

Australian Ethical Income Fund
ARSN 089 919 120

Annual Financial Report for the year ended 30 June 2019

Australian Ethical Income Fund

Annual Financial Report for the year ended 30 June 2019

Contents	Page
Directors' Report	1
Lead Auditor's Independence Declaration	4
Independent Auditor's Report	5
Statement of Profit or Loss and Other Comprehensive Income	7
Statement of Financial Position	8
Statement of Changes in Equity	9
Statement of Cash Flows	10
Notes to the Financial Statements	11
Directors' Declaration	27

Directors' Report
For the year ended 30 June 2019

The directors of Australian Ethical Investment Limited, the "Responsible Entity" of the Australian Ethical Income Fund (the "Scheme") present the directors' report together with the financial report of the Scheme for the year ended 30 June 2019 and the accompanying independent auditor's report.

Responsible Entity

Australian Ethical Investment Limited (ABN 47 003 188 930) serves as the Responsible Entity for the Scheme. The registered office and principal place of business for the Responsible Entity is:

Registered office:
Boardroom Pty Limited
Grosvenor Place
Level 12, 225 George Street
Sydney NSW 2000

Principal place of business is:

Level 8, 124 - 130 Pitt St
Sydney, NSW 2000

The following persons were directors of Australian Ethical Investment Limited (AEIL) during the period under review and up to the date of this report unless otherwise indicated:

Phil Vernon (resigned 31 August 2019)
Kate Greenhill
Stephen Gibbs
Mara Bun
Michael Monaghan
Julie Orr

Principal activities and state of affairs

The principal activity of the Scheme is to pool investors' savings to invest in interest-bearing investments, in accordance with the investment objectives and guidelines as set out in the current Product Disclosure Statement, and within the provisions of the Scheme's constitution. The constitution of the Scheme authorises investments in a range of assets, which may include short-dated deposits, high grade mortgage-backed securities, State and Commonwealth Government bonds, and bank and corporate bonds. Investments are sought to pursue the goal of a just and sustainable society and the protection of the natural environment as well as providing unitholders (the Scheme investors) with a competitive financial return.

There were no other significant changes in the nature of the Scheme's principal activities during the year and there were no significant changes in the Scheme's state of affairs, except those highlighted in the Review of operations.

Review of operations

Overview

The investments of the Scheme are consistent with those set out in the Scheme's Product Disclosure Statement dated 2 October 2018.

Results

Total return is the percentage change of a unitholder's financial interest in the Scheme assuming all distributions are reinvested in the Scheme. These returns are calculated in accordance with FSC Standard 6 Product Performance Calculation of Return. The Scheme achieved the following total returns for the year:

- Retail class 1.97% (2018: 1.31%); and
- Wholesale class 2.26% (2018: 1.97%).

Directors' Report

For the year ended 30 June 2019

Distributions paid and/or payable

Distributions paid and/or payable by the Scheme during the year are shown in the accompanying Statement of Profit or Loss and Other Comprehensive Income.

As per note 11 the Scheme paid interim distributions to the classes as follows:

- Retail class of 0.79 (December 2017: 0.48) cents per unit;
- Wholesale class of 1.00 (December 2017: 0.77) cents per unit; and
- C class of 1.15 (December 2017: 0.91) cents per unit.

The year end distributions payable are as follows:

- Retail class of 1.44 (June 2018: 0.76) cents per unit;
- Wholesale class of 1.53 (June 2018: 1.12) cents per unit; and
- C class of 1.74 (June 2018: 1.34) cents per unit.

An interim distribution of \$2,031,092 was paid in January 2019 and a final distribution of \$3,074,630 was paid in July 2019.

The prior year final distribution of \$1,891,499 was paid during the period.

Net Assets

The value of the Scheme's net assets attributable to unitholders as at 30 June 2019 was \$174,712,991 (30 June 2018: \$140,399,868).

Fees

Responsible Entity fees charged for the year were as follows:

- 1.00% reduced to 0.50% for the retail class effective 2 October 2018 (2018: 1.00%);
- 0.35% of daily net asset value for the wholesale class (2018: 0.35%); and
- Zero for the C class (2018: Zero).

Likely developments

The Responsible Entity continually reviews the Scheme and depending on that review may, during the course of the financial year, make decisions to change the offerings of products to investors. The Responsible Entity plans to continue to invest in line with the strategy set out in the Product Disclosure Statement.

Events occurring after the reporting date

As the investments in the Scheme are measured at their 30 June 2019 fair values in the financial report, any volatility in values subsequent to the balance date is not reflected in the Statement of Profit or Loss and Other Comprehensive Income or the Statement of Financial Position. However the current value of investments is reflected in the current unit price.

During the period between the end of the financial year and the date of this report, there were no items, transactions or events of a material and unusual nature likely in the opinion of the Responsible Entity, to affect significantly the operations of the Scheme, the results of those operations, or the state of affairs of the Scheme in future financial years.

Indemnities and insurance premiums for the Responsible Entity and auditor

No insurance premiums are paid for out of the assets of the Scheme for insurance cover provided to the Responsible Entity, its officers or auditor of the Scheme. Where the Responsible Entity acts in accordance with the Scheme's constitution and the law, it is generally entitled to an indemnity out of the assets of the Scheme against losses incurred while acting on behalf of the Scheme. The auditor of the Scheme is not indemnified out of the assets of the Scheme.

Australian Ethical Income Fund

Directors' Report

For the year ended 30 June 2019

Rounding of amounts

The Scheme is of a kind referred to in ASIC Corporations Instrument 2016/191, issued by the Australian Securities and Investments Commission, relating to 'rounding off'. Amounts in this report have been rounded off in accordance with that Corporations Instrument to the nearest thousand dollars, or in certain cases, the nearest

Related party disclosures

Fees paid to the Responsible Entity and its associates out of Scheme assets is shown in note 14 of the attached financial statements.

Environmental regulation

The operations of the Scheme are not subject to any particular or significant environmental regulations under Commonwealth, State or Territory legislation.

