

IAG ANNUAL REPORT 2006

A RISK MANAGEMENT STORY: **PART 3**
(FROM OUR PEOPLE'S PERSPECTIVE)

“I NEVER THOUGHT
I'D WORK FOR
AN INSURER...”

**“...WHICH DOES
MORE THAN JUST
PAY CLAIMS.”**



This annual report – ‘part three’ of a risk management story – explores how Insurance Australia Group (IAG) operates, this time through the eyes of the people who work there.

It follows last year’s report – ‘part two’ – told from our customers’ perspective, while ‘part one’ introduced the series. We trust this series of reports will help you view each 12-month performance as part of a long-term investment.

Many of the people at IAG would tell you they didn’t grow up dreaming they’d work for an insurance company.



But the fact is, about 12,000 people work at IAG, and most of them stay for many years. Why? Because simply by doing their jobs, they are able to make positive changes to the communities in which they live. And they soon realise that without insurance, many people’s lifestyles or businesses could be destroyed.

Our employees’ decisions are guided by four principles...



**PAYING CLAIMS:
CUSTOMERS EXPECT
THEIR CLAIMS WILL
BE PAID. THAT’S WHY
WE’RE HERE.**

But what makes us different is the way we pay claims – we focus on replacing their goods or getting them back on the road or back to work as quickly as possible.



**UNDERSTANDING
AND PRICING RISK:
WHEN CUSTOMERS
TAKE OUT INSURANCE
THEY WANT TO
KNOW THE PRICE
WE CHARGE IS
ACCURATE AND FAIR.**

That’s why we use our extensive data records to help us calculate each customer’s premium to ensure it is neither overpriced nor underpriced.



**MANAGING COSTS:
OPERATING COSTS
ARE FACTORED INTO
PREMIUM PRICES,
SO WE MUST BE
AS EFFICIENT AS
POSSIBLE.**

IAG’s large scale allows us to manage costs through access to volume discounts across the supply chain, without sacrificing quality, thereby keeping costs per policy down.



**REDUCING RISK:
NO ONE WANTS TO
EXPERIENCE THE
HARDSHIP THAT
LEADS TO MAKING AN
INSURANCE CLAIM.**

IAG invests in programs to reduce the incidence of crime; make our roads, homes and workplaces safer; help prevent fires; and reduce our environmental impact – because the fewer risks there are, the better for everyone.

...stories of how these principles work in practice can be found on the following pages.

CONTENTS

IAG’s Four Principles	1	Business Overview	20	Financial Report	39
Chairman’s Review	10	Summary of Performance	22	Shareholder Information	132
Group Operating Performance	12	Board of Directors	28	Glossary	136
CEO’s Review	14	Corporate Governance	30	Corporate Directory	138

PAYING CLAIMS

“WE JUMPED INTO ACTION AS SOON AS WE HEARD ABOUT THE DISASTER.”



“I saw the pictures of Cyclone Larry at home on the TV. You could see from the devastation that many homes would be a total loss, and like most people, I was keen to help in any way I could. The next day I travelled to Innisfail and visited as many of our customers as we could find, assessing the damage to their properties and getting their claims moving.

“It was completely shattering for those people who had lost everything, so I was really pleased that we were able to pay out millions of dollars to our worst affected customers within the first week.”

Chris Laughton, Claims Assessor



Chris Laughton, a Claims Assessor from Brisbane, travelled to Innisfail the day after Cyclone Larry hit, to help CGU and NRMA Insurance customers sort out their home insurance claims quickly.

24-HOUR HELPLINE CALLS

Number of customer calls for emergency assistance through our 24-hour Helpline during the year:

24,926

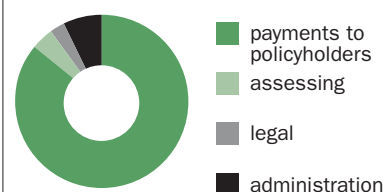
CUSTOMER SATISFACTION INDEX

Overall measure of customer satisfaction in our largest portfolios of direct motor and home insurance in Australia:



THE COST OF A CLAIM

On average, when IAG pays a claim, these are the expenses incurred:



UNDERSTANDING AND PRICING RISK

“WHO ELSE CAUSES HAIL DAMAGE FOR A LIVING?”



