are subsequently reversed through the income statement if the fair value increases and the increase can be objectively related to an event after the impairment loss was recognised in the income statement.

Interests in associates and joint ventures

The Consolidated Entity performs an assessment at each balance date to determine whether there is any objective evidence that its interests in associates and joint ventures are impaired. The entire carrying amount of each investment in associate and joint venture is considered in the assessment. The main indicators of impairment are as for equity securities classified as available for sale, disclosed above.

If there is an indication that an investment in an associate or joint venture may be impaired, then the entire carrying amount of the investment in associate or joint venture is tested for impairment by comparing the recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Impairment losses recognised in the income statement for investments in associates and joint ventures are subsequently reversed through the income statement if there has been a change in the estimates used to determine recoverable amount since the impairment loss was recognised.

(xiii) Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses, if any. Property, plant and equipment are reviewed for impairment at each reporting date. Historical cost includes expenditure directly attributable to the acquisition of the asset. Property, plant and equipment includes assets leased out under operating leases.

Depreciation on assets is calculated on a straight-line basis to allocate the difference between cost and residual values over their estimated useful lives, at the following rates:

Furniture and fittings	10 to 20 per cent
Leasehold improvements[1]	20 per cent
Communication equipment	33 per cent
Computer equipment	33 to 50 per cent
Infrastructure assets	5 to 20 per cent
Aviation	3 to 4 per cent
Other operating lease assets	2 to 50 per cent

[1] Where remaining lease terms are less than five years, leasehold improvements are depreciated over the remaining lease term.

Useful lives and residual values are reviewed annually and reassessed in light of commercial and technological developments. If an asset's carrying value is greater than its recoverable amount, the carrying amount is written down immediately to its recoverable amount. Adjustments arising from such items and on disposal of property, plant and equipment are recognised in the income statement.

Gains and losses on disposal are determined by comparing proceeds with the asset's carrying amount and are recognised in the income statement.

(xiv) Goodwill and other identifiable intangible assets

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Consolidated Entity's share of the identifiable net assets of the acquired entity at the date of acquisition. Goodwill arising from business combinations is included in intangible assets on the face of the statement of financial position. Goodwill arising from acquisitions of associates is included in the carrying amount of investments in associates.

Other identifiable intangible assets

An intangible asset is considered to have an indefinite useful life where it is expected to contribute to the Consolidated Entity's net cash inflows indefinitely.

Licences and trading rights are carried at cost less accumulated impairment losses. These assets are not amortised because they are considered to have an indefinite useful life.

Management rights have a finite useful life and are carried at cost less accumulated amortisation and impairment losses. Amortisation is calculated using the straight-line method to allocate the cost of management rights over the estimated useful life, usually a period not exceeding 20 years.

Customer and servicing contracts acquired with a finite useful life are carried at cost less accumulated amortisation and any impairment losses. Amortisation is calculated based on the timing of projected cash flows of the relationships over their estimated useful lives.

Customer and servicing contracts with an indefinite useful life are carried at cost less accumulated impairment losses.

Software

Certain internal and external costs directly incurred in acquiring and developing certain software are capitalised and amortised over the estimated useful life, usually a period of three years. Costs incurred on software maintenance are expensed as incurred.

Impairment

Goodwill and intangible assets that have an indefinite useful life are not subject to amortisation but are tested annually for impairment, or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. For intangible assets that have a finite useful life, an assessment is made at each reporting date for indications of impairment. 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 the asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are 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). Intangible assets (other than goodwill) that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

(xv) Financial liabilities

The Consolidated Entity has on issue debt securities and instruments which are initially recognised at fair value net of transaction costs incurred, and subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in the income statement over the period of the borrowings using the effective interest method.

Other financial liabilities at fair value through profit or loss

This category includes only those financial liabilities which have been designated by management as held at fair value through profit or loss on initial recognition. The policy of management is to designate a financial liability as such if: the liability contains embedded derivatives which must otherwise be separated and carried at fair value; the liability is part of a group of financial assets and financial liabilities managed and evaluated on a fair value basis; or doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise. Interest expense on such items is recognised in the income statement in interest expense using the effective interest method.

(xvi) Provisions

Employee benefits

A liability for employee benefits is recognised by the entity that has the obligation to the employee. Generally, this is consistent with the legal position of the parties to the employment contract.

Liabilities for unpaid salaries, salary related costs and provisions for annual leave are recorded in the statement of financial position at the salary rates which are expected to be paid when the liability is settled. Provisions for long service leave and other long-term benefits are recognised at the present value of expected future payments to be made.

In determining this amount, consideration is given to expected future salary levels and employee service histories. Expected future payments are discounted to their net present value using discount rates on high quality corporate bonds, except where there is no deep market, in which case rates on Commonwealth Government securities are used. Such discount rates have terms that match as closely as possible the expected future cash flows.

Provisions for unpaid employee benefits are derecognised when the benefit is settled, or is transferred to another entity and the Consolidated Entity are legally released from the obligation and do not retain a constructive obligation.

Notes to the financial statements for the financial year ended 31 March 2012

Note 1

Summary of significant accounting policies continued

Dividends

Provisions for dividends to be paid by the Company are recognised on the statement of financial position as a liability and a reduction in retained earnings when the dividend has been declared.

(xvii) Performance based remuneration

Share-based payments

The ultimate parent entity MGL, operates share-based compensation plans, which include options granted to employees and shares (including those delivered through the Macquarie Group Employee Retained Equity Plan (MEREP)) granted to employees under share acquisition plans. Information relating to these schemes is set out in note 30. The Consolidated Entity recognises an expense (and equity reserve) for its shares and options granted to employees. The shares and options are measured at the grant dates based on their fair value and using the number of equity instruments expected to vest. This amount is recognised as an expense evenly over the respective vesting periods.

Performance hurdles attached to options, and Performance Share Units (PSUs) under the MEREP, that are issued to the Executive Committee members are not taken into account when determining the fair value of the options and PSUs at grant date. Instead, these vesting conditions are taken into account by adjusting the number of equity instruments expected to vest.

The fair value of each option granted in prior years was estimated on the date of grant using standard option pricing techniques based on the Black-Scholes theory.

No grants have been made in the previous two financial years.

In December 2009, MGL established a new equity plan, the MEREP. Restricted Share Units (RSUs)/Deferred Share Units (DSUs) and PSUs for Executive Committee members, have been granted in the current year in respect of 2011. The fair value of each of these grants is estimated using MGL's share price on the date of grant, and for each PSU also incorporates a discounted cash flow method using the following key assumptions:

- risk free interest rate: 5.71 per cent (weighted average);
- expected life of PSU: four years; and
- dividend yield: 5.20 per cent per annum.

While RSUs/DSUs, and PSUs for Executive Committee members, in respect of the current year's performance will be granted in the following financial year, the Consolidated Entity begins recognising an expense (based on an initial estimate) from 1 April of the current financial year related to these future grants. The expense is estimated using MGL's share price as at 31 March 2012 (and for PSUs, also incorporates a risk free interest rate of 5.71 per cent; an expected life of four years; and a dividend yield of 5.20 per cent per annum) and the number of equity instruments expected to vest. In the following financial year, the Consolidated Entity will adjust the accumulated expense recognised for the final determination of fair value for each RSU/DSU and PSU to be granted when granted, and will use this valuation for recognising the expense over the remaining vesting period.

Where options and shares are issued by MGL to employees of the Consolidated Entity and MGL is not subsequently reimbursed by the Consolidated Entity, the Consolidated Entity recognises the equity provided as a capital contribution from MGL. Where MGL is reimbursed, the Consolidated Entity recognises any amount it pays in advance (of the share-based payment to be recognised as an expense over the future vesting period) as a prepaid asset.

Executive Directors' retained profit share that is no longer to be paid in cash is reversed in the current year and recognised in profit, and the RSUs/DSUs granted are accounted for as a share-based payment from the grant date.

The Consolidated Entity annually revises its estimates of the number of shares (including those delivered through MEREP) and options that are expected to vest. It recognises the impact of the revision to original estimates, if any, in the income statement, with a corresponding adjustment to equity.

Profit share remuneration

The Consolidated Entity recognises a liability and an expense for profit share remuneration to be paid in cash, based on a formula that takes into consideration the Consolidated Entity's profit after income tax and its earnings over and above the estimated cost of capital.

(xviii) Cash and cash equivalents

Cash and cash equivalents comprise:

- cash and balances with central banks and short-term amounts included in receivables from financial institutions; and
- certain trading portfolio assets and debt securities with contractual maturity of three months or less.

(xix) Leases

Where finance leases are granted to third parties, the present value of the lease receipts is recognised as a receivable and included in loan assets held at amortised cost. The difference between the gross receivable and the present value of the receivable is unearned interest income. Lease receipts are discounted using interest rate implicit in the lease. Lease income is recognised over the term of the lease using the effective interest method, which reflects a constant rate of return.

Leases entered into by the Company and Consolidated Entity as lessee are primarily operating leases. The total fixed payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Purchased assets, where the Consolidated Entity is the lessor under operating leases, are carried at cost and depreciated over their useful lives which vary depending on each class of asset and range from 2 to 50 years. Operating lease income is recognised on a straight-line basis over the period of the lease unless another systematic basis is more appropriate. Assets leased out under operating leases are included in property, plant and equipment.

(xx) Offsetting financial instruments

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

(xxi) Loan capital

Loan capital is debt issued by the Consolidated Entity with terms and conditions that qualify for inclusion as capital under APRA Prudential Standards. Loan capital debt issues are initially recorded at fair value plus directly attributable transaction costs and thereafter at either amortised cost using the effective interest method (for debt host component of convertible preference securities and subordinated debt at amortised cost) or at fair value through profit or loss (for subordinated debt at fair value through profit or loss).

(xxii) Contributed equity

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

(xxiii) Changes in ownership interests

When acquiring additional interests of a financial asset (such that it becomes an associate, joint venture or subsidiary) or an investment in an associate or joint venture (such that it becomes a subsidiary), previously held interests are revalued to their current fair value and any gain or loss is immediately recognised in profit or loss. For acquisitions occurring on or before 31 March 2010, previously held interests were not revalued for such transactions.

Similarly, when selling ownership interests of a subsidiary (such that control is lost), or an investment in associate or joint venture (such that it becomes a financial asset), retained ownership interests are revalued to their current fair value and any gain or loss is immediately recognised in the income statement. For acquisitions occurring on or before 31 March 2010, retained ownership interests were not revalued for such transactions.

When increasing or decreasing the ownership interests of a subsidiary that remains a subsidiary afterwards, the consideration exchanged is recognised directly in equity. For acquisitions occurring on or before 31 March 2010, transactions with NCI were recognised using the parent-entity approach, which resulted in a gain recognised in the income statement when securities held by NCI were acquired by the Consolidated Entity at a price less than their carrying amount.

(xxiv) Comparatives

Where necessary, comparative information has been restated to conform with changes in presentation in the current year.

(xxv) Rounding of amounts

The Company is of a kind referred to in ASIC Class Order 98/0100 (as amended), relating to the rounding off of amounts in the financial report. Amounts in the financial report have been rounded off in accordance with that Class Order to the nearest million dollars unless otherwise indicated.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 2
Profit for the financial year

	2012 $m	2011 $m
Net interest income		
Interest and similar income received/receivable	378	445
Interest expense and similar charges paid/payable	(557)	(745)
Net interest expense	(179)	(300)
Fee and commission income		
Base fees	344	352
Performance fees	100	11
Mergers and acquisitions, advisory and underwriting fees	639	881
Brokerage and commissions	602	799
Other fee and commission income	251	438
Total fee and commission income	1,936	2,481
Net trading income[1]		
Equities	23	51
Foreign exchange products	(9)	(55)
Interest rate products	89	154
Net trading income	103	150
Share of net profits of associates and joint ventures accounted for using the equity method	65	126

[1] Included in net trading income are fair value losses of $27 million (2011: $129 million) relating to financial assets and financial liabilities designated as held at fair value through profit or loss. Fair value changes relating to derivatives are also reported in net trading income which partially offsets the fair value changes relating to the financial assets and financial liabilities designated at fair value. This also includes fair value changes on derivatives used to hedge the Consolidated Entity's interest rate risk where hedge accounting requirements are not met – refer to note 1(x) – Summary of significant accounting policies.

Note 2

Profit for the financial year continued

	2012 $m	2011 $m
Other operating income and charges		
Net gains on sale of investment securities available for sale	5	19
Impairment charge on investment securities available for sale	(29)	(2)
Net gains on sale of associates (including associates held for sale) and joint ventures	106	6
Impairment charge on investments in associates and joint ventures[1]	(71)	(52)
Impairment charge on associates and disposal groups held for sale	(9)	(16)
Gain on acquiring, disposing and changes in ownership interests in subsidiaries	18	61
Gain/(loss) on re-measurement of retained investments[2]	29	(38)
Impairment charge on non-financial assets	(16)	(1)
Sale of management rights	-	14
Net operating lease income[3]	9	92
Dividends/distributions received/receivable:		
Investment securities available for sale	390	97
Management fees, group service charges and cost recoveries	1	14
Collective allowance for credit losses provided for during the financial year (note 9)	(11)	(13)
Individually assessed provisions:		
Loan assets provided for during the financial year (note 9)	(20)	(5)
Other receivables provided for during the financial year	(22)	(11)
Recovery of other receivables previously provided for	-	2
Loan losses written off	(3)	(1)
Recovery of loans previously written off	3	-
Other income	36	89
Total other operating income and charges	416	255
Net operating income	2,341	2,712

[1] Includes impairment reversals of $37 million (2011: $10 million).

[2] Includes gains/(losses) on re-measurement of retained ownership interests to fair value on the loss of control of investments in subsidiaries and the loss of significant influence on investments associates.

[3] Includes rental income of $12 million (2011: $144 million) less depreciation of $3 million (2011: $52 million) in relation to operating leases where the Consolidated Entity is the lessor.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 2

Profit for the financial year continued

	2012 $m	2011 $m
Employment expenses		
Salary and salary related costs including commissions, superannuation and performance-related profit share	**(1,189)**	(1,392)
Share based payments	**(135)**	(169)
Provision for annual leave	**(11)**	(12)
Provision for long service leave	**1**	-
Total employment expenses	**(1,334)**	(1,573)
Brokerage, commission and trading-related expenses		
Brokerage and other trading related expenses	**(109)**	(110)
Other fee and commission expenses	**(4)**	(6)
Total brokerage, commission and trading-related expenses	**(113)**	(116)
Occupancy expenses		
Operating lease rentals	**(127)**	(139)
Depreciation: furniture, fittings and leasehold improvements (note 12)	**(54)**	(59)
Other occupancy expenses	**(31)**	(28)
Total occupancy expenses	**(212)**	(226)
Non-salary technology expenses		
Information services	**(65)**	(75)
Depreciation: computer equipment (note 12)	**(20)**	(18)
Other non-salary technology expenses	**(24)**	(24)
Total non-salary technology expenses	**(109)**	(117)
Other operating expenses		
Professional fees	**(74)**	(88)
Auditor's remuneration (note 37)	**(8)**	(7)
Travel and entertainment expenses	**(74)**	(92)
Communication expenses	**(16)**	(20)
Amortisation of intangibles	**(17)**	(18)
Depreciation: communication equipment (note 12)	**(2)**	(2)
Other expenses[1]	**(17)**	(266)
Total other operating expenses	**(208)**	(493)
Total operating expenses	**(1,976)**	(2,525)

[1] Other expenses include recharges from Macquarie Group Services Pty Limited (MGSA) which provides administration and central support functions.