Auditor's declaration

The auditor's independence declaration is included on page 4 of the annual report and forms part of the Directors' report for the financial year ended 30 June 2019.

Signed in accordance with a resolution of the directors of Australian Ethical Investment Limited.



Stephen Gibbs

Director

Australian Ethical Investment Limited

24 September 2019



Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To the Directors of Australian Ethical Investment Limited, the Responsible Entity
for the Australian Ethical Income Fund:

I declare that, to the best of my knowledge and belief, in relation to the audit of Australian Ethical
Income Fund for the financial year ended 30 June 2019 there have been:

- i. no contraventions of the auditor independence requirements as set out in the
Corporations Act 2001 in relation to the audit; and
- ii. no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

KPMG

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Andrew Reeves
Partner
Sydney
24 September 2019



Independent Auditor's Report

To the unitholders of Australian Ethical Income Fund

Opinion

We have audited the **Financial Report** of Australian Ethical Income Fund (the Scheme).

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

- giving a true and fair view of the Scheme's financial position as at 30 June 2019 and of its financial performance for the year ended on that date; and
- complying with *Australian Accounting Standards* and the *Corporations Regulations 2001*

The **Financial Report** comprises:

- Statement of financial position as at 30 June 2019
- Statement of profit or loss and other comprehensive income, Statement of changes in equity, and Statement of cash flows for the year then ended
- Notes including a summary of significant accounting policies
- Directors' Declaration.

Basis for opinion

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

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

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

Other Information

Other Information is financial and non-financial information in Australian Ethical Income Fund's annual reporting which is provided in addition to the Financial Report and the Auditor's Report. The Directors are responsible for the Other Information.

Our opinion on the Financial Report does not cover the Other Information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the Financial Report, our responsibility is to read the Other Information. In doing so, we consider whether the Other Information is materially inconsistent with the Financial Report or our knowledge obtained in the audit, or otherwise appears to be materially



misstated.

We are required to report if we conclude that there is a material misstatement of this Other Information, and based on the work we have performed on the Other Information that we obtained prior to the date of this Auditor's Report we have nothing to report .

Responsibilities of the Directors for the Financial Report

The Directors of Australian Ethical Investment Limited (the Responsible Entity) are responsible for:

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

Auditor's responsibilities for the audit of the Financial Report

Our objective is:

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

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with *Australian Auditing Standards* will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

A further description of our responsibilities for the audit of the Financial Report is located at the *Auditing and Assurance Standards Board* website at: http://www.auasb.gov.au/auditors_responsibilities/ar4.pdf. This description forms part of our Auditor's Report.

KPMG

Andrew Reeves
Partner
Sydney
24 September 2019

Australian Ethical Income Fund

Statement of Profit or Loss and Other Comprehensive Income for the year ended 30 June 2019

	Note	2019 \$'000	2018 \$'000
Investment income			
Interest	2	7,230	5,834
Net change in fair value of investments	3	<u>(2,772)</u>	<u>(2,797)</u>
Net investment income		<u>4,458</u>	<u>3,037</u>
Operating expenses			
Management fees	14	<u>32</u>	<u>39</u>
Operating expenses before finance costs		<u>32</u>	<u>39</u>
Profit from operating activities		4,426	2,998
Finance costs			
Distributions paid and payable to unitholders of the Scheme	11	<u>(5,106)</u>	<u>(3,161)</u>
Change in net assets attributable to unitholders (total comprehensive income)	5	<u><u>(680)</u></u>	<u><u>(163)</u></u>

The accompanying notes form part of these financial statements.

Australian Ethical Income Fund

Statement of Financial Position as at 30 June 2019

	Note	2019 \$'000	2018 \$'000
Assets			
Cash and cash equivalents	6	2,428	525
Receivables	7	1,250	844
Term deposits	8	10,207	12,946
Financial assets held at fair value through profit or loss	9	163,903	128,037
Total assets		177,788	142,352
Liabilities			
Payables	10	-	61
Distribution payable	11	3,075	1,891
Total liabilities		3,075	1,952
Net assets attributable to unitholders	5	174,713	140,400
Represented by:			
Net assets attributable to unitholders at Net Asset Value price		177,803	142,367
Distribution payable to unitholders of the scheme		(3,075)	(1,891)
Adjustments arising from different unit pricing and accounting valuation		(15)	(76)
Total net assets attributable to unitholders	5	174,713	140,400

The accompanying notes form part of these financial statements.

Australian Ethical Income Fund

Statement of Changes in Equity for the year ended 30 June 2019

The Scheme's net assets attributable to unitholders are classified as a liability under AASB 132 '*Financial Instruments: Presentation*'. As such the Scheme has no equity and no items of changes in equity at the start and end of the year.

The accompanying notes form part of these financial statements.

Australian Ethical Income Fund

Statement of Cash Flows for the year ended 30 June 2019

	Note	2019 \$'000	2018 \$'000
Cash flows from operating activities			
Interest received		6,825	5,901
Management fees paid		(32)	(39)
Net cash provided by operating activities	13	6,793	5,862
Cash flows from investing activities			
Proceeds from sale of investments		153,483	100,500
Purchase of investments		(189,381)	(147,883)
Net cash used in investing activities		(35,898)	(47,383)
Cash flows from financing activities			
Proceeds from issue of units		81,130	70,623
Payments for redemption of units		(50,081)	(30,918)
Distributions paid to unitholders		(41)	(28)
Net cash provided by financing activities		31,008	39,677
Net (decrease)/increase in cash and cash equivalents		1,903	(1,844)
Cash and cash equivalents at 1 July		525	2,369
Cash and cash equivalents at 30 June	6	2,428	525

The accompanying notes form part of these financial statements.