“My friends think I have the coolest job because we use science to test the performance of roof tiles against hail damage. After we fire a hailstone into tiles, we examine the damage to find out how much it would cost to repair a whole roof. It’s interesting that two tiles which seem the same can be subjected to the same test, but the ultimate repair bill can vary up or down dramatically.

“The information adds to our collective knowledge about hail damage, which in turn helps us make decisions about premiums. The more we understand about building materials and the cost of repairs, the more accurately we can price our premiums.”

James Thomson, Project Engineer



James Thomson, a Project Engineer at IAG's Newington Research Centre, lines up a hail cannon to test the durability of roof tiles, while Matthew Hennessy, Workshop Assistant, loads a hailstone.

TOTAL PROPERTY VALUES INSURED

Total property values insured by IAG as at 30 June 2006:

MORE THAN
\$900 billion

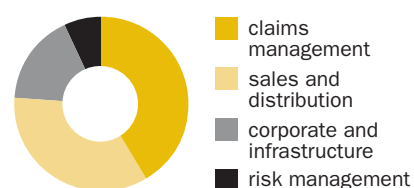
BUSINESS VOLUME

The number of policies and risks that IAG insures:



IAG'S PEOPLE INVOLVED IN MANAGING RISK

Around 12,000 employees across different areas of our business are involved in managing risk:



MANAGING COSTS

“HELPING PEOPLE GET ON WITH THEIR LIVES SOONER IS A WIN FOR EVERYONE.”



“It’s funny to say, but when I began studying public health not long ago, no-one on the course could believe I worked for an insurance company. But when you think that we look after injury claims for around 40,000 people at any one time, understanding medical research and epidemiology makes a huge amount of sense.

“Our team administers funding for medical researchers to understand how to improve treatment, and the cost of treatment, for people with injuries sustained in the workplace or in car accidents. By doing this, we hope to help the people we care for get on with their lives, which is great for them, and it’s also good for our business, the healthcare industry and the community.”

Petrina Casey, Manager of Policy, Research and Planning



Petrina Casey, Manager of Policy, Research and Planning, discusses with Dr David Brown research into spinal injuries for SpinalCure.

ADMINISTRATION RATIO

Our administration ratio (which is underwriting and administration costs measured as a percentage of our net earned premium):

19.6%

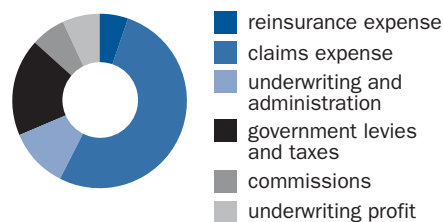
BUSINESS VOLUME PER FULL-TIME EMPLOYEE

The number of policies and risks that IAG insures per FTE:



CONTRIBUTORS TO THE COST OF RUNNING OUR BUSINESS

The split between costs and underwriting profit for every dollar of premium IAG received, for the year to 30 June 2006:



REDUCING RISK

“WE TRY TO HELP STOP INJURIES FROM HAPPENING IN THE FIRST PLACE.”



“Most people only think about insurance when they pay a bill or have to make a claim. In my job, we help employers to spot health and safety risks in their workplace that could lead to a claim, and find ways to minimise the problem.

“It’s like a cycle – the more we can help prevent accidents and injuries from happening, the safer everybody is, and the lower insurance premiums can be.

“This year, we’ve been really proud to help Mission Australia train their people in health and safety, with a new online program. It’s an addition to a claims management project that has seen Mission Australia reduce their premium by helping people get back to work after an injury.”

Gareth Shepherd, National Product Manager, Safety and Risk



Gareth Shepherd, National Product Manager, Safety and Risk, demonstrates an online safety training program to Mission Australia employee Dilly de Silva.