Note 3
Income tax expense

	2012 $m	2011 $m
(i) Income tax expense		
Current tax expense	**(183)**	(225)
Deferred tax benefit	**81**	209
Total	**(102)**	(16)
Deferred income tax revenue included in income tax expense comprises:		
Increase in deferred tax assets	**197**	228
Increase in deferred tax liabilities	**(116)**	(19)
Total	**81**	209
(ii) Numerical reconciliation of income tax expense to prima facie tax payable		
Prima facie income tax expense on operating profit[1]	**(110)**	(56)
Tax effect of amounts which are non assessable/(not deductible) in calculating taxable income:		
Rate differential on offshore income	**14**	118
Share based payments expense	**(10)**	(14)
Other items	**4**	(64)
Total income tax expense	**(102)**	(16)
(iii) Tax benefit/(expense) relating to items of other comprehensive income		
Available for sale investments	**26**	(61)
Cash flow hedges	**–**	16
Foreign currency translation reserve	**55**	34
Share of other comprehensive income of associates and joint ventures	**7**	(10)
Total tax expense relating to items of other comprehensive income	**88**	(21)

1 Prima facie income tax expense on operating profit is calculated at the rate of 30 per cent (2011: 30 per cent). The Australian tax consolidated group has a tax year ending on 30 September.

Revenue authorities undertake risk reviews and audits as part of their normal activities. The Group has assessed these and other taxation claims, including seeking advice where appropriate, and considers that it holds appropriate provisions.

Notes to the financial statements for the financial year ended 31 March 2012 continued

	2012 $m	2011 $m

Note 4

Receivables from financial institutions

Cash at bank[1]	**1,859**	1,248
Other loans to banks	**680**	861
Due from clearing houses	**44**	74
Total receivables from financial institutions	**2,583**	2,183

[1] Included within this balance is $12 million (2011: $137 million) provided as security over payables to other financial institutions.

The majority of the above amounts are expected to be recovered within 12 months of the balance date by the Consolidated Entity.

Note 5

Cash collateral on securities borrowed and reverse repurchase agreements

Financial institutions	**574**	1,319
Other	**–**	53
Total cash collateral on securities borrowed and reverse repurchase agreements	**574**	1,372

The Consolidated Entity enters into stock borrowing and reverse repurchase transactions with counterparties which require lodgement of non-cash collateral. The fair value of collateral held as at 31 March 2012 is $522 million (2011: $1,428 million). Under certain transactions, the Consolidated Entity is allowed to resell or repledge the collateral held.

The above amounts are expected to be recovered within 12 months of the balance date by the Consolidated Entity.

Note 6

Trading portfolio assets

Listed equity securities[1]	**348**	466
Corporate bonds	**245**	–
Bank bills	**20**	–
Foreign government bonds[1]	**20**	9
Total trading portfolio assets[2]	**633**	475

[1] Included within these balance are assets provided as security over issued notes and payables to other external investors and financial institutions. The value of assets provided as security is $nil (2011: $nil).

[2] Included within this balance are trading assets of $nil (2011: $58 million) pledged as collateral to secure liabilities under repurchase and stock lending agreements.

The above amounts are expected to be recovered within 12 months of the balance date by the Consolidated Entity.

	2012 $m	2011 $m

Note 7
Investment securities available for sale

	2012 $m	2011 $m
Equity securities		
Listed	**1,348**	1,497
Unlisted	**515**	224
Debt securities[1]	**161**	419
Total investment securities available for sale	**2,024**	2,140

[1] Included within this balance are debt securities of $143 million (2011: $128 million) which are recognised as a result of total return swaps which meet the pass through test of AASB 139 *Financial Instruments: Recognition and Measurement*. The Consolidated Entity does not have legal title to these assets but has full economic exposure to them.

Of the above amounts $111 million (2011: $191 million) is expected to be recovered within 12 months of the balance date by the Consolidated Entity.

Note 8
Other assets

	2012 $m	2011 $m
Security settlements[1]	**5,749**	4,804
Debtors and prepayments	**825**	948
Other	**7**	7
Total other assets[2]	**6,581**	5,759

[1] Security settlements are receivable within three working days of the relevant trade date.

[2] Included within this balance is $161 million (2011: $68 million) of assets which are provided as security over payables to other financial institutions.

The majority of the above amounts are expected to be recovered within 12 months of the balance date by the Consolidated Entity.

Notes to the financial statements for the financial year ended 31 March 2012 continued

	2012 $m	2011 $m

Note 9

Loan assets held at amortised cost

	2012 $m	2011 $m
Due from clearing houses	**101**	105
Due from governments[1]	**32**	55
Due from other entities		
Other loans and advances	**927**	362
Less individually assessed provisions for impairment	**(37)**	(20)
	890	342
Lease receivables	**124**	142
Total due from other entities	**1,014**	484
Total loan assets before collective allowance for credit losses	**1,147**	644
Less collective allowance for credit losses	**(25)**	(15)
Total loan assets held at amortised cost[2]	**1,122**	629

[1] Governments include federal, state and local governments and related enterprises, predominantly in Australia.

[2] Included within this balance are other loans of $185 million (2011: $44 million) provided as security over issued notes and payables to other external investors and financial institutions.

Of the above amounts $301 million (2011: $254 million) is expected to be recovered within 12 months of the balance date by the Consolidated Entity.

Individually assessed provisions for impairment		
Balance at the beginning of the financial year	**20**	15
Provided for during the financial year (note 2)	**20**	5
Loan assets written-off, previously provided for	**(3)**	-
Balance at the end of the financial year	**37**	20
Individually assessed provisions as a percentage of total gross loan assets	**3.13%**	3.01%

Collective allowance for credit losses		
Balance at the beginning of the financial year	**15**	2
Provided for during the financial year (note 2)	**11**	13
Impact of foreign currency translation	**(1)**	-
Balance at the end of the financial year	**25**	15

The collective allowance for credit losses is intended to cover losses in the existing overall credit portfolio which are not yet individually identifiable.

	2012 $m	2011 $m

Note 10

Impaired financial assets

	2012 $m	2011 $m
Impaired loan assets and other financial assets with individually assessed provisions for impairment	**137**	69
Less individually assessed provisions for impairment	**(87)**	(56)
Total net impaired financial assets	**50**	13

Note 11

Other financial assets at fair value through profit or loss

	2012 $m	2011 $m
Loan assets	**628**	903
Investment securities	**2**	55
Total other financial assets at fair value through profit or loss[1]	**630**	958

[1] Included within this balance is $454 million (2011: $896 million) provided as security over payables to other financial institutions.

Of the above amounts $628 million (2011: $896 million) is expected to be recovered within 12 months of the balance date by the Consolidated Entity.

Notes to the financial statements for the financial year ended 31 March 2012 continued

	2012 $m	2011 $m

Note 12

Property, plant and equipment

	2012 $m	2011 $m
Furniture, fittings and leasehold improvements		
Cost	373	389
Less accumulated depreciation	(196)	(168)
Total furniture, fittings and leasehold improvements	177	221
Communication equipment		
Cost	8	11
Less accumulated depreciation	(6)	(8)
Total communication equipment	2	3
Computer equipment		
Cost	83	93
Less accumulated depreciation	(60)	(59)
Total computer equipment	23	34
Infrastructure assets		
Cost	9	9
Less accumulated depreciation	(2)	(1)
Total infrastructure assets	7	8
Total	209	266
Assets under operating lease		
Aviation		
Cost	–	2,183
Less accumulated depreciation	–	(45)
Total aviation	–	2,138
Other		
Cost	34	33
Less accumulated depreciation	(13)	(10)
Total other	21	23
Total assets under operating lease	21	2,161
Total property, plant and equipment	230	2,427

All of the above are expected to be recovered after 12 months of the balance date by the Consolidated Entity.

	2012 $m	2011 $m

Note 12

Property, plant and equipment continued

Reconciliation of the movement in the Consolidated Entity's property, plant and equipment at their written-down value:

	Furniture, fittings and leasehold improvements $m	Communication equipment $m	Computer equipment $m	Infrastructure assets $m	Total $m
Balance at the beginning of the financial year	221	3	34	8	266
Acquisitions	26	1	11	–	38
Disposals	(4)	–	(1)	–	(5)
Impairments	(7)	–	–	–	(7)
Foreign exchange movements	(5)	–	(1)	(1)	(7)
Depreciation expense (note 2)	(54)	(2)	(20)	–	(76)
Balance at the end of the financial year	177	2	23	7	209

Included in the balance of property, plant and equipment are assets pledged as security over payables to other financial institutions. The terms preclude these assets from being sold or being used as security for further liabilities without the permission of the financial institution. The carrying value of assets pledged is $45 million (2011: $57 million).

Assets under operating lease

	Aviation $m	Other $m	Total $m
Balance at the beginning of the financial year	2,138	23	2,161
Disposals	(2,134)	–	(2,134)
Foreign exchange movements	(4)	–	(4)
Depreciation expense	–	(2)	(2)
Balance at the end of the financial year	–	21	21

Included in the balance of operating leases are assets pledged as security over payables to other financial institutions. The terms preclude these assets from being sold or being used as security for further liabilities without the permission of the financial institution. The carrying value of assets pledged is $21 million (2011: $2,161 million).

The future minimum lease payments expected to be received under non-cancellable operating leases are as follows:

Assets under operating lease	2012 $m	2011 $m
Not later than one year	–	244
Later than one year, not later than five years	–	600
Later than five years	–	167
Total future minimum lease payments receivable	–	1,011

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 13

Interests in associates and joint ventures accounted for using the equity method

	2012 $m	2011 $m
Loans and investments without provisions for impairment	**1,508**	1,339
Loans and investments with provisions for impairment	**934**	932
Less provision for impairment	**(483)**	(396)
Loans and investments at recoverable amount	**451**	536
Total interests in associates and joint ventures accounted for using the equity method	**1,959**	1,875

The fair values of certain interests in material associates and joint ventures, for which there are public quotations, are below their carrying value by $77 million (31 March 2011: $209 million).

Included within this balance is $nil (2011: $48 million) provided as security over payables to other financial institutions.

All of the above amounts are expected to be recovered after 12 months of the balance date by the Consolidated Entity.

(i) Reconciliation of movement in the Consolidated Entity's interests in associates and joint ventures using the equity method:

	2012 $m	2011 $m
Balance at the beginning of the financial year	**1,875**	3,111
Transfer as part of restructure[1]	**54**	58
Associates acquired/equity invested	**247**	362
Share of pre-tax losses of associates and joint ventures	**93**	180
Share of tax benefit of associates and joint ventures	**(28)**	(54)
Dividends received/receivable from associates (note 28)	**(50)**	(115)
Associates disposed of	**(148)**	(113)
Impairment of investments in associates	**(71)**	(52)
Foreign exchange and other adjustments	**(55)**	(137)
Transferred from other asset categories	**42**	(1,365)
Balance at the end of the financial year	**1,959**	1,875

[1] During the year ended March 2012 and March 2011, certain entities were transferred from the Banking Group to the Non Banking Group.

Note 13

Interests in associates and joint ventures accounted for using the equity method continued

(ii) Summarised information of interests in material associates and joint ventures is as follows:

Name of entity	Country of incorporation	Reporting date	Ownership interest 2012 %	Ownership interest 2011 %
BrisConnections Unit Trusts[1, a]	Australia	30 June	**46**	46
Macquarie Goodman Japan Limited[b]	Singapore	31 March	**50**	50
Miclyn Express Offshore Limited[1,c]	Bermuda	30 June	**33**	34
Redford Australian Investment Trust[1, a]	Australia	31 December	**29**	29
Southern Cross Media Group[1, d]	Australia	30 June	**25**	25

1 Significant influence arises due to the Consolidated Entity's voting power and board representation.

a Infrastructure
b Property development/management
c Metals, mining and energy
d Television and radio investments

	2012 $m	2011 $m
(iii) Contingent liabilities of associates and joint ventures are as follows:		
Share incurred jointly with other investors	–	–
For which the Consolidated Entity is severally liable	–	–

	2012 $m	2011 $m
(iv) Financial information of interests in associates and joint ventures are as follows:		
Consolidated Entity's share of:		
Assets	**5,834**	4,534
Liabilities	**3,443**	2,347
Revenues	**1,042**	892
Profit after tax	**75**	116

Notes to the financial statements for the financial year ended 31 March 2012 continued

	Consolidated 2012 $m	Consolidated 2011 $m
Note 14		
Intangible assets		
Goodwill	357	333
Customer and servicing contracts	35	47
Intangible assets with indefinite lives	22	23
Other identifiable intangible assets	50	45
Total intangible assets	464	448

The majority of the above amounts are expected to be recovered after 12 months of the balance date by the Consolidated Entity.

Reconciliation of the Consolidated Entity's movement in intangible assets:

	Goodwill $m	Customer and servicing contracts $m	Intangible assets with indefinite lives $m	Other identifiable intangible assets $m	Total $m
Balance at the beginning of the financial year	333	47	23	45	448
Acquisitions during the financial year	35	-	-	45	80
Adjustments to purchase consideration[1]	(2)	9	-	(1)	6
Disposals during the financial year	(5)	(2)	-	(35)	(42)
Impairment during the financial year	-	(15)	-	(1)	(16)
Amortisation expense for the financial year	-	(10)	-	(7)	(17)
Currency translation difference arising during the financial year	(4)	6	(1)	4	5
Balance at the end of the financial year	357	35	22	50	464

[1] These balances relate to adjustments to purchase considerations and allocations.

In relation to businesses acquired and held for disposal, the individual business is treated as a cash generating unit. Assets associated with strategic business acquisitions are allocated to each of the operating segments (refer to Macquarie Group Limited's financial report) and assessed for impairment on a regional legal entity operating group basis.

The recoverable amount of goodwill is determined using the higher of value-in-use and fair value less costs to sell. Value-in-use calculations are based upon discounting estimated post-tax cash flows at a risk-adjusted interest rate appropriate to the cash generating unit to which the goodwill applies. The determination of both cashflows and discount rates require the exercise of judgement. The calculations use cash flow estimations based on financial budgets and forecasts reviewed by management. These cashflows are discounted at rates that have been determined by reference to historical company and industry experience and publicly available data.

Fair values less costs to sell calculations are determined using an earnings multiple approach applicable to that type of business. These have been determined by reference to historical company and industry experience and publicly available data.