Notes to the Financial Statements for the year ended 30 June 2019

Note 1 - Significant accounting policies

Reporting entity

The Australian Ethical Income Fund ("the Scheme"), a for-profit entity, is a registered managed investment scheme under the Corporations Act 2001. The Scheme was constituted on 2 November 1999 and will terminate on 1 November 2079 unless terminated earlier in accordance with the provisions of the Scheme constitution. The Scheme is domiciled in Australia. The financial statements of the Scheme are for the year ended 30 June 2019.

Statement of compliance

The financial statements are general purpose financial statements which have been prepared in accordance with Australian Accounting Standards (AASBs) adopted by the Australian Accounting Standards Board (AASB) and the Corporations Act 2001. The financial statements of the Scheme complies with International Financial Reporting Standards (IFRSs) and interpretations adopted by the International Accounting Standards Board (IASB).

The financial statements were approved by the Board of Directors of the Australian Ethical Investment Limited on 24 September 2019.

Basis of preparation

These financial statements are presented in Australian dollars which is the functional currency and are prepared on a fair value basis with financial assets designated at fair value through profit or loss and derivatives measured at fair value, with the exception of receivables and payables which are measured at cost.

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

The Statement of Financial Position is prepared on a liquidity basis. All balances including investments are readily converted to cash.

Estimates and judgements

The preparation of financial statements requires the use of accounting estimates which, by definition, will seldom equal the actual results. Management also needs to exercise judgement in applying the Scheme's accounting policies.

Estimates and judgements are continually evaluated and are based on historical experience and other factors including expectations of future events that may have a financial impact on the Scheme and are believed to be reasonable under the circumstances.

Refer to note 15(g) Financial risk management and financial instruments - fair values, which contains information about estimation of fair values of financial instruments.

Cash and cash equivalents

Cash and cash equivalents comprise deposits with banks and highly liquid financial assets with maturities of three months or less from the date of acquisition that are subject to an insignificant risk of changes in their fair value and are used by the Scheme in the management of short-term commitments.

Financial instruments

Financial instruments comprise financial assets held at fair value through profit or loss, receivables, cash and cash equivalents, payables, and distributions payable.

Recognition and initial measurement

A financial instrument is recognised when the Scheme becomes a party to the contractual provisions of the instrument. Purchase and sales of financial assets are accounted for at trade date (i.e. the date the Scheme commits itself to purchase or sell the asset).

Financial assets and liabilities at fair value through profit or loss are recognised initially at fair value, with transaction costs recognised in the Statement of Profit or Loss and Other Comprehensive Income. Financial assets and liabilities not at fair value through profit or loss are initially recognised at fair value plus any directly attributable transaction costs.

Notes to the Financial Statements for the year ended 30 June 2019

Note 1 - Significant accounting policies - continued

Financial instruments - continued

Derecognition

The Scheme derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Scheme neither transfers nor retains substantially all of the risks and rewards of ownership and does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset that is derecognised) and the consideration received (including any new asset obtained less any new liability assumed) is recognised in profit or loss. Any interest in such transferred financial assets that is created or retained by the Scheme is recognised as a separate asset or liability.

The Scheme derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

Classification

Policy applicable until 30 June 2018

Financial assets and financial liabilities that are classified as fair value through profit or loss are further categorised as either held for trading or are designated at fair value through profit or loss. Financial assets and liabilities held for trading include derivative financial instruments. Financial assets and liabilities designated at fair value through profit or loss include equity securities, investments in unit trusts and fixed interest securities.

Policy applicable from 1 July 2018

On initial recognition a financial asset is classified as measured at amortised cost, fair value through profit or loss, or fair value through other comprehensive income debt or equity instrument. Financial liabilities are classified as measured at amortised cost or fair value through profit or loss.

Measurement

Subsequent to initial recognition, all instruments classified at fair value through profit or loss are measured at fair value with changes in their fair value recognised in the Statement of Profit or Loss and Other Comprehensive Income. All other financial instruments are carried at amortised cost using the effective interest rate method less any recognised impairment.

Financial liabilities arising from redeemable units issued by the Scheme are carried at the redemption amount representing the unitholders' rights to the residual interest in the Scheme's assets, effectively the fair value at the reporting date.

Fair value measurement principles

The Scheme can invest into a variety of assets, including cash, equities, fixed and floating rate interest securities, unit trusts and derivative contracts. Generally, valuation information is obtained from third party industry standard service providers to ensure that the most recent security prices are obtained. The prices used to value investments include, but are not limited to:

- independent prices obtained for each security; and
- quoted 'bid' prices on long securities.

For certain investments, prices cannot be obtained from the above sources. In these instances, valuations obtained from service providers are estimated through the use of valuation models which are consistent with accepted industry practice and incorporate the best available information regarding assumptions that market participants would use when pricing the assets or liabilities. Irrespective of the method used by third party industry standard service providers to obtain valuations, prices achieved in actual transactions may be different.

Impairment of financial assets held at amortised cost

Policy applicable until 30 June 2018

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss. If an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, then the decrease in impairment loss is reversed through profit or loss.

Policy applicable from 1 July 2018

AASB 9 replaces the 'incurred loss' model in AASB 139 with an 'expected credit loss' model. The new 'expected credit loss' model applies to financial assets measured at amortised cost, contract assets and debt instruments, but not equity instruments held at fair value through profit or loss. Under AASB 9 credit losses are recognised earlier than under AASB 139.

The financial assets at amortised cost consists of trade receivables and cash and cash equivalents.

Notes to the Financial Statements for the year ended 30 June 2019

Note 1 - Significant accounting policies - continued

Financial instruments - continued

Offsetting

Financial assets and liabilities are offset and the net amount reported in 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 asset and settle the liability simultaneously.

Derivative financial instruments

In accordance with the Investment Mandate, the Scheme may invest in derivative financial instruments to gain or hedge exposure to equities, interest rates or foreign currencies. Derivative financial instruments are recognised initially at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the Statement of Profit or Loss and Other Comprehensive Income.

Receivables

Receivables are carried at amortised cost and may include accrued income and other receivables such as Reduced Input Tax Credits (RITC).