COMMUNITY INVESTMENT

Funds invested by IAG in programs to reduce risk in the Australian community during the year to 30 June 2006:

\$14.4
million

CREATING A SAFE WORKPLACE

IAG's lost time injury frequency rate for Australian operations:



THE AREAS THAT IAG TARGETS TO REDUCE ITS ENVIRONMENTAL IMPACT

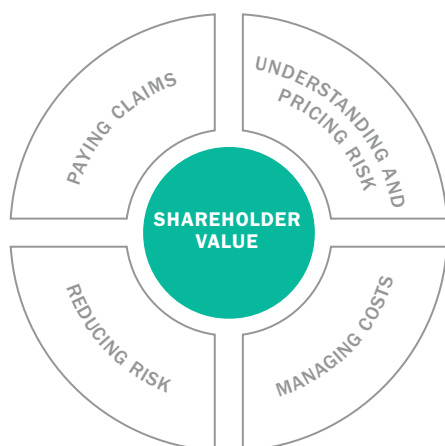
- Increasing recycled waste
- Reducing CO₂e emissions through:
 - electricity use
 - recycled print paper consumption
 - office paper consumption
 - fuel use
 - air travel

BUILDING A SUSTAINABLE CULTURE

The opening pages of this report feature just a few of the many IAG employees who bring life to our company's purpose – helping to pay claims, understand and price risk, manage costs and reduce risk.

We believe building a common culture based on these four principles will enable us to deliver value to our customers and shareholders over the long term.

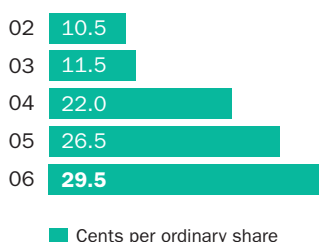
The solid performance achieved by IAG this financial year, despite a difficult operating environment, is testament to this philosophy, the strength of our strategy and the dedication of our people.



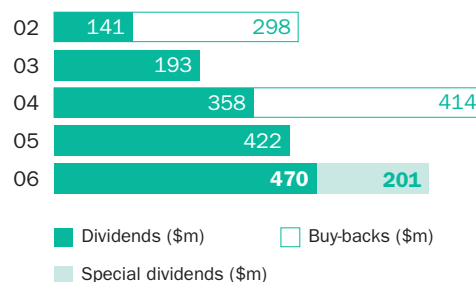
James Strong
Chairman



DIVIDENDS (INTERIM AND FINAL) IN RESPECT OF THE YEAR ENDED 30 JUNE



CASH RETURNED TO ORDINARY SHAREHOLDERS IN RESPECT OF THE YEAR ENDED 30 JUNE



ACHIEVING SUSTAINABLE RESULTS

I am pleased to report that IAG again delivered a solid performance for the year to 30 June 2006.

IAG recorded a net profit after tax of \$759 million, and its second-highest insurance margin and return on equity since listing.

We achieved this by maintaining high customer retention in all major portfolios, and adhering to risk and underwriting disciplines rather than chasing unprofitable market share. We contained our expenses, and we benefited from the first financial contribution from our recently acquired Asian insurance operations.

Record investment returns on our shareholders' funds also contributed to the strength of the result, driven by buoyant equity markets and the additional value generated by our asset managers.

The Board has declared a fully franked final dividend of 16 cents per ordinary share, to be paid on 9 October 2006. This brings total dividends for the year to 29.5 cents per share, representing an 11.3% increase on the previous year. In addition, IAG paid a special dividend of 12.5 cents per ordinary share in June 2006, in line with our commitment to return \$200 million in surplus capital to shareholders.

When measured since 1 January 2002, IAG's cumulative total shareholder return is 104.4%, which ranks the Group 25th of companies in the S&P/ASX100 that operated throughout the period.

DELIVERING ON STRATEGY

We have made significant progress against the corporate strategy to which we committed in 2002.