Note 15

Deferred tax assets

	2012 $m	2011 $m
The balance comprises temporary differences attributable to:		
Other assets and liabilities	**246**	111
Tax losses	**181**	120
Investment in subsidiaries, associates and joint ventures	**380**	397
Intangible assets	**8**	(1)
Tax effect of reserves	**10**	(22)
Fixed assets	**52**	63
Set-off of deferred tax liabilities	**20**	52
Total deferred tax assets	**897**	720
Financial Instruments	**(89)**	22
Set-off of deferred tax assets	**(20)**	(53)
Total deferred tax liabilities	**(109)**	(31)
Net deferred tax assets	**788**	689

All of the above are expected to be recovered after 12 months of the Balance date by the Consolidated Entity and the Company.

Potential tax assets of approximately $53 million (2011: $62 million) attributable to tax losses carried forward by subsidiaries have not been brought to account in the subsidiaries and in the Consolidated Entity as the Directors do not believe the realisation of the tax assets is probable.

The principles of the balance sheet method of tax effect accounting have been adopted whereby the income tax expense for the financial year is the tax payable on the current year's taxable income adjusted for changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements and to unused tax losses. Deductible temporary differences and tax losses give rise to deferred tax assets. Deferred tax assets are not recognised unless the benefit is probable of realisation.

The deferred tax assets have been applied against deferred tax liabilities to the extent that they are expected to be realised in the same year, within the same tax paying entity.

Notes to the financial statements for the financial year ended 31 March 2012 continued

	2012 $m	2011 $m

Note 16

Non-current assets and disposal groups classified as held for sale

Non-current assets and assets of disposal groups classified as held for sale

	2012 $m	2011 $m
Associates	**134**	79
Total non-current assets and assets of disposal groups classified as held for sale	**134**	79

The above non-current assets of disposal groups classified as held for sale are expected to be disposed of to other investors within 12 months of being classified as held for sale unless events or circumstances occur that are beyond the control of the Consolidated Entity, and the Consolidated Entity remains committed to its plan to sell the assets.

(i) Summarised information of material associates and joint ventures classified as held for sale is as follows:

			Ownership interest	
Name of entity	**Country of incorporation**	**Reporting date**	**2012 %**	2011 %
Retirement Villages Group[a]	Australia	30 June	**10**	10
American Manufactured Communities REIT Inc[b]	United States	31 December	**53**	–
Soria Finance Co[c]	Mexico	31 December	**–**	22

[a] Retirement homes

[b] Property Development/Management Entity

[c] Infrastructure

All associates and joint ventures classified as held for sale are unlisted entities.

Voting power is equivalent to ownership interest unless otherwise stated.

(ii) For associates and joint ventures classified as held for sale the Consolidated Entity's share of contingent liabilities, is as follows:

The Consolidated Entity's share of contingent liabilities in associates and joint ventures classified as held for sale is $nil (2011: $nil).

(iii) For associates and joint ventures classified as held for sale, financial information is as follows:

	2012 $m	2011 $m
Consolidated Entity's share of:		
Assets	**471**	321
Liabilities	**317**	229
Revenues	**4**	–
Loss after tax	**(2)**	–

	2012 $m	2011 $m

Note 17

Cash collateral on securities lent and repurchase agreements

Financial institutions	**47**	440
Other	**–**	74
Total cash collateral on securities lent and repurchase agreements	**47**	514

Note 18

Trading portfolio liabilities

Listed equity securities	**44**	75
Other government securities	**64**	–
Total trading portfolio liabilities	**108**	75

Note 19

Other liabilities

Due to brokers and customers	**5,641**	4,817
Accrued charges and sundry provisions	**685**	839
Creditors	**448**	751
Other	**64**	71
Total other liabilities	**6,838**	6,478

The majority of the above amounts are expected to be settled within 12 months of the balance date by the Consolidated Entity.

Note 20

Payables to financial institutions

OECD banks	**190**	1,275
Clearing houses[1]	**6**	3
Other	**131**	500
Total payable to financial institutions	**327**	1,778

[1] Amounts due to clearing houses are settled on the next business day.

Notes to the financial statements for the financial year ended 31 March 2012 continued

	2012 $m	2011 $m

Note 21

Other financial liabilities at fair value through profit or loss

	2012 $m	2011 $m
Equity linked notes	**603**	558
Debt issued at fair value	**439**	871
Exchangeable shares[1]	**39**	59
Total other financial liabilities at fair value through profit or loss	**1,081**	1,488

[1] Exchangeable shares were issued by two subsidiaries:

Issued in November 2007 as cash consideration for the acquisition of Orion Financial Inc. They are eligible to be exchanged one-for-one for shares in MGL (subject to staff trading restrictions) and will pay dividends equal to the MGL dividends during their legal life. The exchangeable shares will expire in November 2017 and carry no MGL voting rights.

Issued by a subsidiary in August 2009 as consideration for the acquisition of Tristone Capital Global Inc. They are eligible to be exchanged one-for-one for shares in MGL (subject to staff trading restrictions) or cash at MGL's discretion and will pay dividends equal to MGL dividends during their legal life. The exchangeable shares must be exchanged by August 2019 and carry no MGL voting rights.

Note 22

Debt issued at amortised cost

	2012 $m	2011 $m
Debt issued at amortised cost	39	11
Total debt issued at amortised cost	39	11

The Consolidated Entity has not had any defaults of principal, interest or other breaches with respect to its debt during the years reported.

Reconciliation of debt issued at amortised cost and other financial liabilities at fair value through profit or loss by major currency:
(in Australian dollar equivalent)

	2012 $m	2011 $m
South African rand	**747**	1,173
Korean won	**317**	247
Canadian dollars	**39**	60
Others	**17**	19
Total by currency	**1,120**	1,499

The Consolidated Entity's primary sources of domestic and international debt funding are its multi-currency, multi-jurisdictional Debt Instrument Program and domestic NCD issuance. Securities can be issued for terms varying from one day to 30 years.

Note 23

Provisions

	2012 $m	2011 $m
Provision for annual leave	**44**	43
Provision for long service leave	**16**	15
Provision for other employee entitlements	**4**	7
Total provisions	**64**	65

The majority of the above amounts are expected to be settled within 12 months of the balance date by the Consolidated Entity.

	2012 $m	2011 $m

Note 24

Loan capital

Subordinated debt

Agreements between the Consolidated Entity and the lenders provide that, in the event of liquidation, entitlement of such lenders to repayment of the principal sum and interest thereon is and shall at all times be and remain subordinated to the rights of all other present and future creditors of the Consolidated Entity. Details of selected capital instruments are discussed below.

Macquarie Convertible Preference Securities

In July 2008, Macquarie CPS Trust, a subsidiary of the Company, issued six million Macquarie CPS at face value of $100 each. These instruments are non-cumulative and unsecured and may be resold, mandatorily converted into Macquarie ordinary shares (subject to certain conditions being satisfied) or redeemed on 30 June 2013. The Macquarie CPS bears fixed-rate coupons at 11.095 per cent per annum, paid semi-annually until 30 June 2013, whereby a floating rate will apply.

Macquarie Preferred Membership Interests

On 2 December 2010, Macquarie PMI LLC, a subsidiary of the Company, issued $US400 million of $US denominated Preferred Membership Interests (Macquarie PMI). These instruments are non-cumulative and unsecured equity interests in the issuer. They are redeemable at the Company's option on any distribution date from 2 December 2015, and are non-dilutive, as they will only exchange to MGL preference shares in specified circumstances, and mandatorily on 26 November 2035. The Macquarie PMI bears fixed-rate coupons at 8.375 per cent per annum, paid semi-annually.

Maturity and currency profiles of loan capital instruments

The dates upon which the Consolidated Entity has committed to repay the principal sum to the lenders are as follows:

	2012 $m	2011 $m
Less than 12 months	**28**	11
12 November 2014	**10**	10
Subordinated debt	**38**	21
Instruments where the Consolidated Entity has conditional repayment obligations:		
Macquarie CPS	**600**	600
Macquarie PMI	**386**	386
Total loan capital[1]	**1,024**	1,007
Reconciliation of subordinated debt by major currency: *(In Australian dollar equivalent):*		
Australian dollars	**619**	600
United States dollars	**395**	397
Euro	**10**	10
Total loan capital[1]	**1,024**	1,007

[1] Balance disclosed excludes $2 million (2011: $nil) of directly attributable costs related to the issue of Macquarie PMI.

The Consolidated Entity has not had any defaults of principal, interest or other breaches with respect to its loan capital during the years reported.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 25

Contributed equity

	2012 Number of shares	2011 Number of shares	2012 $m	2011 $m
Ordinary share capital				
Opening balance of fully paid ordinary shares	**16,162,223,475**	16,711,909,270	**16,219**	16,757
Issue of shares to MGL on retraction of exchangeable shares in the range of $21.93 to $34.72 (31 March 2011:$35.63 to $47.05) per share	**198,398**	256,363	**5**	10
Issue of shares to MGL on retraction of exchangeable shares in the range of $22.97 to $34.66 (31 March 2011:$36.19 to $36.50) per share	**62,162**	57,842	**2**	2
Capital reduction of shares at $1.00 per share	**(797,144,689)**	(550,000,000)	**(800)**	(550)
Closing balance of fully paid ordinary shares	**15,365,339,346**	16,162,223,475	**15,426**	16,219
Contributed equity on group restructures				
Transfer from reserves arising from group restructure of combining entities under common control[1]	**–**	–	**(14,023)**	–
Balance at the end of the financial year	**–**	–	**(14,023)**	–
Equity contribution from ultimate parent entity				
Balance at the beginning of the financial year	**–**	–	**299**	265
Additional paid up capital[2, 3]	**–**	–	**7**	34
Balance at the end of the financial year	**–**	–	**306**	299
Closing balance of contributed equity	**15,365,339,346**	16,162,223,475	**1,709**	16,518

[1] Reserves arising from group restructure of combining entities under common control relate predominantly to transactions in the 31 March 2007 and 31 March 2008 financial years where these reserves and ordinary share capital were disclosed on a gross basis to explain the impacts of restructures of entities under the control of MGL. While the presentation was relevant to those reporting periods, there is no continuing value to the users of the accounts in carrying forward the gross disclosures on the face of the statement of financial position and as such, these reserves have been presented in contributed equity.

[2] During the year ended 31 March 2010, the Company's ultimate parent entity, MGL, introduced the MEREP, which grants RSUs, DSUs and PSUs to eligible staff of the Consolidated Entity. Under the MEREP the staff retained profit share is held in the shares of MGL by Macquarie Group Employee Retained Equity Plan Trust (MEREP Trust). Where the MEREP awards are issued by MGL to employees of the Consolidated Entity and MGL is not subsequently reimbursed by the Consolidated Entity, the Consolidated Entity recognises the equity provided as a capital contribution from MGL. During the year ended 31 March 2012 compensation expense relating to the MEREP which has been treated as additional paid up capital totalled $nil (2011: $14,723,877). For further information regarding the terms and conditions of the MEREP (refer to note 30 – Employee equity participation).

[3] MGL operates a share-based compensation plan, the Macquarie Group Employee Share Option Plan (MGESOP), which grants options to employees of the Consolidated Entity. Staffs eligible to participate are those of Associate Director level and above and certain consultants to the Consolidated Entity. The options are measured at their grant dates based on their fair value and the number expected to vest. This amount is recognised as an expense evenly over the respective vesting periods and the equity provided is treated as a capital contribution from MGL. For the year ended 31 March 2012, compensation expense relating to the MGESOP totalled $7,158,375 (2011: $18,958,798). In addition, pursuant to an amendment to the terms of the Macquarie Group Staff Share Acquisition Plan (MGSSAP) and Employee Share Plan (ESP) to allow the issue of new shares as an alternative to acquiring existing shares on-market, compensation expense relating to these plans was recognised as additional paid up capital during the financial year, totalling $41,001 (2011: $98,220). Disclosures on the MGESOP, MGSSAP and ESP are disclosed in note 30 – Employee equity participation.

	Company 2012 $m	Company 2011 $m

Note 26

Reserves, retained earnings and non-controlling interests

	Company 2012 $m	Company 2011 $m
Reserves		
Foreign currency translation reserve		
Balance at the beginning of the financial year	**(195)**	(95)
Currency translation differences arising during the financial year, net of hedge and net of tax	**72**	(100)
Balance at the end of the financial year	**(123)**	(195)
Available for sale reserve		
Balance at the beginning of the financial year	**85**	(56)
Revaluation movement for the financial year, net of tax	**(61)**	(117)
Transfer to income statement for impairment, net of tax	**21**	–
Transfer to profit/loss on realisation	**(25)**	258
Balance at the end of the financial year	**20**	85
Cash flow hedging reserve		
Balance at the beginning of the financial year	**(9)**	33
Revaluation movement for the financial year, net of tax	**6**	(42)
Balance at the end of the financial year	**(3)**	(9)
Share of reserves of interests in associates and joint ventures using the equity method		
Balance at the beginning of the financial year	**(10)**	(34)
Share of other comprehensive (expense)/income during the financial year	**(17)**	24
Balance at the end of the financial year	**(27)**	(10)
Reserves arising from group restructure of combining entities under common control		
Balance at the beginning of the financial year	**(14,026)**	(14,025)
Arising from acquisitions of subsidiaries from the Banking Group (note 38)	**3**	(1)
Transfer to contributed equity[1]	**14,023**	–
Balance at the end of the financial year	**–**	(14,026)
Total reserves at the end of the financial year	**(133)**	(14,155)
Retained earnings		
Balance at the beginning of the financial year	**1,262**	1,094
Profit attributable to ordinary equity holders of Macquarie Financial Holdings Limited	**261**	168
Balance at the end of the financial year	**1,523**	1,262
Non-controlling interests		
Ordinary share capital	**28**	32
Preference share capital	**2**	–
Foreign currency translation reserve	**(14)**	(11)
Retained earnings	**54**	44
Total non-controlling interests	**70**	65

[1] Reserves arising from group restructure of combining entities under common control relate predominantly to transactions in the 31 March 2007 and 31 March 2008 financial years where these reserves and ordinary share capital were disclosed on a gross basis to explain the impacts of restructures of entities under the control of MGL. While the presentation was relevant to those reporting periods, there is no continuing value to the users of the accounts in carrying forward the gross disclosures and as such, these reserves have been transferred to contributed equity.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 27

Notes to the statement of cash flows

Reconciliation of cash and cash equivalents

	Company 2012 $m	Company 2011 $m
Cash and cash equivalents at the end of the financial year as shown in the statement of cash flows is reconciled to related items in the statement of financial position as follows:		
Due from related body corporate entity[1]	**1,221**	3,185
Due from other financial institutions		
Receivables from financial institutions[2]	**2,579**	2,062
Trading portfolio assets and debt securities[3]	**23**	178
Cash and cash equivalents at the end of the financial year	**3,823**	5,425

[1] This comprises cash balances held with a related body corporate entity, Macquarie Bank Limited (MBL).

[2] Includes cash at bank, overnight cash at bank, other loans to banks and amounts due from clearing houses as per note 1(xviii) – Summary of significant accounting policies.

[3] Includes short-term debt securities as per note 1(xviii) – Summary of significant accounting policies.