Payables

Payables are carried at amortised cost and may include amounts for unsettled purchases, accrued expenses and other payables such as GST and redemption monies owing by the Scheme. Unsettled purchases are amounts due to brokers for securities purchased that have not been paid at reporting date. Trades are recorded on trade date and normally settle within three business days. Accrued expenses include management fees payable.

Distributions paid and payable

In accordance with the Constitution, the Scheme fully distributes its net income to unitholders. The distributions are determined by reference to the net taxable income of the Scheme. Distributable income includes capital gains arising from the disposal of investments. Unrealised gains and losses are transferred to net assets attributable to unitholders and are not assessable or distributable until realised. Realised capital losses are not distributed to unitholders but are retained to be offset against any future realised capital gains. Distributions paid and payable to unitholders are recognised in the Statement of Profit or Loss and Comprehensive Income as 'Finance costs'.

From 1 July 2017 the Scheme elected into the new tax regime for managed investment trusts (MITs). Responsible Entity's of eligible MITs who elect into the new attribution managed investment trust (AMIT) regime are required to calculate the income entitlements of unitholders on an 'attribution' basis, which will be reflected in the AMIT member annual (AMMA) statement. The AMMA statement (previously the tax statement) is provided to each person or entity who received a distribution from the Scheme during the income year. This event has no impact on the classification of net assets attributable to unitholders as liabilities in the financial statements.

Change in net assets attributable to unitholders

Change in net assets attributable to unitholders may consist of realised net capital losses and unrealised increments and decrements arising from fluctuations in the value of investments. They are included in the determination of distributable income when assessable for taxation purposes.

Revenue

Interest income

Interest income is recognised in the Statement of Profit or Loss and Other Comprehensive Income as it accrues. Interest income is recognised on a gross basis, including withholding tax, if any. Interest is measured using the effective interest rate method.

Income tax

Under current income tax legislation the Scheme is not liable to pay income tax as the net income of the Scheme is assessable in the hands of the beneficiaries (the unitholders). The income of the Scheme is to be attributed to unitholders in accordance with the Scheme Constitution which requires the distribution of the net accounting income for the year.

Notes to the Financial Statements for the year ended 30 June 2019

Note 1 - Significant accounting policies - continued

Income tax - continued

Deferred taxes have not been recognised in the financial statements in relation to differences between the carrying amounts of assets and liabilities and their respective tax bases, including taxes on capital gains which could arise in the event of a sale of investments for the amount at which they are stated in the financial statements. In the event that taxable gains are realised by the Scheme, these gains would be included in the taxable income that is assessable in the hands of the unitholders as noted above.

Realised capital losses are not distributed to unitholders but are retained within the Scheme to be offset against any realised capital gains. The benefit of any carried forward capital losses are also not recognised in the financial statements. If in any period realised capital gains exceed realised capital losses, including those carried forward from earlier periods and eligible for offset, the excess is included in taxable income that is assessable in the hands of unitholders in that period and is distributed to unitholders in accordance with the requirements of the Scheme's Constitution.

Net assets attributable to unitholders

In accordance with AASB 132, unitholders' funds are classified as a financial liability and disclosed as such in the Statement of Financial Position, being referred to as 'Net assets attributable to unitholders'. The units can be put back to the Scheme at any time for cash equal to the proportionate share of the Scheme's net asset values. The value of redeemable units is measured at the redemption amount that is payable (based on the redemption unit price) at the Statement of Financial Position date if unitholders exercised their right to put the units back to the Scheme. Changes in the value of this financial liability are recognised in the Statement of Profit or Loss and Other Comprehensive Income.

Expenses

All expenses, including management fees, are recognised in the profit or loss on an accruals basis.

Standards and interpretations on issue not yet adopted

Certain new accounting standards and interpretations have been published that are not mandatory for the 30 June 2019 reporting period and have not been early adopted by the Scheme.

Standards and interpretations on issue recently adopted

The assessment of the impact of these new standards (to the extent relevant to the Scheme) and interpretations is set out below:

AASB 9 Financial Instruments (effective for reporting periods beginning on or after 1 July 2018)

AASB 9 replaces existing guidance on classification and measurement of financial assets and introduces additions related to the classification and measurement of financial liabilities (as part of the project to replace AASB 139 Financial Instruments: Recognition and Measurement). It has also introduced new hedge accounting requirements and revised certain requirements for impairment of financial assets. The Responsible Entity is satisfied this standard does not have any impact on the recognition and measurement of the Scheme's financial instruments as they are carried at fair value through profit or loss. The de-recognition rules have not been changed from previous requirements and the Scheme does not apply hedge accounting.

AASB 15 Revenue from Contracts with Customers (effective for reporting periods beginning on or after 1 July 2018)

The AASB has issued a new standard for the recognition of revenue. This will replace AASB 118 which covers contracts for goods and services and AASB 111 which covers construction contracts. The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing notion of risks and rewards. The Scheme's main sources of income are interest, dividends and gains on financial instruments held at fair value. All of these are outside the scope of the new revenue standard. As a consequence, the Responsible Entity is satisfied the adoption of the new revenue recognition rules does not have any impact on the recognition and measurement of the Scheme's revenue.

Australian Ethical Income Fund

Notes to the Financial Statements for the year ended 30 June 2019

Note 2 - Interest income	2019	2018
	\$'000	\$'000
Interest income from securities designated at fair value through profit or loss	6,882	5,446
Interest income from financial assets carried at amortised cost:		
Bank interest	44	44
Term deposits	304	344
	7,230	5,834

Note 3 - Net change in fair value of investments

Unrealised gain/(loss) arising on financial assets designated as at fair value through profit or loss	(18)	(98)
Realised loss arising on the disposal of investments	(2,754)	(2,699)
Net change in fair value of financial assets	(2,772)	(2,797)

Note 4 - Issued units

Each unit represents a right to an individual share in the Scheme per the Constitution. C-class units are issued to other schemes managed by the Responsible Entity and the Australian Ethical Retail Superannuation Fund (AERSF), and are not charged a Responsible Entity fee. All other rights attached to C-class units are the same as those of the other classes.