At that time, we recognised the need to generate scale in Australia and New Zealand, and diversify our business by geography, product and distribution channel to ensure we spread our risks and ensure sustainable profitability. We achieved these goals primarily through the acquisition of CGU and NZI, and by continuing to improve our franchises.

We also recognised the need to expand internationally, to achieve acceptable growth rates for our shareholders over the long term. As a result, we decided to build an Asian foothold as the first phase of our international expansion. We made progress against this goal during the past 12 months, having acquired interests in Thailand, Malaysia and Singapore. We also moved closer to completing a major investment in China's second largest general insurer. These steps provide us with access to some of the world's fastest-growing insurance markets.

CORPORATE GOVERNANCE

To ensure we create value for our shareholders in a sustainable fashion, IAG is committed to the highest standard of corporate governance.

Our approach to governance is based on the view that it must be more than just compliance. Whilst we already have the systems to help comply with a multitude of regulations, codes, rules and practices which govern how we operate, we believe the best protection for a company is a healthy risk management culture based on strong values and a commitment to achieving the company's goals.

We have developed a system for measuring the health of our culture. This has been incorporated into management reporting and is being used to identify and motivate areas needing improvement.

We are also upgrading our risk and governance framework to cater for our growing portfolio of international interests.

Your Directors have a constant focus on these important issues, and I would like to thank each of them for their consistent contribution over the course of the year.

With the challenges facing the company in its domestic market and in growing internationally, CEO Michael Hawker made a number of changes to his executive team to ensure the Group has appropriately skilled management. These changes ensure roles are better matched to business areas, and are discussed in the CEO's Review.

On behalf of the Board, I would like to express appreciation to Michael Hawker and his executive team. IAG's strong performance is a reflection of their leadership, which has helped to create an enthusiastic and productive workforce.

I believe the strength of the executive team will carry the company into its next phase of growth.

LOOKING FORWARD

We will continue to explore additional opportunities to generate global scale, by building a portfolio of assets throughout Asia and other international insurance markets, whilst continuing to improve our domestic operations.

James Strong
Chairman

HOW WE'VE PERFORMED

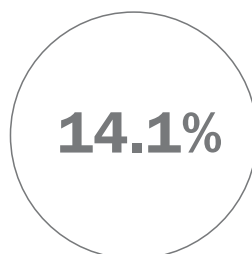
HIGHLIGHTS

NET PROFIT AFTER TAX



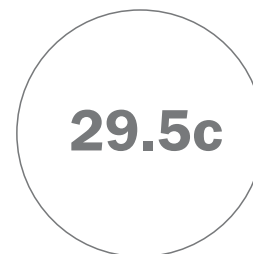
Net profit after tax of \$759 million was achieved.

INSURANCE MARGIN



Insurance margin of 14.1% was the Group's second-highest insurance margin since listing^A.

TOTAL DIVIDENDS PER SHARE EXCLUDING SPECIAL DIVIDEND



Dividends per share of 29.5 cents was achieved, compared with 26.5 cents in the previous year.

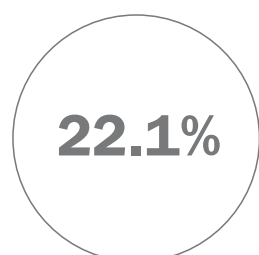
OPERATIONAL HIGHLIGHTS

	2005*	2006
Gross written premium The total amount we received from customers for the payment of their insurance policies.	\$6,673m	\$6,435m
Net earned premium The portion of premiums written which relate to the financial year, minus the reinsurance expense.	\$6,144m	\$6,132m
Net claims expense The amount paid out in claims during the year, as well as an estimate of how much we need to pay on unsettled claims, plus claims handling costs such as legal and administrative expenses, less recoveries from reinsurers and other parties.	(\$4,090m)	(\$3,900m)
Underwriting expenses The costs associated with researching risk and determining appropriate premiums, underwriting, administering the policy information required to run the business, marketing, commissions, distribution, fire services levies and meeting the Group's compliance requirements.	(\$1,624m)	(\$1,699m)
Underwriting result The profit or loss we make from our premium income before we consider related investment income.	\$430m	\$533m
Investment returns from claims reserves The income received from investing reserves held to pay future claims, net of expenses.	\$516m	\$310m
Insurance result The addition of our underwriting and investment returns from claims reserves.	\$946m	\$843m
Investment income on shareholders' funds The income received from investing our shareholders' funds.	\$455m	\$539m
Net profit attributable to shareholders The net result after allowing for income taxes and the share of profit owing to minority shareholders.	\$811m	\$759m