Reconciliation of profit after income tax to net cash flows (used in)/from operating activities

	Company 2012 $m	Company 2011 $m
Profit after income tax	**263**	171
Adjustments to profit:		
Depreciation and amortisation	**96**	149
Fair value changes on financial assets and liabilities at fair value through profit or loss and realised investment securities available for sale	**(22)**	265
Gain on acquiring, disposing, and change in ownership interest in subsidiaries and businesses held for sale	**(18)**	(61)
Provision and impairment charge on financial and non-financial assets	**181**	99
Interest on available for sale financial assets	**(18)**	(19)
Net (gains)/losses on sale of investment securities available for sale and associates and joint ventures	**(140)**	13
Sale of management rights	**–**	(14)
Share-based payment expense	**7**	34
Share of net profits of associates and joint ventures accounted for using the equity method	**(65)**	(126)
Changes in assets and liabilities:		
Change in dividends receivable	**6**	(7)
Change in value of associates due to dividends received	**50**	115
Change in fees and non-interest income receivable	**(34)**	32
Change in fees and commissions payable	**(15)**	3
Change in tax balances	**65**	(18)
Change in provisions for employee entitlements	**(1)**	(15)
Change in loan assets	**(1,172)**	(2,127)
Change in debtors, prepayments, accrued charges and creditors	**(408)**	55
Change in net trading portfolio assets and liabilities and net derivative financial instruments	**446**	(466)
Change in net interest payable, amounts due to other financial institutions, deposits and other borrowings	**201**	(948)
Net cash flows used in operating activities	**(578)**	(2,865)

Note 28

Related party information

Ultimate parent entity

The Company's ultimate parent entity is MGL, a company incorporated in Australia and which produces financial statements that are available for public use.

Transactions between the Consolidated Entity and the ultimate parent entity principally arise from the provision and repayment of loans and the provision of administration and central support functions.

MGL as the ultimate parent entity of the Macquarie Group is the head entity of the Australian tax consolidated group. The terms and conditions of the tax funding agreement are set out in note 1(vi) – Summary of significant accounting policies. During the year ended 31 March 2012, amount payable by the Consolidated Entity attributed to MGL as the head entity of the tax consolidated group amounted to $36 million (2011: $48 million receivable).

The following balances with the ultimate parent entity were outstanding as at financial year end:

	2012 $m	2011 $m
Amounts payable	**(6,359)**	(8,694)

Other related body corporate entities

Transactions between the Consolidated Entity and other related body corporate entities under common control principally arise from the granting of loans, the provision of management and administration services and the provision of guarantees in respect of debt.

During the financial year, the following transactions occurred with other related body corporate entities:

	2012 $m	2011 $m
Interest income received/receivable	**121**	166
Interest expense paid/payable	**(328)**	(486)
Fee and commission income	**278**	358
Other operating expense	**(65)**	(183)
Management fees, group service charges and cost recoveries	**1**	14
The following balances with other related body corporate entities were outstanding as at financial year end:		
Amounts receivable	**2,131**	5,419
Amounts payable	**(644)**	(359)

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 28

Related party information continued

Associates and joint ventures

Transactions between the Consolidated Entity and its associates and joint ventures principally arise from the provision of corporate advisory services, the granting of loans, derivative transactions and the provision of management services. All transactions undertaken with associates and joint ventures are eliminated where they are unrealised, to the extent of ownership interests held by the Consolidated Entity, in the consolidated income statement.

During the financial year, the following transactions occurred with associates and joint ventures:

	2012 $m	2011 $m
Fee and commission income[1]	**386**	439
Other income	**–**	1
Gains on sale of securities[2]	**36**	6
Dividends and distributions[3] (note 13)	**50**	115
Brokerage, commission and trading-related expenses	**(6)**	(9)

1 Fee and commission income includes all fees charged to associates.

2 Gains on sale of securities are shown after elimination of unrealised profits/losses calculated by reference to the Consolidated Entity's ownership interest in the associate.

3 Dividends and distributions are shown as gross amounts. Under the equity method, these amounts are not taken up as profit but are recorded as a reduction of the carrying amount of the investment.

The following balances with associates and joint ventures were outstanding at the end of the financial year (these exclude amounts which in substance form part of the Consolidated Entity's net investment in associates, disclosed in note 13 – Interests in associated and joint ventures accounted for using the equity method):

	2012 $m	2011 $m
Amounts receivable	**121**	127
Amounts payable	**(118)**	(139)

Balances arising from lending and borrowing activities between the Consolidated Entity and its associates and joint ventures are typically repayable on demand, but may be extended on a term basis and where appropriate may be either subordinated or collateralised.

Note 29

Key Management Personnel disclosure

Key Management Personnel

The following persons were Voting Directors of MFHL during the past two financial periods ended 31 March 2012 and 31 March 2011, unless otherwise indicated:

Voting Directors

K. Bennett	(appointed 24 August 2009; resigned 23 September 2009; appointed 17 November 2009, resigned 21 October 2010)
M. Ferrier	
C.T. Lynam	(appointed 21 October 2010)
R.N. Upfold	

In addition to the Voting Directors listed above the following persons, who were members of MGL's Executive Committee, also had authority and responsibility for planning, directing and controlling the activities of the Company and its subsidiaries during the financial periods ended 31 March 2012 and 31 March 2011.

Executives

S.D. Allen	
T.C. Bishop	(appointed 2 July 2010)
M. Carapiet	(retired 11 July 2011)
A.J. Downe	
G.A. Farrell	(appointed 2 July 2010)
R.S. Laidlaw	(retired 31 December 2011)
P.J. Maher	
M. McLaughlin	(appointed 1 January 2012)
N.W. Moore	
W.R. Sheppard	(retired 20 December 2011)
S. Vrcelj	(appointed 2 July 2010)
G.C. Ward	
S. Wikramanayake	

	For the year ended 31 March 2012 $	For the year ended 31 March 2011 $
Key Management Personnel Remuneration		
Amounts paid to Key Management Personnel in relation to their role as KMP of the Company and its subsidiaries	**12,271,093**	23,717,448

The Key Management Personnel (KMP) did not receive any other benefits or consideration in connection with the management of the Company and its subsidiaries. All other benefits that were received by the KMP were solely related to other services performed with respect to their employment by MGL and its subsidiaries.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 30

Employee equity participation

Macquarie Group Employee Retained Equity Plan

In December 2009, MGL's shareholders approved the implementation of the Macquarie Group Employee Retained Equity Plan (MEREP) in conjunction with remuneration arrangements. These arrangements included a decrease in the portion of staff profit share paid in cash and an increase in the portion delivered as equity, an increase in the proportion of deferred remuneration and cessation of new option grants under the Macquarie Group Employee Share Option Plan (MGESOP).

Award Types under the MEREP

Restricted Share Units (RSUs)

A RSU is a beneficial interest in a Macquarie share held on behalf of a MEREP participant by the plan trustee (Trustee). The participant is entitled to receive dividends on the share and direct the Trustee how to exercise voting rights in the share. The participant also has the right to request the release of the share from the Trust, subject to the vesting and forfeiture provisions of the MEREP.

Deferred Share Units (DSUs)

A DSU represents the right to receive on exercise of the DSU either a share held in the Trust or a newly issued share (as determined by Macquarie in its absolute discretion) for no cash payment, subject to the vesting and forfeiture provisions of the MEREP. A MEREP participant holding a DSU has no right or interest in any share until the DSU is exercised. MGL may issue shares to the Trustee or procure the Trustee to acquire shares on-market for potential future allocations to holders of DSUs. Generally DSUs will provide for cash payments in lieu of dividends paid on MGL shares before the DSU is exercised. Further, the number of shares underlying a DSU will be adjusted upon any bonus issue or other capital reconstruction of MGL in accordance with the ASX Listing Rules, so that the holder of a DSU does not receive a benefit that holders generally of MGL shares do not receive. These provisions are intended to provide the holders of DSUs, as far as possible, with the same benefits and risks as are provided to holders of RSUs. However, holders of DSUs will have no voting rights as to any underlying MGL shares. DSUs will only be offered in jurisdictions where legal or tax rules make the grant of RSUs impractical, or where PSUs are structured as DSUs (see PSUs below).

Performance Share Units (PSUs)

PSUs are structured as DSUs or RSUs with performance hurdles that must be met before the underlying share or cash equivalent (as the case may be) will be delivered. Where PSUs are structured as DSUs, holders have no right to dividend equivalent payments before the PSUs vest. In all other respects, holders of these PSUs will have the same rights as holders of DSUs. For 2011, the PSUs granted to the MGL Executive Committee, including the MGL CEO, are structured as DSUs with performance hurdles. The rights under any future PSUs structured as RSUs will generally be the same as the rights under RSUs, except for the PSU performance hurdles which will not apply to RSUs.

Note 30

Employee equity participation continued

Macquarie Group Employee Retained Equity Plan continued

The following is a summary of Awards which have been granted pursuant to the MEREP:

	Number of RSU Awards 2012	Number of RSU Awards 2011
RSUs on issue at the beginning of the financial year	**5,402,220**	3,788,953
Granted during the financial year	**6,914,935**	3,464,402
Vested RSUs withdrawn or sold from the MEREP during the financial year	**(1,238,881)**	(611,049)
Forfeited during the financial year	**(550,274)**	(490,151)
Transfers (to) related body corporate entities	**(851,245)**	(749,935)
RSUs on issue at the end of the financial year	**9,676,755**	5,402,220
RSUs vested and not withdrawn from the MEREP at the end of the financial year	**362,753**	273,173

The weighted average fair value of the RSU Awards granted during the financial year was $31.31 (2011: $42.60).

	Number of DSU Awards 2012	Number of DSU Awards 2011
DSUs on issue at the beginning of the financial year	**1,066,237**	528,219
Granted during the financial year	**1,609,748**	719,825
Exercised during the financial year	**(75,306)**	(26,066)
Forfeited during the financial year	**(201,425)**	(155,741)
Transfers (to) related body corporate entities	**(14,336)**	-
DSUs on issue at the end of the financial year	**2,384,918**	1,066,237
DSUs exercisable at the end of the financial year	**108,199**	34,979

The weighted average fair value of the DSU Awards granted during the financial year was $31.18 (2011: $42.25).

	Number of PSU Awards 2012	Number of PSU Awards 2011
PSUs on issue at the beginning of the financial year	**103,924**	34,300
Granted during the financial year	**71,317**	69,624
Exercised during the financial year	**(3,201)**	–
Expired during the financial year	**(8,232)**	–
PSUs on issue at the end of the financial year	**163,808**	103,924
PSUs exercisable at the end of the financial year	**-**	–

The weighted average fair value of the PSU Awards granted during the financial year was $20.89 (2011: $34.63).

The awards are measured at their grant dates based on their fair value and for each PSU, the number expected to vest. This amount is recognised as an expense evenly over the respective vesting periods and the equity provided is treated as a capital contribution.

For the year ended 31 March 2012, compensation expense relating to the MEREP totalled $126 million (2011:$144 million).

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 30

Employee equity participation continued

Participation in the MEREP is currently provided to the following Eligible Employees:

- Executive Directors with retained Directors' Profit Share (DPS) from 2009 onwards, a proportion of which is allocated in the form of MEREP awards (Retained DPS Awards);
- Executive Directors with pre-2009 retained DPS (which they elected to transition into the MEREP);
- staff other than Executive Directors with retained profit share (Retained Profit Share Awards) and staff who are promoted to Associate Director, Division Director or Executive Director, who receive a fixed allocation of MEREP awards (Promotion Awards);
- new Macquarie Group staff who commence at Associate Director, Division Director or Executive Director level are awarded a fixed number of MEREP awards depending on level (New Hire Awards); and
- in limited circumstances, Macquarie staff who may receive an equity grant instead of a remuneration or consideration payment in cash. Current examples include individuals who become employees of the Macquarie Group on the acquisition of their employer by a Macquarie Group entity or who receive an additional award at the time of joining Macquarie (also referred to below as New Hire Awards).

Vesting periods are as follows:

- Retained DPS awards representing 2009 retention for all Executive Directors vest in five equal tranches following the third, fourth, fifth, sixth and seventh anniversaries of 1 July 2009[1]
- Retained DPS awards representing 2010 and 2011 retention awarded to Non-Designated Executive Directors vest in three equal tranches following the third, fourth and fifth anniversaries of 1 July 2010 and 2011 respectively;
- Retained DPS awards representing 2010 and 2011 retention awarded to Designated Executive Directors vest in five equal tranches following the third, fourth, fifth, sixth and seventh anniversaries of 1 July 2010 and 2011 respectively[2];
- Pre-2009 DPS transitioned into the MEREP vests in seven equal tranches for Executive Committee Members and five equal tranches for other Executive Directors on the first day of a staff trading window in the seven or five years following 1 July 2010;
- Retained Profit Share awards, Promotion awards and New Hire Awards vest in three equal tranches after the second, third and fourth anniversaries of the date of allocation[2];
- In limited cases, the Application Form for awards may set out a different Vesting Period, in which case that period will be the Vesting Period for the Award.

For Retained Profit Share Awards representing 2011 retention, the allocation price was the volume weighted average price from 9 May 2011 up to and including 20 June 2011. The price was calculated to be $33.06 (2011: $43.48).

The number of Awards allocated was calculated by adjusting the employee's relevant retained profit share amount, or retained DPS, for any applicable on-costs, dividing this amount by the applicable price outlined above, and rounding down to the nearest whole number. The grant of Awards to Eligible Employees working in Australia is subject to payroll tax, calculated based on the market value of shares on the Acquisition Date.

Vesting of Performance Share Units

PSUs will only be released or become exercisable upon the achievement of certain performance hurdles. Currently, only members of the MGL and MBL Executive Committees are eligible to receive PSUs. For the PSUs allocated to Executive Committee Members, two performance hurdles have been determined and each will apply individually to 50 per cent of the total number of PSUs awarded. These hurdles are set out below. The BRC will periodically review the performance hurdles, including the reference group, and has the discretion to change the performance hurdles in line with regulatory and remuneration trends. Any change will be disclosed in the Consolidated Entity's Annual Report.

Performance Hurdle 1

50 per cent of the PSUs, based solely on the relative average annual return on ordinary equity (ROE) of MGL over the vesting period compared to a reference group of domestic and international financial institutions.

Vesting is on a sliding scale with 50 per cent vesting above the 50th percentile and 100 per cent vesting at the 75th percentile. For example, if ROE achievement is at the 60th percentile, 70 per cent of the Award would vest. The reference group comprises significant Australian financial companies within the ASX100 as well as Macquarie's major international investment banking peers with whom Macquarie competes and frequently compares its performance. The reference group comprises ANZ Group, Commonwealth Bank, National Australia Bank, Westpac, Suncorp, Bank of America, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan, Morgan Stanley and UBS.

[1] Vesting will occur on the first day of a staff trading window following 1 July of the specified year. If an Executive Director has been on leave without pay (excluding leave to which the Executive Director may be eligible under local laws) for 12 months or more, the vesting period may be extended accordingly.