<i>Retail class</i>	2019	2018
	Units	Units
On issue at beginning of period	1,486,764	1,513,970
Issued	182,783	207,349
Transferred to other classes	(90,964)	(50,534)
Redeemed	(212,974)	(184,021)
On issue at period end	1,365,609	1,486,764

Wholesale class

On issue at beginning of period	6,531,497	6,609,127
Issued	778,160	1,626,499
Transferred from other classes	90,851	50,468
Redeemed	(1,017,496)	(1,754,597)
On issue at period end	6,383,012	6,531,497

C class

On issue at beginning of period	134,664,863	92,207,753
Issued	84,816,045	71,735,470
Redeemed	(49,168,555)	(29,278,360)
On issue at period end	170,312,353	134,664,863

Note 5 - Net assets attributable to unitholders

The Scheme manages its net assets attributable to unitholders as capital, notwithstanding net assets attributable to unitholders are classified as a liability. The amount of net assets attributable to unitholders can change significantly on a daily basis as the Scheme is subject to daily applications and redemptions at the discretion of unitholders. Daily applications and redemptions are reviewed relative to the liquidity of the Scheme's underlying assets on a daily basis by the Responsible Entity. Under the terms of the Scheme's Constitution, the responsible entity has the discretion to reject an application for units and to defer a redemption of units if the exercise of such discretion is in the best interest of the unitholders.

The objective of the Scheme is to provide unitholders with returns in accordance with the Product Disclosure Statement. The Scheme aims to generate an income stream consistent with prevailing short-term interest rates while minimising the risk of capital loss. The Scheme is not subject to any externally imposed capital requirements.

Australian Ethical Income Fund

Notes to the Financial Statements for the year ended 30 June 2019

Note 5 - Net assets attributable to unitholders - continued

	2019	2018
	\$'000	\$'000
Opening balance	140,400	98,684
Issued	81,130	70,623
Distributions reinvested	3,882	2,235
Redeemed	(50,019)	(30,979)
Change in net assets attributable to unitholders	(680)	(163)
Total net assets attributable to unitholders	174,713	140,400

Note 6 - Cash and cash equivalents

Cash at bank	2,428	525
	2,428	525

Cash at bank earns interest at floating rates based on daily bank deposit rates. Cash includes cash at bank and cash on deposit.

Note 7 - Receivables

Interest	1,249	843
GST	1	1
	1,250	844

Note 8 - Term deposits

Term deposits	10,207	12,946
	10,207	12,946

Term deposits mature between 1 and 12 months.

Note 9 - Financial assets at fair value through profit or loss

Designated at fair value through profit or loss			Note
Interest bearing securities			
Government securities		84,890	47,341
Notes/debt instruments unsecured		79,013	80,696
	15	163,903	128,037

The Scheme's accounting policy on fair value measurements is disclosed in note 1.

Note 10 - Payables

Redemptions	-	61
	-	61

Note 11 - Distributions paid and payable

Distributions paid during the year	2,031	1,270
Distributions payable	3,075	1,891
	5,106	3,161

The Scheme paid interim distributions to the classes as follows:

- Retail class of 0.79 (December 2017: 0.48) cents per unit;
- Wholesale class of 1.00 (December 2017: 0.77) cents per unit; and
- C class of 1.15 (December 2017: 0.91) cents per unit.

Australian Ethical Income Fund

Notes to the Financial Statements for the year ended 30 June 2019

Note 11 - Distributions paid and payable - continued

The year end distributions payable are as follows:

- Retail class of 1.44 (June 2018: 0.76) cents per unit;
- Wholesale class of 1.53 (June 2018: 1.12) cents per unit; and
- C class of 1.74 (June 2018: 1.34) cents per unit.

The prior year final distribution of \$1,891,499 was paid during the period.

Note 12 - Auditor's remuneration

Audit and tax fees in relation to the Scheme are paid directly by the Responsible Entity. During the year the following fees were paid or payable by the Responsible Entity for services in relation to the audit of the Scheme.

	2019	2018
	\$	\$
Financial statements audit fees	10,250	10,608
Compliance plan audit	4,569	4,371
Tax compliance service	4,724	3,984
	19,543	18,963

Note 13 - Reconciliation of profit for the period to net cash provided by operating activities

	2019	2018
	\$'000	\$'000
Net profit from operating activities	4,426	2,998
Adjustments for:		
Net losses on disposal of investments	2,754	2,699
Net gains/(losses) on revaluation of investments	18	98
Changes in assets and liabilities:		
Decrease/(Increase) in income and other receivables	(405)	67
Net cash provided by operating activities	6,793	5,862

Non-cash financing and investing activities

During the year income distributions totalling \$3,881,923 (2018: \$2,235,258) were reinvested by unitholders for additional units in the Scheme.

Note 14 - Related party disclosures

Australian Ethical Investment Limited (AEIL), as Responsible Entity of each Scheme, provides investment services for the Scheme in accordance with each Scheme's constitution. Transactions with the Responsible Entity are undertaken on commercial terms and conditions.

The Scheme does not employ personnel in its own right. However it is required to have an incorporated Responsible Entity to manage the activities of the Scheme and this is considered the key management personnel.

Notes to the Financial Statements for the year ended 30 June 2019

Note 14 - Related party disclosures - continued

The following persons were directors of Australian Ethical Investment Limited during the whole of the financial year and up to the date of this report unless otherwise indicated:

Phil Vernon (resigned 31 August 2019)
 Kate Greenhill
 Stephen Gibbs
 Mara Bun
 Michael Monaghan
 Julie Orr

None of the directors have an investment in the Scheme.

There were no other persons with responsibility for planning, directing and controlling the activities of the Scheme, directly and indirectly during or since the end of the financial year.