* The Group was required to adopt Australian equivalents of International Financial Reporting Standards (AIFRS) when preparing its financial report for the year ended 30 June 2006. For comparative purposes, results for the 2005 financial year have also been restated under AIFRS.

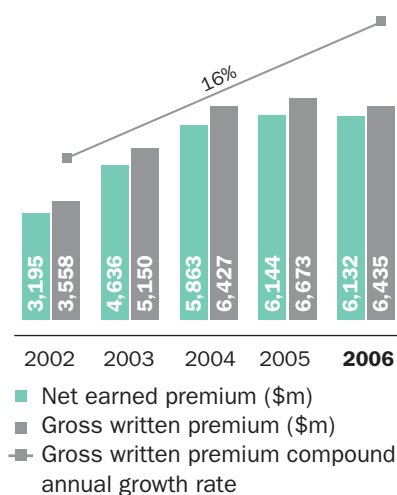
^A Insurance margin is reported differently in the statutory financial statements, due to the reclassification of the Group's captive insurer's results from the consolidated operations back to the businesses from which the captive earned profits.

RETURN ON EQUITY

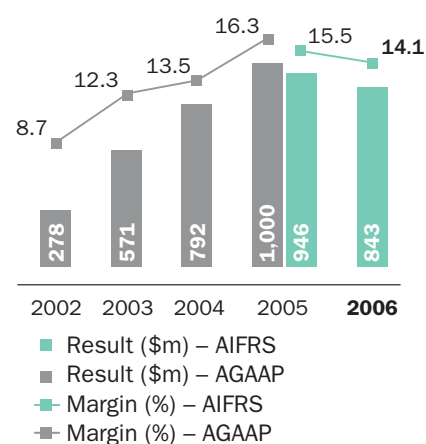


Return on equity of 22.1% (or 15.8% on a normalised basis) exceeded our target of 1.5 times our weighted average cost of capital.

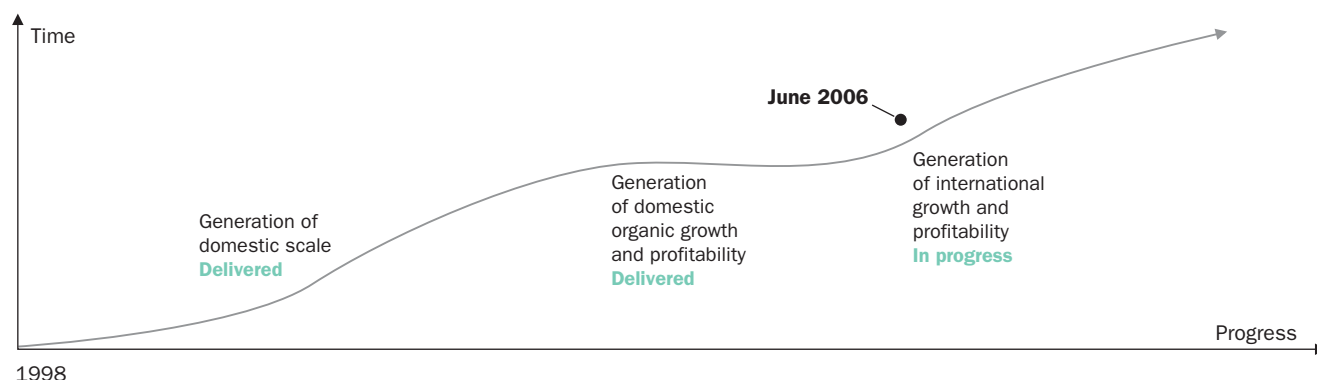
REVENUE GROWTH FOR THE YEAR ENDED 30 JUNE