[2] Vesting will occur on the first day of a staff trading window following 1 July of the specified year.

Note 30

Employee equity participation continued

Performance Hurdle 2

50 per cent of the PSUs, based solely on the compound annual growth rate (CAGR) in earnings per share (EPS) of MGL over the vesting period.

Awards will vest on a sliding scale with 50 per cent vesting at EPS CAGR of 9.0 per cent and 100 per cent vesting at EPS CAGR of 13.0 per cent. For example, if EPS CAGR were 11 per cent, 75 per cent of the Award would vest.

Under both performance hurdles, the objective is to be examined once only, effectively at the calendar quarter end immediately before vesting. If the condition is not met when examined, the PSUs due to vest expire.

Other arrangements

There are certain arrangements with employees which take the form of a share-based payment but which are held outside the MEREP. Employees do not have a legal or beneficial interest in the underlying shares; however the arrangements have the same economic benefits as those held in the MEREP.

Compensation expense relating to these awards for the year ending 31 March 2012 was $1 million (2011: $0.19 million)

Option Plan

MGL has suspended new offers under the Macquarie Group Employee Share Option Plan (MGESOP) under remuneration arrangements which were the subject of shareholder approvals obtained at a General Meeting of MGL in December 2009. The last grant of Options under the MGESOP was on 8 December 2009. Currently, MGL does not expect to issue any further Options under the MGESOP.

Options now on issue are all five year options over unissued ordinary fully paid shares in MGL and were granted to individuals or the individual's controlled Company or an entity approved under the MGESOP to hold options. The options were issued for no consideration and were granted at prevailing market prices.

At 31 March 2012 there were 855 (2011: 1,035) MFHL participants of the MGESOP.

The following is a summary of options which have been granted pursuant to the MGESOP:

	Number of options 2012	**Weighted average exercise price 2012 $**	Number of options 2011	Weighted average exercise price 2011 $
Outstanding at the beginning of the financial year	**16,061,537**	**60.50**	23,881,860	60.80
Forfeited during the financial year	**(225,931)**	**43.69**	(1,725,654)	57.02
Exercised during the financial year	**(13,011)**	**26.95**	(20,679)	29.74
Transfers to related body corporate entities	**28,080**	**50.06**	(722,061)	58.46
Lapsed during the financial year	**(5,426,546)**	**62.62**	(5,351,929)	63.37
Outstanding at the end of the financial year	**10,424,129**	**60.00**	16,061,537	60.50
Exercisable at the end of the financial year	**8,268,267**	**62.00**	9,398,033	63.08

For options exercised during the financial year the weighted average share price at the date of exercise was $32.60 (2011: $36.00).

The range of exercise prices for options outstanding at the end of the financial year was $17.10 to $94.48 (2011: $17.10 to $94.48).

Notes to the financial statements for the financial year ended 31 March 2012 continued

The weighted average remaining contractual life for the share options outstanding as at 31 March 2012 is 1.02 years (2011: 1.62 years). The weighted average remaining contractual life when analysed by exercise price range is:

Exercise price range $	**Number of options 2012**	**Remaining life (years) 2012**	Number of options 2011	Remaining life (years) 2011
10 – 20	**4,000**	**1.94**	6,000	2.94
20 – 30	**136,057**	**1.83**	161,000	2.86
30 – 40	**207,341**	**1.75**	261,263	2.65
40 – 50	**138,413**	**1.66**	208,661	2.50
50 – 60	**6,044,641**	**1.36**	7,190,157	2.34
60 – 70	**130,550**	**0.91**	3,644,118	0.39
70 – 80	**3,555,329**	**0.39**	4,325,546	1.32
80 – 90	**140,935**	**0.23**	197,929	1.23
90 – 100	**66,863**	**0.17**	66,863	1.18
	10,424,129	1.02	16,061,537	1.62

There were no options issued in the financial year. The number of outstanding options, including those not able to be exercised due to performance hurdles not being met as at 31 March 2012 is 8,271,267 and as at 27 April 2012 is 8,171,996.

The market value of shares issued during the year as a result of the exercise of these options was $424,152 (2011: $1 million).

The market value of shares which would be issued from the exercise of the outstanding options at 31 March 2012 was $303 million (2011: $588 million).

The options were measured at their grant dates based on their fair value and the number expected to vest. This amount is recognised as an expense evenly over the respective vesting periods and the equity provided is treated as a capital contribution.

Options granted vest in three equal tranches after the second, third and fourth anniversaries of the date of allocation of the options. Subject to the MGESOP rules and MGL's personal dealing policy, options can be exercised after the vesting period during an options exercise period up to expiry. In individual cases, such as where an employee leaves with the Company's agreement towards the end of a vesting period, MGL's Executive Committee has the power to waive the remainder of any vesting period and allow exercise of some or all of the relevant options.

For options granted to the members of MBL and MGL's Executive Committees, Executive Voting Directors and other Executive Directors where the invitation to apply for the options was sent to the Executive on or after 30 June 2006, in respect of each tranche of vested options, options will only be exercisable if MGL's average annual return on ordinary equity for the three previous financial years is above the 65th (Executive Committee and Executive Voting Directors) and 50th (other Executive Directors) percentiles, of the corresponding figures for all companies in the then S&P/ASX 100 Index, with the conditions to be examined only upon vesting.

Fully paid ordinary shares issued on the exercise of options rank pari passu with all other fully paid MGL ordinary shares then on issue.

The options do not confer any right to directly participate in any share issue or interest issue by MGL or any other body corporate or scheme and carry no dividend or voting rights. The options include terms that provide for the adjustment of the number options, the exercise price and/or the number of shares to be issued on the exercise of options, in the following circumstances:

- an issue of new shares by way of capitalisation of profits or reserves;
- an issue to holders of shares of rights (pro-rata with existing shareholdings) to subscribe for further shares;
- a pro-rata bonus issue;
- a subdivision, consolidation, cancellation or return of capital;
- other reorganisations.

These terms are consistent with the ASX Listing Rules for the adjustment of options in these circumstances, which are intended to ensure that these types of transactions do not result in either a dilution of option holders' interests or an advantage to option holders which holders of ordinary shares do not receive.

For the year ended 31 March 2012, compensation expense relating to exchangeable shares, retention securities and option plans totalled $9 million (2011: $25 million).

Note 30

Employee equity participation continued

Employee Share Plan

Following shareholder approval at the 1997 Annual General Meeting, MBL introduced the Macquarie Bank Employee Share Plan whereby each financial year, eligible employees are offered up to $1,000 worth of fully paid ordinary MBL shares for no cash payment. MGL has since introduced the Macquarie Group Employee Share Plan (ESP) on the same terms.

Shares issued under the ESP cannot be sold until the earlier of three years after issue or the time when the participant is no longer employed by the Company or a subsidiary of the Company. In all other respects, shares issued rank equally with all other fully paid ordinary shares then on issue.

The latest offer under the ESP was made during December 2011. A total of 41 (2011: 101) staff participated in this offer. On 28 December 2011, the participants were each issued with 41 (2011: 24) fully paid ordinary shares based on the offer amount of $1,000 and the then calculated average market share price of $23.81 (2011: $40.52), a total of 1,681 (2011: 2,424) shares were issued. The shares were issued for no cash consideration.

Staff Share Acquisition Plan

Following shareholder approval at the 1999 Annual General Meeting, MBL introduced the Macquarie Bank Staff Share Acquisition Plan (MBSSAP) whereby each financial year, Australian based Eligible Employees were given the opportunity to nominate an amount of their pre-tax available profit share or future commission to purchase fully paid ordinary MBL shares on-market. MGL subsequently introduced the Macquarie Group Staff Share Acquisition Plan (MGSSAP) on the same terms. In early 2010, MGL suspended new offers under the MGSSAP following Australian taxation changes implemented in late 2009 which would have significantly limited the future participation in the plan. MGL does not expect it will make any future allocations under MGSSAP.

The total number of shares purchased under the MGSSAP was limited in any financial year to 3 per cent of MGL's shares as at the beginning of that financial year.

The shares allocated under the MGSSAP were either newly issued shares or shares acquired on-market by the MGSSAP Plan Company, at the direction of MGL.

Shares acquired under the MGSSAP cannot be sold, transferred or disposed of for a period of six months from the date that the shares are transferred into a participating employee's name except in special circumstances if the employee resigns. The shares held in the MGSSAP are also subject to forfeiture by an employee in a number of circumstances including theft, fraud, dishonesty, or defalcation in relation to the affairs of the Company or a related company or if they carry out an act or fail to do an act which brings the Company or a related company into disrepute.

Shares held in the MGSSAP will be withdrawn on the earlier of:

- an employee's resignation from the Company or a related entity;
- upon request by the employee (after the expiration of the non-disposal period); and
- 10 years from the date that the shares are registered in an employee's name.

In all other respects, the shares rank equally with all other fully paid ordinary shares then on issue.

Previously, the Eligible Employees were Australian based permanent full-time or part-time employees or fixed term contract employees of the Company or a related company who either received available profit share in the relevant year of at least $1,000 in total or allocated at least $1,000 in available commission towards the MGSSAP.

The Macquarie Bank Executive Director Share Acquisition Plan (MBEDSAP) was a sub-plan of the MBSSAP which was created in 2003 and was open to eligible Executive Directors. The disposal and forfeiture restrictions in the MBEDSAP differ to those in the MBSSAP. MGL subsequently introduced a Macquarie Group Executive Director Share Acquisition Plan (MGEDSAP) on the same terms but no offers have been made under the plan.

In April 2008, a further sub-plan of the MGSSAP was created, the Macquarie Group Executive Committee Acquisition Plan, whereby members of MGL's Executive Committee were required to contribute certain proportions of their annual profit share to acquire Company shares, which must be held for at least three years. The first offers under this sub-plan were made in May 2008. MGL does not intend making any further allocations under this sub-plan, as Executive Committee members now receive the equity component of their retained profit share under the Macquarie Group Employee Retained Equity Plan.

No offers under the MGSSAP (including the Macquarie Group Executive Committee Acquisition Plan) were made during the year to 31 March 2012 (2011: Nil).

Non-Executive Director Share Acquisition Plan

Following shareholder approval at the 1999 Annual General Meeting, MBL also introduced the Macquarie Bank Non-Executive Director Share Acquisition Plan whereby each financial year certain Australian based Non-Executive Directors (NEDs) of the Macquarie Group of companies were given the opportunity to contribute some or all of their future pre-tax remuneration from the Macquarie Group to acquire Macquarie Bank Limited shares. MGL subsequently introduced a Macquarie Group Non-Executive Director Share Acquisition Plan (NEDSAP) on the same terms. The Australian taxation changes referred to above in respect of the MGSSAP also apply to the NEDSAP. Accordingly, MGL has currently suspended new offers under the NEDSAP and does not expect to make any future allocations under the plan.

Previously, NEDs could elect to participate in the NEDSAP by nominating a minimum of $1,000 of their NED remuneration per buying period to go towards the NEDSAP. Participating NEDs could also subsequently apply to reduce their previously nominated contribution

Notes to the financial statements for the financial year ended 31 March 2012 continued

provided that the relevant buying period has not commenced.

The shares were acquired at prevailing market prices. Brokerage fees were applied to the NEDs' account.

Shares acquired under the NEDSAP cannot be sold, transferred or disposed of for a period of six months from the date that the shares were transferred into a NED's name except in special circumstances if the NED resigns. The shares held in the NEDSAP are also subject to forfeiture by a NED in a number of circumstances including theft, fraud, dishonesty, or defalcation in relation to the affairs of the Company or a related company or if they carry out an act or fail to do an act which brings the Company or a related company into disrepute.

Shares held in the NEDSAP will be withdrawn on the earlier of:

- the participant ceasing to be a NED of the Company;
- upon request by the NED (after the expiration of the non-disposal period); and
- 10 years from the date that the shares are registered in a NED's name.

In all other respects, shares rank equally with all other fully paid ordinary shares then on issue.

Shares resulting from participation in the NEDSAP may count towards meeting the minimum shareholding requirements of NEDs.

No offers under the NEDSAP were made during the year ended 31 March 2012 (2011: Nil).

Other plans

The Consolidated Group operates other local share-based compensation plans, none of which, individually or in aggregate are material.

	2012 $m	2011 $m

Note 31

Contingent liabilities and commitments

The following details of contingent liabilities and assets exclude derivatives.

	2012 $m	2011 $m
Contingent liabilities exist in respect of:		
Guarantees	104	70
Total contingent liabilities[1]	104	70
Commitments exist in respect of:		
Undrawn credit facilities	857	372
Forward asset purchases	926	1,427
Total commitments[2]	1,783	1,799
Total contingent liabilities and commitments	1,887	1,869

1 Contingent liabilities exist in respect of actual and potential claims and proceedings that arise in the conduct of the Consolidated Entity's business. A provision is recognised where some loss is probable and can be reliably estimated. The Consolidated Entity is currently not engaged in any litigation or claim which is likely to have a material adverse effect on the Consolidated Entity's business, financial condition or performance.

2 Total commitments also represent contingent assets. Such commitments to provide credit may convert to loans and other assets in the ordinary course of business.

Note 32

Lease commitments

Non-cancellable operating leases expiring:

	2012 $m	2011 $m
Not later than one year	84	79
Later than one year and not later than five years	239	282
Later than five years	215	264
Total operating lease commitments	538	625

Operating leases relate to commercial buildings. The future lease commitments disclosed are net of any rental incentives received.

Note 33

Capital and other expenditure commitments

Capital and other expenditure commitments expected to be incurred:

	2012 $m	2011 $m
Not later than one year	2	6
Later than one year and not later than five years	4	10
Later than five years	–	1
Total capital and other expenditure commitments	6	17

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 34

Derivative financial instruments

Objectives of holding and issuing derivative financial instruments

The Consolidated Entity is an active price maker in derivatives on equities. Its objective is to earn profits from the price making spread and from managing the residual exposures on positions. Proprietary position taking is an immaterial part of the Consolidated Entity's trading activities. Risks on derivatives are managed together with all other trading positions as part of an overall trading position. All trading positions are marked to fair value daily.

The Consolidated Entity also uses derivatives for asset/liability management. Certain derivative transactions may qualify as cash flow, fair value or net investment in foreign operations hedges, if they meet the appropriate strict hedge criteria outlined in note 1(x) – Summary of significant accounting policies:

Cash flow hedges: The Consolidated Entity is exposed to volatility in future interest cash flows arising from floating rate issued debt used to fund fixed rate asset positions. The aggregate principal balances and interest cash flows across these portfolios form the basis for identifying the non-trading interest rate risk of the Consolidated Entity, which is hedged with interest rate swaps and cross currency swaps.

At 31 March 2012, the fair value of outstanding derivatives held by the consolidated entity and designated as cash flow hedges was $nil (2012: $12 million negative value).

During the year the consolidated entity recognised $nil (2011: $nil) in the income statement due to hedge ineffectiveness on cash flow hedges.