The Responsible Entity earns fees for the management and administration of the Scheme. Responsible Entity fees charged for the year were as follows:

- 1.00% reduced to 0.50% for the retail class effective 2 October 2018 (2018: 1.00%);
- 0.35% of daily net asset value for the wholesale class (2018: 0.35%); and
- Zero for the C class (2018: Zero).

	2019	2018
	\$	\$
Management fees	31,562	38,687
	31,562	38,687

Fees payable to the Responsible Entity at 30 June 2019 were \$427 (2018: \$221) and are included in payables.

Australian Ethical Superannuation Pty Ltd (ABN 43 079 259 733), a subsidiary of AEIL, is the Trustee of the Australian Ethical Retail Superannuation Fund (AERSF). Transactions with the AERSF are undertaken on commercial terms and conditions.

Australian Ethical Income Fund

Notes to the Financial Statements for the year ended 30 June 2019

Note 14 - Related party disclosures - continued

Parties related to the Scheme held units in the Scheme (C class) as follows:

30 June 2019	Units held opening	Units held closing	Interest held	Units acquired	Distributions paid/payable by the Scheme
	\$	\$	%	\$	\$
AERSF	86,009,434	97,368,638	55.70%	11,685,518	2,836,313
Australian Ethical Balanced Fund	46,496,556	69,839,195	39.95%	23,573,493	2,074,770
30 June 2018	Units held opening	Units held closing	Interest held	Units acquired	Distributions paid/payable by the Scheme
	\$	\$	%	\$	\$
AERSF	69,300,352	86,009,434	61.27%	16,778,938	1,897,691
Australian Ethical Balanced Fund	21,393,382	46,496,556	33.12%	25,204,743	1,117,486

Distributions paid/payable to related parties represent those distributions that accrued during the current financial year.

Note 15 - Financial risk management and financial instruments

The Responsible Entity recognises that risk is part of doing business and that the ongoing management of risk is critical to its success. The approach to managing risk is articulated in the Risk Management Strategy and the Risk Appetite Statement. The Chief Risk Officer is responsible for the design and maintenance of the risk and compliance framework, establishing and maintaining group wide risk management policies, and providing regular risk reporting to the Audit, Risk & Compliance Committee (ARC). The Board regularly monitors the overall risk profile of the Responsible Entity and sets the risk appetite, usually in conjunction with the annual planning process.

The Board is responsible for ensuring that management has appropriate processes in place for managing all types of risk. To assist in providing ongoing assurance and comfort to the Board, responsibility for risk management oversight has been delegated to the ARC. The main functions of the Committee are to identify emerging risks, determine treatment and monitor current and emerging risks. In addition, the Committee is responsible for seeking assurances from management that:

- the systems and policies in place to assist the Responsible Entity to meet and monitor its risk management responsibilities contain appropriate, up-to-date content and are being maintained;
- the Responsible Entity is complying with its Licences, and the regulatory requirements relevant to its roles as fund manager; and
- there is a structure, methodology and timetable in place for monitoring material service providers.

The Scheme is exposed to a variety of financial risks from investments in financial instruments, including operational risk, market risk, credit risk and liquidity risk. This note presents information about the Scheme's exposure to each of the above risks, the Scheme's objectives, policies and processes for measuring and managing risks and the management of unitholder funds.

Notes to the Financial Statements for the year ended 30 June 2019

Note 15 - Financial risk management and financial instruments - continued

(a) Categories of financial instruments	2019	2018
<i>Financial assets</i>	\$'000	\$'000
Cash and cash equivalents	2,428	525
Fair value through profit or loss (FVTPL)	163,903	128,037
Term deposits held at amortised cost	10,207	12,946
Receivables	1,250	844
	<u>177,788</u>	<u>142,352</u>
 <i>Financial liabilities</i>		
Other financial liabilities		
Payables	-	61
Distribution payable	3,075	1,891
Net assets attributable to unitholders	<u>174,713</u>	<u>140,400</u>
	<u>177,788</u>	<u>142,352</u>

(b) Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the processes, technology and infrastructure supporting the Scheme's activities with financial instruments, either internally within the Scheme or externally at the Scheme's service providers.

The Scheme's objective is to manage operational risk so as to balance the limiting of financial losses and damage to its reputation with achieving its investment objective of generating returns to investors.

This responsibility is supported by the development of overall standards for the management of operational risk, which encompasses the controls and processes at the service providers and the establishment of service levels with the service providers, in the following areas:

- requirements for:
 - appropriate segregation of duties between various functions, roles and responsibilities;
 - reconciliation and monitoring of transactions; and
 - periodic assessment of operational risk faced;
- documentation of controls and procedures;
- the adequacy of controls and procedures to address the risks identified;
- compliance with regulatory and other legal requirements;
- development of contingency plans;
- training and professional development;
- ethical and business standards; and
- risk mitigation, including insurance.

Assessment of the adequacy of the controls and processes in place at the service providers with respect to operational risk is carried out via regular discussions, monthly/quarterly KPI's, incident reporting, monitoring visits and a review of the service providers' Controls Reports (GS007) on internal controls.

All of the assets of the Scheme are held by external custodian National Australia Bank Limited Asset Servicing (NAS). The Fund Accounting team monitors the credit ratings and capital adequacy of its custodian on a quarterly basis.

(c) Financial risk management objectives

The Scheme is exposed to a number of risks due to the nature of its activities as further set out in its Product Disclosure Statement. These risks include market risk (including currency risk, interest rate risk and price risk), credit risk, and liquidity risk. The Scheme's objective in managing these risks is the protection and enhancement of unitholder value.

The Scheme's risk management policies are approved by the Responsible Entity and seek to minimise the potential adverse effects of these risks on the Scheme's financial performance. The risk management system is an ongoing process of identification, measurement, monitoring and controlling risk.

Notes to the Financial Statements for the year ended 30 June 2019

Note 15 - Financial risk management and financial instruments - continued

(c) Financial risk management objectives - continued

The Responsible Entity Board oversee the processes which govern the investment of money of the Scheme for which Australian Ethical Investment Limited is the responsible entity. The Board bears primary responsibility for the oversight of processes for the management of the above financial risks. It meets on a regular basis to analyse financial risk exposure and to evaluate management strategies in the context of the most recent economic conditions and forecasts.