INSURANCE RESULT AND MARGIN[^] FOR THE YEAR ENDED 30 JUNE



STRATEGY REMAINS ON TRACK



PERFORMED WELL AGAINST STRATEGIC FINANCIAL GOALS

Goals	Progress
Top quartile shareholder return	Measured from 1 January 2002, IAG's cumulative total shareholder return of 104.4% ranks it 25th of the companies in the S&P/ASX100 that operated throughout this period.
Return on equity of at least 1.5 times weighted average cost of capital	Return on equity exceeded goal.
Establish an Asian foothold	Acquired interests in Malaysia, Thailand and Singapore, and progressed a major transaction in China.
Maintain an 80:20 mix of short-tail: long-tail premiums	The Group's mix of short-tail and long-tail premiums remained at 81:19.
Maintain an 'AA' category rating	Maintained very strong 'AA' insurer financial strength ratings from S&P for our key wholly owned licensed insurers.

MANAGING RISK FOR LONG TERM SUCCESS

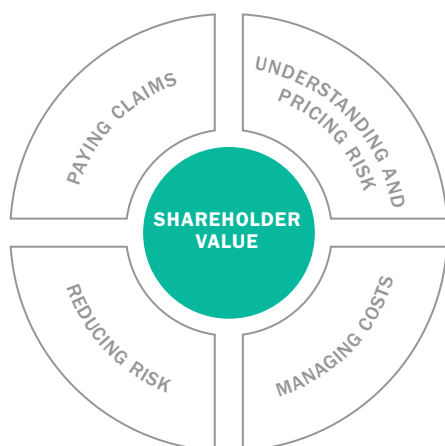
Insurance is a complex business.

The past year provides proof of that. We helped customers bear the impact of one of the worst cyclones ever to hit a populated area of Australia; we experienced major competitive pressures; and we faced slower economic growth in our key operating markets.

Each of these factors affected our performance. And yet we managed to deliver a quality financial result, maintain high customer satisfaction and improve employee engagement during the year.

We did this by focusing on long-term objectives and by learning from and adapting to our changing environment and evolving customer needs.

We also did it by employing people who are expert in managing our business and committed to improving our customers' experience. Some of these people are featured in this report.



Michael Hawker
Chief Executive Officer



Like many people in the industry, I never imagined I would become an insurance executive. But once I was part of the industry, I knew it would keep me engaged for many years. That is because I find it is a business that is both vital to society and intellectually challenging.

For instance, IAG paid more than \$12 million in claims every day over the past 12 months, helping millions of people get on with their lives. These people included children injured in horrific car crashes, families whose homes had been devastated by cyclones or fires, small business owners who had been the victims of burglary, and employees who had been injured while at work.

Providing that kind of assistance makes you realise the value of insurance.

At the same time, insurance is incredibly complex. It is a business in which you sell your product before you know its cost, and many of the factors which influence the cost are outside your control.

For example, a major weather event may occur, like Cyclone Larry for which we will pay customers about \$165 million to cover thousands of claims. Or the competitive environment may change – in the last year we have seen some insurers, particularly commercial insurers, pricing products at what we believe are unsustainably low levels and, as a result, we have ceded some market share rather than sacrifice our underwriting disciplines. Government policy may change, such as the introduction of the new Lifetime Care & Support Scheme in NSW, that will provide treatment and support for people severely injured in a motor vehicle collision, regardless of who was at fault. Crime rates, motor car accident frequency and other external factors also influence our costs.

For these reasons, we assess the risks we manage over long-term trends.

Similarly, we encourage investors to view the financial performance of IAG over the long term, factoring in the various influences on the business which may have a short-term effect on our results. The key for us is to build and deliver sustainable earnings over time.