Fair value hedges: The Consolidated Entity's fair value hedges consist of foreign exchange forward contracts used to hedge against changes in the fair value of foreign denominated equity instruments as a result of movements in market foreign exchange rates.

As at 31 March 2012, the fair value of outstanding derivatives held by the consolidated entity and designated as fair value hedges was $nil (2011: $1 million negative value).

During the year fair value gains on the hedging instruments of $nil (2011: $nil) have been recognised, offset by $nil (2011: $nil) on the hedged item.

Net investment in foreign operations hedges: The Consolidated Entity has applied net investment hedging for foreign exchange risk arising from non-core foreign operations.

At 31 March 2012, the fair value of outstanding derivatives held by the consolidated entity and designated as net investment in foreign operations hedges was $2 million positive value (2011: $7 million negative value). During the year the consolidated entity recognised $2 million gain (2011: $6 million gain) in the income statement due to hedge ineffectiveness on net investment hedges.

The types of contracts which the Consolidated Entity trades and uses for hedging purposes are detailed below:

Futures: Futures contracts provide the holder with the obligation to buy a specified financial instrument or commodity at a fixed price and fixed date in the future. Contracts may be closed early via cash settlement. Futures contracts are exchange traded.

Forwards and forward rate agreements: Forward contracts, which resemble futures contracts, are an agreement between two parties that a financial instrument or commodity will be traded at a fixed price and fixed date in the future. A forward rate agreement provides for two parties to exchange interest rate differentials based on an underlying principal amount at a fixed date in the future.

Swaps: Swap transactions provide for two parties to swap a series of cash flows in relation to an underlying principal amount, usually to exchange a fixed interest rate for a floating interest rate. Cross-currency swaps provide a tool for two parties to manage risk arising from movements in exchange rates.

Options: Option contracts provide the holder the right to buy or sell financial instruments or commodities at a fixed price over an agreed period or on a fixed date. The contract does not oblige the holder to buy or sell, however the writer must perform if the holder exercises the rights pertaining to the option.

Note 35

Financial risk management

Risk Management Group

Risk is an integral part of the Consolidated Entity's businesses. The main risks faced by the Consolidated Entity are market risk, equity risk, credit risk, liquidity risk, operational risk, legal risk and compliance risk. Responsibility for management of these risks lies with the individual businesses giving rise to them. It is the responsibility of the Risk Management Group (RMG) to ensure appropriate assessment and management of these risks.

RMG is independent of all other areas of the Consolidated Entity. The Head of RMG, as Macquarie's Chief Risk Officer, is a member of the Executive Committee of MGL and reports directly to the Managing Director and Chief Executive Officer with a secondary reporting line to the Board Risk Committee. RMG authority is required for all material risk acceptance decisions. RMG identifies, quantifies and assesses all material risks and sets prudential limits. Where appropriate, these limits are approved by the Executive Committee and the Board.

The risks which the Consolidated Entity is exposed to are managed on a globally consolidated basis for MGL as a whole, including all subsidiaries, in all locations. Macquarie's internal approach to risk ensures that risks in subsidiaries are subject to the same rigour and risk acceptance decisions (i.e. not differentiating where the risk is taken within Macquarie).

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 35.1

Credit risk

Credit risk is defined as the risk of a counterparty failing to complete its contractual obligations when they fall due.

The credit risk exposures within the Consolidated Entity are managed on a Group basis by RMG.

Maximum exposure to credit risk

The table below details the concentration of credit exposure of the Consolidated Entity's assets to significant geographical locations and counterparty types. The amounts shown represent the maximum credit risk of the Consolidated Entity's assets.

Credit risk – 2012

	Receivables from financial institutions $m	Cash collateral on securities borrowed and reverse repurchase agreements[1] $m	Trading portfolio assets $m	Derivative assets $m
Australia				
Governments	–	–	–	–
Financial institutions	35	–	–	14
Other	–	1	–	33
Total Australia	35	1	–	47
Asia Pacific				
Governments	–	–	–	–
Financial institutions	889	–	9	20
Other	–	–	–	1
Total Asia Pacific	889	–	9	21
Europe, Middle East and Africa				
Governments	–	–	–	–
Financial institutions	538	47	–	7
Other	–	–	4	–
Total Europe, Middle East and Africa	538	47	4	7
Americas				
Governments	–	–	12	–
Financial institutions	1,121	449	192	46
Other	–	77	68	5
Total Americas	1,121	526	272	51
Total	2,583	574	285	126
Total gross credit risk				

[1] Classified based on the exposure to the underlying security borrowed.

The following provides detail around the active management of credit risk by the Consolidated Entity:

The Consolidated Entity enters into master netting agreements with certain counterparties to manage the credit risk where it has trading derivatives in the Macquarie Securities Group and Fixed Income, Currencies and Commodities. Stock borrowing and reverse repurchase arrangements entered into by the Consolidated Entity with external counterparties normally require collateral in excess of 100 per cent (which is consistent with industry practice). Other risk mitigation measures include blocked deposits, bank guarantees and letters of credit.

Debt investment securities available for sale[2] $m	Other assets $m	Loan assets held at amortised cost $m	Other financial assets at fair value through profit or loss $m	Due from related body corporate entities $m	Credit commitments and contingent liabilities $m	Total $m
–	1	–	–	–	–	1
98	33	6	–	1,741	–	1,927
33	631	199	–	239	193	1,329
131	665	205	–	1,980	193	3,257
–	32	–	–	–	–	32
–	–	133	–	–	–	1,051
–	2,007	–	–	13	98	2,119
–	2,039	133	–	13	98	3,202
–	13	–	–	–	–	13
7	–	14	630	–	–	1,243
4	1,170	46	–	108	254	1,586
11	1,183	60	630	108	254	2,842
–	35	32	–	–	–	79
8	–	157	–	–	120	2,093
11	2,511	535	–	30	1,222	4,459
19	2,546	724	–	30	1,342	6,631
161	6,433	1,122	630	2,131	1,887	15,932
						15,932

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 35.1

Credit risk continued

Maximum exposure to credit risk continued

Credit risk – 2011

	Receivables from financial institutions $m	Cash collateral on securities borrowed and reverse repurchase agreements[1] $m	Trading portfolio assets $m	Derivative assets $m
Australia				
Governments	–	–	–	–
Financial institutions	35	–	–	4
Other	–	31	–	10
Total Australia	35	31	–	14
Asia Pacific				
Governments	–	–	–	–
Financial institutions	809	1	9	5
Other	–	–	–	1
Total Asia Pacific	809	1	9	6
Europe, Middle East and Africa				
Governments	–	–	–	–
Financial institutions	620	300	–	13
Other	–	–	–	–
Total Europe, Middle East and Africa	620	300	–	13
Americas				
Governments	–	–	–	–
Financial institutions	719	741	–	–
Other	–	299	–	4
Total Americas	719	1,040	–	4
Total	2,183	1,372	9	37
Total gross credit risk				

[1] Classified based on the exposure to the underlying security borrowed.

The following provides detail around the active management of credit risk by the Consolidated Entity:

The Consolidated Entity enters into master netting agreements with certain counterparties to manage the credit risk where it has trading derivatives in the Macquarie Securities Group and Fixed Income, Currencies and Commodities. Stock borrowing and reverse repurchase arrangements entered into by the Consolidated Entity with external counterparties normally require collateral in excess of 100 per cent (which is consistent with industry practice). Other risk mitigation measures include blocked deposits, bank guarantees and letters of credit.

Debt investment securities available for sale[2] $m	Other assets $m	Loan assets held at amortised cost $m	Other financial assets at fair value through profit or loss $m	Due from related body corporate entities $m	Credit commitments and contingent liabilities $m	Total $m
–	4	2	–	–	–	6
103	–	6	–	4,720	–	4,868
12	747	67	7	335	607	1,816
115	751	75	7	5,055	607	6,690
–	25	–	–	–	–	25
–	–	157	–	–	19	1,000
1	2,793	22	–	9	19	2,845
1	2,818	179	–	9	38	3,870
–	30	–	–	–	–	30
185	37	–	895	–	–	2,050
4	719	42	1	42	104	912
189	786	42	896	42	104	2,992
68	17	34	–	–	–	119
4	–	89	–	–	4	1,557
42	1,233	210	–	313	1,116	3,217
114	1,250	333	–	313	1,120	4,893
419	5,605	629	903	5,419	1,869	18,445
						18,445

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 35.1

Credit risk continued

Cash collateral on securities borrowed and reverse repurchase agreements

Securities borrowed and reverse repurchase agreements are fully collateralised with highly liquid securities as they require collateral to be in excess of the loaned amount.

Other financial assets at fair value through profit or loss

Financing provided to clients for investing had a carrying value at year end of $441 million (2011 $903 million). This amount is fully secured by the underlying securities investments or cash deposits of the investors.

Derivative financial instruments

Exchange traded derivatives contracts have limited credit risk as counterparties have to be members of the exchange and demonstrate they have adequate resources to fulfil obligations when they become due. Members are required to provide initial margins in accordance with the exchange rules in the form of cash or stock, and provide daily variation margins usually in cash to cover changes in market values. Further, all members are generally required to contribute to (and guarantee) the compensation or reserve fund which may be used in the event of default and shortfall of a member.

For Over The Counter (OTC) derivative contracts, the Company often has master netting agreements (usually ISDA Master Agreements) with certain counterparties to manage the credit risk. Master netting arrangements are generally insufficient to allow offset in the Statement of Financial Position. However, the credit risk associated with positive replacement value contracts is reduced by master netting arrangements that in an event of default requires balances with a particular counterparty covered by the agreement (e.g. derivatives and cash margins) to be terminated and settled on a net basis. Macquarie also often executes a Credit Support Annex in conjunction with a master netting agreement, which facilitates the transfer of margin between parties during the term of arrangements, to mitigate counterparty risk arising from changes in market values of the derivatives.

Other assets

Brokerage receivables of $5,685 million, (2011: $4,724 million) are included in Other assets, which represent amounts owed by an exchange (or a client) for equities sold (or bought on behalf of a client). Macquarie holds the underlying equity security as collateral until settled, which is usually less than 3 days after trade.

Credit quality of financial assets

The table below shows the credit quality by class of financial asset (based upon ultimate risk counterparty) for credit exposures, based on the Consolidated Entity's credit rating system.

Credit quality – 2012

	Neither past due nor impaired					
	Investment Grade $m	Below Investment Grade $m	Default $m	Unrated $m	Past due or individually impaired $m	Total $m
Receivables from financial institutions	2,541	42	–	–	–	2,583
Cash collateral on securities borrowed and reverse repurchase agreements						574
Financial institutions	419	77	–	–	–	496
Other	74	4	–	–	–	78
Trading portfolio assets						285
Governments	12	–	–	–	–	12
Financial institutions	35	166	–	–	–	201
Other	4	68	–	–	–	72
Derivative assets						126
Financial institutions	53	34	–	–	–	87
Other	–	39	–	–	–	39
Debt investment securities available for sale						161
Financial institutions	113	–	–	–	–	113
Other	30	18	–	–	–	48
Other assets						6,433
Governments	81	–	–	–	–	81
Financial institutions	–	–	–	–	33	33
Other	2,335	3,462	–	428	94	6,319
Loan assets held at amortised cost						1,122
Governments	31	1	–	–	–	32
Financial institutions	104	203	3	–	–	310
Other	281	456	–	–	43	780
Other financial assets at fair value through profit or loss						630
Financial institutions	630	–	–	–	–	630
Due from related body corporate entities						2,131
Financial institutions	1,741	–	–	–	–	1,741
Other	–	–	–	390	–	390
Total						14,045

Included in the past due category are balances in which an amount was overdue by one day or more.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 35.1

Credit risk continued

Credit quality of financial assets continued

The table below shows the credit quality by class of financial asset (based upon ultimate risk counterparty) for credit exposures, based on the Consolidated Entity's credit rating system.

Credit quality – 2011

	Neither past due nor impaired					
	Investment Grade $m	Below Investment Grade $m	Default $m	Unrated $m	Past due or individually impaired $m	Total $m
Receivables from financial institutions	2,074	109	–	–	–	2,183
Cash collateral on securities borrowed and reverse repurchase agreements						1,372
Financial institutions	939	103	–	–	–	1,042
Other	330	–	–	–	–	330
Trading portfolio assets						9
Financial institutions	–	9	–	–	–	9
Derivative assets						37
Financial institutions	14	8	–	–	–	22
Other	1	14	–	–	–	15
Debt investment securities available for sale						419
Governments	68	–	–	–	–	68
Financial institutions	289	3	–	–	–	292
Other	13	46	–	–	–	59
Other assets						5,605
Governments	76	–	–	–	–	76
Financial institutions	–	–	–	–	37	37
Other	3,577	1,645	–	236	34	5,492
Loan assets held at amortised cost						629
Governments	35	1	–	–	–	36
Financial institutions	195	54	3	–	–	252
Other	209	116	4	–	12	341
Other financial assets at fair value through profit or loss						903
Financial institutions	895	–	–	–	–	895
Other	8	–	–	–	–	8
Due from related body corporate entities						5,419
Financial institutions	4,720	–	–	–	–	4,720
Other	–	–	–	699	–	699
Total						16,576

Included in the past due category are balances in which an amount was overdue by one day or more.

Note 35.1

Credit risk continued

Credit quality of financial assets continued

Financial assets whose terms have been renegotiated
The table below includes the carrying value, as at the reporting date, of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.

	2012 $m	2011 $m
Loans assets held at amortised cost		
Other	–	–

Ageing analysis of assets past due but not impaired and impaired assets

Class of financial asset	Past due but not impaired: Less than 30 days $m	31 to 60 days $m	61 to 90 days $m	More than 91 days $m	Impaired $m	Total $m	Fair value of collateral held $m
							2012
Other assets							
Financial institutions	32	1	–	–	–	33	29
Other	55	24	8	–	7	94	29
Loan assets held at amortised cost							
Other	–	–	–	–	43	43	9
Total	87	25	8	–	50	170	67

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 35.1

Credit risk continued

Credit quality of financial assets continued

	Past due but not impaired						
Class of financial asset	Less than 30 days $m	31 to 60 days $m	61 to 90 days $m	More than 91 days $m	Impaired $m	Total $m	Fair value of collateral held $m
							2011
Other assets							
Financial institutions	36	1	–	–	–	37	35
Other	24	2	7	–	1	34	–
Loan assets held at amortised cost							
Other	–	–	–	–	12	12	–
Total	60	3	7	–	13	83	35

A facility is considered to be past due when a contractual payment falls overdue by one or more days. When a facility is classified as past due, the entire facility balance is disclosed in the past due analysis.

The factors taken into consideration by the Consolidated Entity when determining whether an asset is impaired are set out in note 1(xii) – Summary of significant accounting policies.

Of the collateral held against past due and impaired balances for loan assets held at amortised cost, $nil (2011: $nil) relates to collateral held against past due balances on leased assets.

The collateral held against past due and impaired balances for other assets represents equity securities held as security against failed trade settlements.

Repossessed collateral

During the year the Consolidated Entity took possession of property assets with a carrying value of $nil (2011: $nil).