(d)(i) Market risk

Market risk is the risk that the fair value of future cash flows or a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: foreign exchange (currency risk), market interest rates (interest rate risk) and market prices (price risk). The portfolio manager manages the financial risks relating to the operations of the Scheme in accordance with an investment mandate set out in accordance with the Scheme's constitution and Product Disclosure Statement. The Scheme's investment mandate is to invest in a diversified portfolio of interest-bearing investments. There has been no change to the Scheme's exposure to market risks or the manner in which it manages and measures the risk.

(d)(ii) Interest rate risk management

Interest rate risk represents the risk that the Scheme's financial performance will be adversely affected by fluctuations in interest rates.

The exposure the Scheme has to interest rate changes is investing in interest rate sensitive financial assets such as cash deposits, loans, notes and mortgage backed securities, with counterparties. The returns from these investments are exposed to variations in prevailing interest rates and are dependent upon the prevailing interest rate offered and other market conditions. The risk is managed by the Scheme by maintaining an appropriate mix between fixed and floating rate borrowings.

The Scheme's interest rate risk is managed on a daily basis by the portfolio managers in accordance with the defined investment process and within the guidelines and restrictions outlined in the Scheme's investment mandate. The Scheme is monitored for mandate compliance. Where the interest rate risk exposure moves outside the Scheme's mandate restrictions or guidelines, the portfolio managers will rebalance the portfolios.

The Scheme's exposures to interest rates on financial assets and financial liabilities are detailed in liquidity risk management (see note 15(f)).

Management has performed a sensitivity analysis relating to the Scheme's exposure to interest rate risk at balance sheet date. This sensitivity analysis demonstrates the effect on the current year results and net assets attributable to unitholders which could result from a change in interest rates by 1% (2018: 1%). In the analysis it is assumed that the amount of financial assets exposed to fluctuations in interest rates as at balance sheet date is representative of balances held throughout the financial year. No other flow on effects of fluctuations in interest rates have been taken into account.

At balance date, the effect on profit and net assets attributable to unitholders, as a result of changes in the interest rate, with all other variables remaining constant would be as follows:

	2019	2018
	\$'000	\$'000
Increase in interest rate by 1%	(349)	(134)
Decrease in interest rate by 1%	349	134

Notes to the Financial Statements for the year ended 30 June 2019

Note 15 - Financial risk management and financial instruments - continued

(d)(iii) Price risk - continued

Price risk is the risk that the total value of investments will fluctuate as a result of changes in market prices, whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in the market. The Scheme has investments in floating rate instruments and bonds which exposes it to price risk. The investment manager manages the Scheme's market risk on a monthly basis in accordance with the Scheme's investment objectives and policies.

The Schemes' price risk is managed on a daily basis by the portfolio managers in accordance with the defined investment process and within the guidelines and restrictions outlined in the Schemes' investment mandates. The Schemes are monitored for mandate compliance. Where the price risk exposure moves outside the Schemes' mandate restrictions or guidelines, the portfolio managers will rebalance the portfolios.

As the majority of the Scheme's financial instruments are carried at fair value with changes in fair value recognised in the Statement of Profit or Loss and Other Comprehensive Income, all changes in market conditions will directly affect investment income.

Management has performed a sensitivity analysis relating to the Scheme's exposure to price risk at the balance sheet date. This sensitivity analysis demonstrates the effect on current year results and net assets attributable to unitholders which could result from a change in market prices of 10% (2018: 10%) driven by change in the underlying yield of the financial assets. In the analysis it is assumed that the amount of financial assets exposed to fluctuations in market prices as at the balance sheet date is representative of balances held throughout the financial year. No other flow on effects or fluctuations in fair value have been taken into account.

At balance date, the effect on net assets attributable to unitholders and the change in net assets attributable to unitholders as a result of changes in market prices with all other variables remaining constant would be as follows:

	2019	2018
	\$'000	\$'000
Increase in market prices by 10%	16,390	12,804
Decrease in market prices by 10%	(16,390)	(12,804)

(e)(i) Management and exposure to credit risk

Credit risk is the risk of financial loss from a counterparty failing to meet its contractual commitments. The Scheme is predominately exposed to credit risk through its interest bearing securities, deposits at banks and Income and other receivables.

The Scheme's policy over credit risk is to minimise its exposure to counterparties, holding cash and cash equivalents at financial institutions with a credit rating of 'A' or higher and settling income and other receivables on a monthly basis.

In order to manage the exposure to risk, limitations are imposed on the level of unrated securities that can be held (no more than 2.5%), the total value of securities with a rating of less than BBB (no more than 40%), and no single investment is to exceed 10% of the value of the Fund.

At the balance sheet date, all cash was held with National Australia Bank, which carries a Standard & Poor's rating of AA- at 30 June 2019 (2018: AA-).

No financial assets carried at amortised cost were past due or impaired at 30 June 2019 (2018: nil).

The maximum credit risk exposure is represented by the respective carrying amounts of the relevant financial asset in the Statement of Financial Position.

Notes to the Financial Statements for the year ended 30 June 2019

Note 15 - Financial risk management and financial instruments - continued

(e)(i) Management and exposure to credit risk - continued

The table below details the maximum exposure to credit risk for the assets held by the Scheme.

Cash and cash equivalents	2,428	525
Receivables	1,250	844
Interest bearing securities	163,903	128,037
Term deposits	10,207	12,946
	<u>177,788</u>	<u>142,352</u>

(e)(ii) Investments in interest bearing securities, loans and receivables

At 30 June the Scheme was invested in interest bearing securities, loans and receivables with the following credit quality ratings:

	2019	2018
Rating	%	%
AAA/ AA	72%	71%
A	6%	10%
BBB	21%	18%
Unrated	1%	1%
	<u>100%</u>	<u>100%</u>

(f) Liquidity risk management

Liquidity risk is the risk that the Scheme will encounter difficulty in realising assets or otherwise raising funds to meet commitments associated with financial instruments.