I am pleased to report the Group delivered a strong net profit after tax of \$759 million, return on equity of 22.1%, and an insurance margin of 14.1%^A for the year to 30 June 2006.

Our ability to sustainably deliver return on equity that exceeds 1.5 times our weighted average cost of capital is testament to our strategy to build a business based on scale, with diversity across products, geography and distribution channels.

AUSTRALIA AND NEW ZEALAND

In our home markets of Australia and New Zealand, where we are the largest general insurance group, we achieved solid results despite increased industry-wide competition, lower average premiums in commercial, motor and compulsory third party (CTP) insurance, and the impact of a severe cyclone and storms.

This demonstrates our ability to strike the right balance between risk-based pricing, maintaining our leading market position and keeping premiums in commercial, motor and CTP insurance affordable for customers.

Our Australian Personal Insurance operations delivered a 12.6% insurance margin. This was a strong result, although lower than the previous year due to reduced business volumes compounded by lower average premiums in CTP and direct motor insurance. In addition, a significant amount of management time was spent resolving a debate with the NSW smash repair industry during the first half. We learnt valuable lessons during this debate and believe the steps we have taken placed us back on track to improving the way we work with our industry partners.

In the second half, following an improvement to our competitive price position, renewal rates reached their highest level in almost two years in our largest portfolio, NSW comprehensive motor, and new business levels improved significantly. Customer satisfaction also remained high.

We expect this positive momentum will continue in the current year as we leverage our competitive price position and continue to implement customer service and claims improvement programs.

In our Australian Commercial Insurance operations, we focused on improving our relationships with existing customers and selectively pursuing new business. We were also unwilling to drop our prices below sustainable levels despite increased competition from local and international players. Together with the ongoing benefits of tort reform, these factors contributed to an insurance margin of 18.0%.

Meanwhile, we achieved a strong insurance result in New Zealand, on the back of improvements in our claims processes, and dealing with only one major weather event during the year.

We continued to change the systems that support our business and contain our operating costs. By increasing automation, rolling out a new franchise model, enhancing distribution channels, and reinvigorating our approach to customer interactions, we aim to become more efficient, thereby increasing revenue per full-time employee, while improving service to our customers.

^A Insurance margins are reported differently in the statutory financial statements, due to the reclassification of the Group's captive insurer's results from the consolidated operations back to the businesses from which the captive earned profits.

CEO'S REVIEW

BUILDING AN INTERNATIONAL PORTFOLIO

To continue to generate sustainable earnings, we are growing our business offshore, initially in Asia. This will further diversify our risks and improve our resilience against the impact of regional insurance cycles.

During the year, we made investments in insurance businesses in Thailand and Malaysia, and have reached a preliminary agreement to invest in 24.9% of China's second-largest insurer. We established a regional office in Singapore, and agreed to acquire a Lloyd's managing agency and specialist Asian syndicate, Alba, primarily to provide reinsurance support to our new Asian partners.

Our share of gross written premium from our Asian businesses during the year was \$65 million. However, this reflects

only the part of the year during which we had a controlling interest in those businesses. On a full-year basis, our share would have been \$150 million. We aim to increase gross written premium as we build our global portfolio and work with our new partners to further improve their businesses. Asian markets are anticipated to deliver higher growth due to both the natural underlying economic growth and an increase in the penetration of insurance.

In keeping with our philosophy to manage for the long term, we have also started to pursue potential growth opportunities in other insurance markets, including those in Europe.

STRONG INVESTMENT RETURNS

The Group generated strong investment income, driven by favourable equities markets and significant value added by the Group's in-house asset management team.

This, together with our quality insurance result, contributed to our strong result for our shareholders.

The Group's investment portfolio, totalling approximately \$10 billion at year end, returned 8.3% during the year. Our asset management team outperformed portfolio benchmarks, contributing an additional \$124 million to pre-tax profit.

Investment return on shareholders' funds contributed \$539 million to the Group's pre-tax result. Despite rising interest rates, investment returns from claims reserves income contributed \$310 million to the Group's pre-tax insurance result.