Note 35.2

Liquidity risk

The Consolidated Entity's liquidity risk management framework ensures that it is able to meet its funding requirements as they fall due under a range of market conditions.

Liquidity management is performed centrally by Group Treasury, with oversight from the Asset and Liability Committee, the MGL Board and RMG. The Consolidated Entity's liquidity policies are approved by the Board after endorsement by the Asset and Liability Committee. The Asset and Liability Committee includes the Chief Executive Officer, the Chief Financial Officer, Chief Risk Officer, Treasurer and Operating Group Heads.

Contractual undiscounted cash flows

The table below summarises the maturity profile of the Consolidated Entity's financial liabilities as at 31 March based on contractual undiscounted repayment obligations. Repayments which are subject to notice are treated as if notice were given immediately.

Derivatives (other than those designated in a hedging relationship) and trading portfolio liabilities are included in the 'less than 3 months' column at their fair value. Liquidity risk on these items is not managed on the basis of contractual maturity, since they are not held for settlement according to such maturity and will frequently be settled in the short term at fair value. Derivatives designated in a hedging relationship are included according to their contractual maturity.

	On demand $m	Less than 3 months $m	3 to 12 months $m	1 to 5 years $m	More than 5 years $m	Total $m
						2012
Cash collateral on securities lent and repurchase agreements	47	–	–	–	–	47
Trading portfolio liabilities	–	108	–	–	–	108
Derivative liabilities (trading)	–	120	–	–	–	120
Derivative liabilities (hedging relationship)						
Contractual amounts payable	–	344	36	–	–	380
Contractual amounts receivable	–	(246)	(33)	–	–	(279)
Deposits	2	104	–	–	–	106
Other liabilities[1]	–	6,089	–	–	–	6,089
Other financial liabilities at fair value through profit and loss	1	264	501	356	–	1,122
Due to related body corporate entities	(817)	313	2,348	3,555	3,594	8,993
Payables to financial institutions	12	101	162	53	23	351
Debt issued at amortised cost[2]	–	–	–	48	–	48
Macquarie Convertible Preference Securities	–	33	33	633	–	699
Subordinated debt	–	17	17	492	–	526
Total undiscounted cash flows	(755)	7,247	3,064	5,137	3,617	18,310
Contingent liabilities	–	104	–	–	–	104
Commitments	–	1,783	–	–	–	1,783
Total undiscounted contingent liabilities and commitments[3]	–	1,887	–	–	–	1,887

1 Excludes items that are not financial instruments and non-contractual accruals and provisions.

2 Included in this balance are amounts payable to SPE note holders. The contractual maturity of the notes is dependent on the repayment of the underlying loans. This has been reflected in the maturity analysis.

3 Cash flows on contingent liabilities and commitments are dependent on the occurrence of various future events and conditions, and may or may not result in an outflow of resources. These are reported in the 'less than 3 months' column unless the contractual terms specify a cash flow date outside this bucket.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 35.2

Contractual undiscounted cash flows continued

	On demand $m	Less than 3 months $m	3 to 12 months $m	1 to 5 years $m	More than 5 years $m	Total $m
						2011
Cash collateral on securities lent and repurchase agreements	512	2	–	–	–	514
Trading portfolio liabilities	–	75	–	–	–	75
Derivative financial instruments (trading)	–	101	–	–	–	101
Derivative financial instruments (hedging relationship)						
Contractual amounts payable	–	119	7	23	–	149
Contractual amounts receivable	–	(112)	(1)	–	–	(113)
Deposits	24	121	2	22	14	183
Other liabilities[1]	–	5,557	–	–	–	5,557
Other financial liabilities at fair value through profit and loss	200	104	768	467	–	1,539
Due to related body corporate entities	197	61	2,481	5,585	3,361	11,685
Payables to financial institutions	29	43	111	1,719	29	1,931
Debt issued at amortised cost[2]	–	–	–	12	–	12
Macquarie Convertible Preference Securities	–	33	33	700	–	766
Subordinated debt	–	17	17	527	–	561
Total undiscounted cash flows	962	6,121	3,418	9,055	3,404	22,960
Contingent liabilities	–	70	–	–	–	70
Commitments	–	1,799	–	–	–	1,799
Total undiscounted contingent liabilities and commitments[3]	–	1,869	–	–	–	1,869

[1] Excludes items that are not financial instruments and non-contractual accruals and provisions.

[2] Included in this balance are amounts payable to SPE note holders. The contractual maturity of the notes is dependent on the repayment of the underlying loans. This has been reflected in the maturity analysis.

[3] Cash flows on contingent liabilities and commitments are dependent on the occurrence of various future events and conditions, and may or may not result in an outflow of resources. These are reported in the 'less than 3 months' column unless the contractual terms specify a cash flow date outside this bucket.

Note 35.3

Market risk

Market risk is the exposure to adverse changes in the value of the Consolidated Entity's trading portfolios as a result of changes in market prices or volatility. The Consolidated Entity is exposed to the following risks in each of the major markets in which it trades:

- foreign exchange and bullion: changes in spot and forward exchange rates and bullion prices and the volatility of exchange rates and bullion prices;
- interest rates and debt securities: changes in the level, shape and volatility of yield curves, the basis between different interest rate securities and derivatives and credit margins;
- equities: changes in the price and volatility of individual equities, equity baskets and equity indices, including the risks arising from equity underwriting activity;
- commodities and energy: changes in the price and volatility of base metals, agricultural commodities and energy products;

and to the correlation of market prices and rates within and across markets.

The Company is not exposed to any material market risk.

Value-at-Risk (VaR) figures

The table below shows the average, maximum and minimum VaR over the year for the major markets in which the Consolidated Entity operates. The VaR shown in the table is based on a one-day holding period. The aggregated VaR is on a correlated basis.

	2012 Average $m	2012 Maximum $m	2012 Minimum $m	2011 Average $m	2011 Maximum $m	2011 Minimum $m
Equities	**1.83**	**4.15**	**0.75**	2.54	10.03	0.83
Interest rates	**0.56**	**3.49**	**0.17**	0.83	4.25	0.28
Foreign exchange and bullion	**1.30**	**6.47**	**0.12**	1.28	3.54	0.23
Commodities	**0.01**	**1.12**	**–**	–	–	–
Aggregate	**2.56**	**5.99**	**0.87**	2.84	9.59	1.35

Value-at-Risk

The VaR model uses a Monte Carlo simulation to generate normally distributed price and volatility paths, based on three years of historical data. VaR focuses on unexceptional price moves so that it does not account for losses that could occur beyond the 99 per cent level of confidence. These factors can limit the effectiveness of VaR in predicting future price moves when changes to future risk factors deviate from the movements expected by the above assumptions. For capital adequacy purposes, debt-specific risk is measured using APRA's standard method, whilst all other exposures are captured by the VAR model. This combined approach has been approved by APRA and is subject to periodic review.

Interest rate risk

The Consolidated Entity also has exposure to non-traded interest rate risk generated by banking products such as loans and deposits. Banking businesses have small limits to accumulate small levels of interest rate risk. Wherever possible, these interest rate risks are transferred into the trading books of FICC and Group Treasury and managed within traded market risk limits and are included within the VaR figures presented above. Some residual interest rate risks remain in the banking book. These residual risks have independent limits that are monitored by RMG.

These residual interest rate risks are not material to the Consolidated Entity.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 35.3

Market risk continued

Foreign currency risk

The Consolidated Entity is exposed to foreign currency risk arising from transactions entered into in its normal course of business and as a result of the Consolidated Entity's investments in foreign operations. Movements in foreign currency exchange rates will result in gains or losses in the income statement due to the revaluation of certain balances or in movements in the foreign currency translation reserve due to the revaluation of foreign operations.

In order to manage this risk, the Consolidated Entity has a policy that non-trading foreign currency exposures are appropriately hedged unless specifically approved by RMG, and trading foreign currency exposures remain within trading limits set by RMG.

Forward foreign exchange contracts, or borrowings in the same currency as the exposure, are designated as hedges under Australian accounting standards and offset movements on the net assets within foreign operations and are transferred to the foreign currency translation reserve.

Responsibility for monitoring and managing foreign currency exposures arising from transactions rests with individual businesses which will enter into internal transactions as necessary to transfer the underlying foreign exchange risk to our trading businesses. Any residual foreign exchange risk residing in non-trading divisions is included in the internal model capital calculation by RMG, with the exception of specific investments in core foreign operations as discussed below.

The hedging policy of the group is designed to reduce the sensitivity of the group's regulatory capital position to foreign currency movements. This is achieved by leaving specific investments in core foreign operations exposed to foreign currency translation movements. The resultant change in the Australian dollar value of the foreign investment is captured in the foreign currency translation reserve, a component of regulatory capital. This offsets the corresponding movement in the capital requirements of these investments.

As a result of the Consolidated Entity's foreign exchange policy, the Consolidated Entity is partially exposed to currency risk in relation to the translation of its net investment in foreign operations to Australian dollars.

The table below indicates the sensitivity to movements in the Australian dollar rate against various foreign currencies at 31 March. The Consolidated Entity is active in various currencies globally – those with the most impact on the sensitivity analysis below are USD, GBP, HKD and CAD.

	2012		2011	
Geographic region	Movement in exchange price %	Sensitivity of equity after tax $m	Movement in exchange price %	Sensitivity of equity after tax $m
Australian dollar	+10	(38.1)	+10	(49.6)
Australian dollar	-10	46.6	-10	60.6

Note 35.3

Market risk continued

Equity price risk

The table below indicates the equity markets to which the Consolidated Entity had significant exposure at 31 March on its non-trading investment portfolio excluding interests in associates and joint ventures. The effect on equity (as a result of a change in the fair value of equity instruments held as available for sale at 31 March) and the income statement due to a reasonably possible change in equity prices, with all other variables held constant, is as follows:

	2012		2011	
Geographic region	**Movement in equity price %**	**Sensitivity of equity after tax $m**	Movement in equity price %	Sensitivity of equity after tax $m
Listed				
Australia	**+10**	**90.8**	+10	96.7
Asia Pacific	**+10**	**0.9**	+10	5.1
Europe, Middle East and Africa	**+10**	**–**	+10	–
Americas	**+10**	**3.0**	+10	3.3
Unlisted	**+10**	**34.2**	+10	16.1
Listed				
Australia	**-10**	**(90.8)**	-10	(96.7)
Asia Pacific	**-10**	**(0.9)**	-10	(5.1)
Europe, Middle East and Africa	**-10**	**–**	-10	–
Americas	**-10**	**(3.0)**	-10	(3.3)
Unlisted	**-10**	**(34.2)**	-10	(16.1)

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 36

Fair values of financial assets and liabilities

Fair value reflects the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Quoted prices or rates are used to determine fair value where an active market exists. If the market for a financial instrument is not active, fair values are estimated using present value or other valuation techniques, using inputs based on market conditions prevailing on the measurement date. The values derived from applying these techniques are affected by the choice of valuation model used and the underlying assumptions made regarding inputs such as timing and amounts of future cash flows, discount rates, credit risk, volatility and correlation.

Financial instruments measured at fair value are categorised in their entirety, in accordance with the levels of the fair value hierarchy as outlined below:

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);

Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The appropriate level for an instrument is determined on the basis of the lowest level input that is significant to the fair value measurement.

The following methods and significant assumptions have been applied in determining the fair values of financial instruments:

- trading portfolio assets and liabilities, financial assets and liabilities at fair value through profit or loss, derivative financial instruments, and other transactions undertaken for trading purposes are measured at fair value by reference to quoted market prices when available (e.g. listed securities). If quoted market prices are not available, then fair values are estimated on the basis of pricing models or other recognised valuation techniques;
- investment securities classified as available for sale are measured at fair value by reference to quoted market prices when available (e.g. listed securities). If quoted market prices are not available, then fair values are estimated on the basis of pricing models or other recognised valuation techniques. Unrealised gains and losses, excluding impairment write-downs, are recorded in the available for sale Reserve in equity until the asset is sold, collected or otherwise disposed of;
- fair values of fixed rate loans and issued debt classified as at fair value through profit or loss is estimated by reference to current market rates offered on similar loans;
- for financial instruments carried at fair value the determination of fair value includes credit risk (i.e. the premium over the basic interest rate). Counterparty credit risk inherent in these instruments is factored into their valuations via credit valuation adjustments (CVA). This amount represents the estimated market value of protection required to hedge credit risk from counterparties, taking into account expected future exposures, collateral, and netting arrangements. CVA is determined when the market price (or parameter) is not indicative of the credit quality of the specific counterparty. Where financial instruments are valued using an internal model that utilise observable market parameters, market practice is to quote parameters equivalent to an interbank credit rating (that is, all counterparties are assumed to have the same credit quality). Consequently, a CVA calculation is necessary to reflect the credit quality of each derivative counterparty to arrive at fair value.

Note 36

Fair values of financial assets and liabilities continued

Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated periodically to test that outputs reflect prices from observable current market transactions in the same instrument or other available observable market data. To the extent possible, models use only observable market data (e.g. for over-the-counter derivatives), however management is required to make assumptions for certain inputs that are not supported by prices from observable current market transactions in the same instrument, such as credit risk, volatility and correlation.