The Scheme is exposed to daily cash redemptions of redeemable units. Therefore, the approach to managing liquidity is for the Scheme to invest a significant portion of their funds in financial instruments which under normal market conditions are readily convertible into cash (for example, the Scheme's fixed interest securities). As a result, there is a risk that the Scheme may not be able to liquidate all of these investments at their fair value in order to meet its liquidity requirements. In the event of significant redemptions, the Scheme has the ability to suspend redemptions until it can realise investments to meet the redemptions.

All payables of the Scheme are classed as normal operating obligations and are to be paid within one month of balance date.

Australian Ethical Income Fund

Notes to the Financial Statements for the year ended 30 June 2019

Note 15 - Financial risk management and financial instruments - continued

(f) Liquidity risk management - continued

The table below details the financial instrument composition and maturity analysis.

	Weighted average interest rate %	2019				Total \$'000
		0-3 months	3 months to 1 year	1 to 5 years	5+ years	
		\$'000	\$'000	\$'000	\$'000	
Variable interest-bearing assets						
Cash and cash equivalents	1.38	2,428	-	-	-	2,428
Financial assets	3.47	30,153	78,906	51,751	3,094	163,904
Fixed interest rate instruments						
Term deposits	2.43	2,027	8,179	-	-	10,206
Other non-interest bearing						
Receivables	N/A	1,250	-	-	-	1,250
Total financial assets		35,858	87,085	51,751	3,094	177,788
Non-interest bearing						
Payables	N/A	-	-	-	-	-
Distribution payable	N/A	3,075	-	-	-	3,075
Amounts payable to unitholders	N/A	174,713	-	-	-	174,713
Total financial liabilities		177,788	-	-	-	177,788
	Weighted average interest rate %	2018				Total \$'000
		0-3 months	3 months to 1 year	1 to 5 years	5+ years	
		\$'000	\$'000	\$'000	\$'000	
Variable interest-bearing assets						
Cash and cash equivalents	1.40	525	-	-	-	525
Financial assets	3.41	17,106	48,255	59,613	3,063	128,037
Fixed interest rate instruments						
Term deposits	2.62	6,981	5,965	-	-	12,946
Other non-interest bearing						
Receivables	N/A	844	-	-	-	844
Total financial assets		25,456	54,220	59,613	3,063	142,352
Non-interest bearing						
Payables	N/A	61	-	-	-	61
Distribution payable	N/A	1,891	-	-	-	1,891
Amounts payable to unitholders	N/A	140,400	-	-	-	140,400
Total financial liabilities		142,352	-	-	-	142,352

Notes to the Financial Statements for the year ended 30 June 2019

Note 15 - Financial risk management and financial instruments - continued

(g) Fair values

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

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

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

Level 3: Derived from valuation techniques that include inputs for the asset or liability that is not based on observable market data (unobservable inputs). This category includes instruments valued using quoted prices in active markets for similar instruments, quoted prices for identical or similar instruments in markets that are considered less than active or other valuation techniques.

	2019			Total \$'000
	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	
Financial assets at fair value through profit or loss				
Designated at fair value through profit or loss				
Interest bearing securities				
Government Securities	66,218	18,672	-	84,890
Notes/debt instruments unsecured	1,594	77,419	-	79,013
	<u>67,812</u>	<u>96,091</u>	<u>-</u>	<u>163,903</u>
	2018			Total \$'000
	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	
Financial assets at fair value through profit or loss				
Designated at fair value through profit or loss				
Interest bearing securities				
Government Securities	34,781	12,560	-	47,341
Notes/debt instruments unsecured	1,573	79,123	-	80,696
	<u>36,354</u>	<u>91,683</u>	<u>-</u>	<u>128,037</u>

The fund does not hold any level 3 assets. During the year there was no transfers between levels.

Carrying amounts versus fair value

The fair values of financial assets and liabilities approximates their carrying amounts in the Statement of Financial Position.

Note 16 - Contingencies and commitments

There are no contingent assets or liabilities or commitments as at 30 June 2019 (2018: Nil).

Notes to the Financial Statements for the year ended 30 June 2019

Note 17 - Events subsequent to the reporting date

As the investments in the Scheme are measured at their 30 June 2019 fair values in the financial report, any volatility in values subsequent to the balance date is not reflected in the Statement of Profit or Loss and Other Comprehensive Income or the Statement of Financial Position. However the current value of investments is reflected in the current unit price.

During the period between the end of the financial year and the date of this report, there were no items, transactions or events of a material and unusual nature likely in the opinion of the Responsible Entity, to affect significantly the operations of the Scheme, the results of those operations, or the state of affairs of the Scheme in future financial years.

Australian Ethical Income Fund

Directors' Declaration

In the opinion of the Directors of Australian Ethical Investment Limited, the Responsible Entity of the Australian Ethical Income Fund (formerly Australian Ethical Cash Fund, the "Scheme"):

(a) The annual financial statements and notes that are set out on pages 7 to 26 are in accordance with the Corporations Act 2001, including:

- i. Giving a true and fair view of the Scheme's financial position as at 30 June 2019 and of its performance for the financial year ended on that date; and
- ii. Complying with Australian Accounting Standards and Corporations Regulations 2001; and

(b) There are reasonable grounds to believe that the Scheme will be able to pay its debts when they become due and payable.

(c) The Scheme has operated during the year in accordance with the provisions of the Schemes constitution.

The Directors draw attention to Note 1 of the financial statements which contains a statement of compliance with International Financial Reporting Standards.

Signed in accordance with a resolution of the directors of Australian Ethical Investment Limited.

A handwritten signature in black ink, appearing to read 'S. P. Gibbs', with a stylized flourish at the end.

Stephen Gibbs
Director
Australian Ethical Investment Limited
24 September 2019