The following methods and significant assumptions have been applied in determining the fair values of financial instruments which are carried at amortised cost:

- the fair values of liquid assets and other instruments maturing within three months approximate their carrying amounts. This assumption is applied to liquid assets and the short-term elements of all other financial assets and financial liabilities;
- the fair value of demand deposits with no fixed maturity is approximately their carrying amount as they are short term in nature or are payable on demand;
- the fair values of variable rate financial instruments, including loan assets and liabilities carried at amortised cost, cash collateral on securities borrowed/cash collateral on securities lent and reverse repurchase or repurchase agreements, are approximated by their carrying amounts. The fair value of loan assets repayable without penalty is approximated by their carrying value;
- the fair value of fixed rate loans is estimated by reference to current market rates offered on similar loans and the credit worthiness of the borrower;
- the fair value of debt issued and subordinated debt is based on market prices where available. Where market prices are not available the fair value is based on discounted cash flows using rates appropriate to the term and issue and incorporates changes in the Consolidated Entity's own credit spread;
- substantially all of the Consolidated Entity's commitments to extend credit are at variable rates. As such, there is no significant exposure to fair value fluctuations resulting from interest rate movements relating to these commitments; and
- the fair values of balances due from or to related body corporate entities (in the consolidated financial statements) are approximated by their carrying amount.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 36

Fair values of financial assets and liabilities continued

The table below summarises the carrying value and fair value of financial assets and liabilities held at amortised cost of the Consolidated Entity at 31 March 2012:

	2012 Carrying value $m	2012 Fair value $m	2011 Carrying value $m	2011 Fair value $m
Assets				
Receivables from financial institutions	2,583	2,583	2,183	2,183
Loan assets held at amortised cost	1,122	1,136	629	650
Due from related body corporate entities	2,131	2,131	5,419	5,419
Total assets	5,836	5,850	8,231	8,252
Liabilities				
Deposits	104	104	183	183
Due to related body corporate entities	7,003	7,003	9,053	9,053
Payables to financial institutions	327	327	1,778	1,778
Debt issued at amortised cost	39	39	11	11
Macquarie Convertible Preference Securities	617	638	600	642
Subordinated debt at amortised cost	405	364	407	394
Total liabilities	8,495	8,475	12,032	12,061

Note 36

Fair values of financial assets and liabilities continued

The following tables summarise the levels of the fair value hierarchy for financial instruments measured at fair value of the Consolidated Entity at 31 March 2012:

	Level 1 $m	Level 2 $m	Level 3 $m	Total $m
				2012
Assets				
Trading portfolio assets	**360**	**273**	**–**	**633**
Derivative assets	**2**	**115**	**9**	**126**
Investment securities available for sale	**1,348**	**307**	**369**	**2,024**
Other financial assets at fair value through profit or loss	**–**	**630**	**–**	**630**
Total assets	**1,710**	**1,325**	**378**	**3,413**
Liabilities				
Trading portfolio liabilities	**62**	**46**	**–**	**108**
Derivative liabilities	**–**	**125**	**–**	**125**
Other financial liabilities at fair value through profit or loss	**–**	**1,081**	**–**	**1,081**
Total liabilities	**62**	**1,252**	**–**	**1,314**
				2011
Assets				
Trading portfolio assets	462	13	–	475
Derivative assets	6	30	1	37
Investment securities available for sale	1,743	173	224	2,140
Other financial assets at fair value through profit or loss	51	907	–	958
Total assets	2,262	1,123	225	3,610
Liabilities				
Trading portfolio liabilities	71	4	–	75
Derivative liabilities	12	97	8	117
Other financial liabilities at fair value through profit or loss	59	1,429	–	1,488
Total liabilities	142	1,530	8	1,680

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 36

Fair values of financial assets and liabilities continued

Reconciliation of balances in Level 3 of the fair value hierarchy

The following table reconciles the balances in Level 3 of the fair value hierarchy for the Consolidated Entity for the financial year ended 31 March 2012:

	Investment securities available for sale $m	Derivative financial instruments (net replacement values)[2] $m	Total $m
Balance at the beginning of the financial year	224	(7)	217
Purchases	153	6	159
Sales	(2)	–	(2)
Settlements	(6)	–	(6)
Net transfers into/out of Level 3	(1)	8	7
Fair value gains recognised in the income statement[1]	1	2	3
Balance at the end of the financial year	369	9	378
Fair value gains for the period included in the income statement for assets and liabilities held at the end of the financial year end[1]	(7)	3	(4)

[1] The Consolidated Entity employs various economic hedging techniques in order to manage risks, including risks in Level 3 positions. Such techniques may include the purchase or sale of financial instruments that are classified in Levels 1 and/or 2. The realised and unrealised gains and losses for assets and liabilities in Level 3 presented in the table above do not reflect the related realised or unrealised gains and losses arising on economic hedging instruments classified in Levels 1 and/or 2.

[2] The derivative financial instruments in the table above are represented on a net basis. On a gross basis, derivative financial assets are $9 million (2011: $1 million) and derivative liabilities are $Nil million (2011: $8 million).

Note 36

Fair values of financial assets and liabilities continued

Reconciliation of balances in Level 3 of the fair value hierarchy

The following table reconciles the balances in Level 3 of the fair value hierarchy for the Consolidated Entity for the financial year ended 31 March 2011:

	Investment securities available for sale $m	Derivative financial instruments (net replacement values)[2] $m	Total $m
Balance at the beginning of the financial year	115	(12)	103
Purchases	137	–	137
Sales	(15)	–	(15)
Issues	–	(16)	(16)
Settlements	(5)	14	9
Net transfers out of Level 3	(9)	–	(9)
Fair value gains recognised in the income statement[1]	3	7	10
Fair value losses recognised in other comprehensive income[1]	(2)	–	(2)
Balance at the end of the financial year	224	(7)	217
Fair value (losses)/gains for the period included in the income statement for assets and liabilities held at the end of the financial year end[1]	–	1	1

[1] The Consolidated Entity employs various economic hedging techniques in order to manage risks, including risks in Level 3 positions. Such techniques may include the purchase or sale of financial instruments that are classified in Levels 1 and/or 2. The realised and unrealised gains and losses for assets and liabilities in Level 3 presented in the table above do not reflect the related realised or unrealised gains and losses arising on economic hedging instruments classified in Levels 1 and/or 2.

[2] The derivative financial instruments in the table above are represented on a net basis. On a gross basis, derivative financial instruments – positive values are $1 million (2010: $1 million) and derivative financial instruments – negative values are $8 million (2010: $13 million).

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 36

Fair values of financial assets and liabilities continued

Significant transfers between levels of the fair value hierarchy

During the financial year the Consolidated Entity did not have significant transfers between Level 1 and Level 2. Transfers into level 3 were due to the lack of observable valuation inputs for certain securities and investments. Transfers out of level 3 were principally due to valuation inputs becoming observable during the year.

Unrecognised gains

For financial assets and financial liabilities measured at fair value through profit or loss, when the transaction price in a non-active market is different to the fair market value from other observable current market conditions in the same instrument or based on valuation technique whose variables include other data from observable markets, the Consolidated Entity recognises the difference between the transaction price and the fair value in the income statement. In cases where use is made of data which is not observable, profit or loss is only recognised in the income statement when the inputs become observable, or over the life of the instrument.

The table below summarises the deferral and recognition of profit or loss where a valuation technique has been applied for which not all inputs are observable in the market:

	2012 $m	2011 $m
Balance at the beginning of the financial year	2	4
Deferral on new transactions	11	3
Amounts recognised in the income statement during the year	(5)	(5)
Balance at the end of the financial year	8	2

Sensitivity analysis of valuations using unobservable inputs

The table below shows the sensitivity in changing assumptions to reasonably possible alternative assumptions, for those financial instruments for which fair values are determined in whole or in part using valuation techniques such as discounted cashflows, which are based on assumptions that have been determined by reference to historical company and industry experience.

	Favourable changes		Unfavourable changes	
	Profit and loss $m	Equity $m	Profit and loss $m	Equity $m
Product type				**2012**
Equity and equity linked products	2	45	(2)	(23)
Total	2	45	(2)	(23)
Product type				2011
Equity and equity linked products	1	20	(1)	(3)
Total	1	20	(1)	(3)

Note 37

Audit and other services provided by PricewaterhouseCoopers

During the financial year, the auditor of the Company and Consolidated Entity PricewaterhouseCoopers (PwC), and its related practices earned the following remuneration:

	2012 $000's	2011 $000's
PwC – Australian firm		
Audit and review of financial reports of the Company or any entity in the Consolidated Entity	**899**	530
Other audit-related work	**53**	762
Other assurance services	**511**	137
Total audit and other assurance services	**1,463**	1,429
Other advisory services	**111**	317
Taxation	**354**	91
Total remuneration paid to PwC – Australian firm	**1,928**	1,837
Related Practices of PwC Australian Firm (including PwC – Overseas Firms)		
Audit and review of financial reports of the Company or any entity in the Consolidated Entity	**4,749**	3,919
Other audit-related work	**4**	30
Other assurance services	**98**	66
Total audit and other assurance services	**4,851**	4,015
Advisory services	**10**	79
Taxation	**875**	1,282
Total remuneration paid to related practices of PwC – Australian Firm	**5,736**	5,376
Total remuneration paid to PwC (Note 2)	**7,664**	7,213

Use of PwC's services for engagements other than audit and assurance is restricted in accordance with the Company's Auditor Independence policy. These assignments are principally tax compliance and agreed upon assurance procedures in relation to acquisitions.

Certain fees for advisory services are in relation to Initial Public Offerings and due diligence services for new funds. These fees may be recovered by the Consolidated Entity upon the successful establishment of the funds.

It is the Company's policy to seek competitive tenders for all major advisory projects.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 38

Acquisitions and disposals of subsidiaries

Significant entities acquired or consolidated due to acquisition of control:

There were no significant entities or businesses acquired or consolidated due to acquisition of control during the financial year.

Other entities acquired or consolidated due to acquisition of control during the financial year are as follows:

Macquarie Korea Asset Management Co. Limited, Macquarie Real Estate Korea Limited, Regal Capital Advisors LLC, Regal Capital Group LLC and Tax Ease Holdings LLC.

Aggregate details of the above entities or businesses acquired or consolidated due to acquisition of control are as follows:

	2012 $m	2011 $m
Fair value of net assets acquired[1]		
Cash, other financial assets and other assets	119	299
Goodwill and other intangible assets	54	30
Property, plant and equipment	–	2,268
Payables, provisions, borrowings and other liabilities	(94)	(2,185)
Non-controlling interest	(2)	–
Total fair value of net assets acquired	77	412
Consideration		
Cash consideration	48	244
Deferred consideration	2	–
Fair value of previously held interest	27	125
Total consideration	77	369
Net cash flow		
Cash consideration	(47)	(244)
Less:		
Cash and cash equivalents acquired	27	175
Net cash outflow	(20)	(69)

[1] In relation to the acquisition of certain subsidiaries from the Banking Group, assets and liabilities acquired are recognised at carrying amounts. In accordance with the Consolidated Entity's accounting policy, the difference between the fair value of the consideration given over the carrying amounts recognised is recorded directly in reserves. For the year ended 31 March 2012, $3 million (year ended 31 March 2011: $1 million) was recognised in Reserves arising from group restructure of combining entities under common control.

The operating results of the acquisitions have not had a material impact on the results of the Consolidated Entity.There are no significant differences between the fair value of net assets acquired and their carrying amounts, other than goodwill and other intangible assets as noted above.

There are no significant differences between the fair value of net assets acquired and their carrying amounts. The goodwill acquired during the current financial year has arisen due to the value of the businesses acquired over their individual asset values and synergies the Consolidated Entity expects to realise from the acquisitions.

The 31 March 2011 comparatives principally relate to Macquarie AirFinance Limited and Sal. Oppenheim jr. & Cie, being the significant entities and businesses acquired or consolidated due to acquisition of control.

Note 38

Acquisitions and disposals of subsidiaries continued

Significant entities disposed of or deconsolidated due to loss of control:

Macquarie AirFinance Limited

On 1 April 2011, a subsidiary of the Company disposed of its 100 per cent interest in Macquarie AirFinance Limited, an aircraft lessor. This was sold to a subsidiary of the Banking group.

Other entities disposed of or deconsolidated during the period are as follows:

Fifi Investments Limited, Macquarie Finance (India) Private Limited, Macquarie Precision Marketing (Japan) Limited, Macquarie Technology Sevices (Canada) Limited, Municipal and Infrastructure Assurance Corporation, SurePark Pty Limited and Taurus Aerospace Holdings, LLC.

Aggregate details of the above entities disposed of or deconsolidated are as follows:

	2012 $m	2011 $m
Carrying value of assets and liabilities disposed of or deconsolidated		
Cash, other financial assets and other assets	378	3
Goodwill and other intangible assets	37	–
Property, plant and equipment	2,135	512
Payables, provisions, borrowings and other liabilities	2,053	(386)
Total carrying value of assets and liabilities disposed of or deconsolidated	4,603	129
Consideration		
Cash consideration	512	102
Total consideration	512	102
Net cash flow		
Cash consideration	512	102
Less:		
Cash and cash equivalents disposed of or deconsolidated	(211)	–
Net cash inflow	301	102

The 31 March 2011 comparatives relate principally to Macquarie Asset Leasing Trust, being the significant entity disposed of.

Notes to the financial statements for the financial year ended 31 March 2012 continued

Note 39

Company financial information

	2012 $m	2011 $m
Statement of financial position		
Assets		
Current assets	**8,204**	8,007
Non-current assets	**4,950**	6,861
Total assets	**13,154**	14,868
Liabilities		
Current liabilities	**4,655**	4,665
Non-current liabilities	**5,536**	6,271
Total liabilities	**10,191**	10,936
Equity		
Contributed equity	**15,426**	16,219
Foreign currency translation reserve	**(2)**	(2)
Accumulated losses	**(12,461)**	(12,285)
Total equity	**2,963**	3,932

	2012 $m	2011 $m
Statement of comprehensive income		
(Loss)/profit after income tax for the financial year	**(175)**	537
Total comprehensive (expense)/income for the financial year	**(175)**	534

Contingent liabilities

The following details of contingent liabilities exclude derivatives.

	2012 $m	2011 $m
Contingent liabilities exist in respect of:		
Guarantees[1]	**2,169**	2,908
Indemnities	**19**	19
Total contingent liabilities[2]	**2,188**	2,927

1 Guarantees issued by the Company are over subsidiaries of the Consolidated Entity.

2 Contingent liabilities exist in respect of actual and potential claims and proceedings that arise in the conduct of the Company's business. A provision is recognised where some loss is probable and can be reliably estimated. The Company is currently not engaged in any litigation or claim which is likely to have a material adverse effect on the Company's business, financial condition or performance.

Note 40

Events after the reporting date

There were no material events subsequent to 31 March 2012 that have not been reflected in the financial statements.

Macquarie Financial Holdings Limited
Directors' declaration

In the Directors' opinion

(a) the financial statements and notes set out on pages 5 to 81 are in accordance with the *Corporations Act 2001 (Cth)*, including:

   (i) complying with Australian Accounting Standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements; and

   (ii) giving a true and fair view of the Company and Consolidated Entity's financial position as at 31 March 2012 and of its performance, as represented by the results of its operations and its cash flows, for the financial year ended on that date; and

(b) there are reasonable grounds to believe that Macquarie Financial Holdings Limited will be able to pay its debts as and when they become due and payable; and

(c) the financial statements also comply with International Financial Reporting Standards as issued by International Accounting Standards Board.

The Directors have been given the declarations by the chief executive officer and chief financial officer required by section 295A of the *Corporations Act 2001 (Cth)*.

This declaration is made in accordance with a resolution of the Directors.

Robert Upfold
Director

Sydney
31 May 2012

Independent audit report to the members of Macquarie Financial Holdings Limited

pwc

Report on the financial report

We have audited the accompanying financial report of Macquarie Financial Holdings Limited (the Company), which comprises the statement of financial position as at 31 March 2012, and the income statement, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration for the Macquarie Financial Holdings group (the consolidated entity). The consolidated entity comprises the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001 (Cth)* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with *International Financial Reporting Standards*.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error.

In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

Our procedures include reading the other information in the Annual Report to determine whether it contains any material inconsistencies with the financial report.

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

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001 (Cth)*.

Auditor's opinion

In our opinion:

(a) the financial report of Macquarie Financial Holdings Limited is in accordance with the *Corporations Act 2001 (Cth)*, including:

  (i) giving a true and fair view of the consolidated entity's financial position as at 31 March 2012 and of its performance for the year ended on that date; and

  (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001 (Cth)*; and

(b) the financial report and notes also comply with International Financial Reporting Standards as disclosed in Note 1.

PricewaterhouseCoopers

DH Armstrong
Partner

Sydney
31 May 2012

Liability is limited by scheme approved under Professional Standards Legislation