CAPITAL STRENGTH

The Group retained its very strong capital position, with a multiple of 1.83 times APRA's minimum capital requirement at 30 June 2006. This remains above our internal benchmarks.

Our capital strength enabled us to pay shareholders a special dividend in June 2006, bringing dividends in aggregate for the year to 42 cents per share.

We are pleased to have been in the financial position to return \$200 million to shareholders at the same time as having made further international acquisitions.

REINVIGORATED EXECUTIVE MANAGEMENT TEAM

At the executive level, rotation of responsibilities, promotion of internal managers and new appointments were made during the year. These changes were designed to share talent and depth of capability across the Group, and ensure executive roles were better matched to business areas:

- David Issa became CEO, Personal Insurance, while retaining his previous responsibility for Technology Services;



From left to right:

Sam Mostyn
Group Executive, Culture & Reputation

Christine McLoughlin
Group Executive, Strategy

Jan van der Schalk
CEO, Asset Management & Reinsurance

- Nick Hawkins became CEO, IAG New Zealand, having previously been Head of Asset Management & Group Strategy;
- Jacki Johnson, formerly Head of Risk Management Services, became CEO, Business Partnerships;
- Justin Breheny joined IAG as CEO, Asia, a newly created role to manage our growing portfolio of Asian businesses;
- Christine McLoughlin became Group Executive, Strategy, having previously been Group Executive, Office of the CEO; and
- Jan van der Schalk became CEO, Asset Management & Reinsurance, having previously held the position of Head of Reinsurance.

I am delighted to have appointed three internal candidates, Jacki, Nick and Jan, to our executive, as it highlights the depth of talent in our broader management team and our focus on succession planning and career development.

As we transition from a purely Australian organisation to an international business, we will continue to evolve our executive structure to ensure we make best use of our expertise.

Rick Jackson, formerly CEO, Personal Insurance, and David Smith, formerly CEO, IAG New Zealand, decided to leave IAG. I would like to thank Rick and David for their significant contributions, each having played a fundamental role in the Group's growth and profitability in recent years. I would also like to thank Ian Brown, former Deputy CEO, who retired during the year.

LOOKING FORWARD

I am confident we will continue to grow and diversify our business in the 2007 financial year.

We expect our Australian Personal Insurance business will grow in line with the market during the 2007 financial year, and moderately above market thereafter, and we expect the 'soft cycle' in the commercial market to remain challenging for pricing while the claims environment is expected to be favourable.

Our New Zealand operations should generate similar results to those in Australia, and our Asian insurance business is expected to grow at least in line with the higher growth rates in those markets.

We should complete the acquisition of a 24.9% stake in China's second largest insurer, and we are continuing to investigate other potential acquisitions in general insurance markets in Asia and Europe.

The Group aims to continue to generate quality, sustainable returns for shareholders. We expect to grow gross written premium by 5-10% in the coming year by maintaining our pricing discipline, continuing our focus on cost management, pursuing shareholder accretive acquisitions and actively managing our capital.

PERFORMING SUSTAINABLY

To deliver sustainable financial returns for our shareholders, we believe it is vital that we adapt to our customers' changing needs, reduce our environmental impact, create value for society, and develop a strong internal culture for our employees.

Measuring and reporting on our financial, social and environmental goals are an important part of keeping check on our progress in these areas. Highlights of our progress are listed overleaf.

Our activities in this area also benefited from the advice of an Expert Community Advisory Committee, an independent panel of individuals who represent a range of community interests and professional expertise, which we convened during the year. The Committee's mandate is to provide the Board and executive with independent advice on issues that may impact our standing within the communities in which we operate.



George Venardos (left)
Chief Financial Officer

Tony Coleman (right)
Chief Risk Officer &
Group Actuary

CEO'S REVIEW

OUR PEOPLE

Being able to navigate the complexities of the insurance industry requires resilient and agile employees who understand the purpose, and share the values of our organisation. That is why we have recently invested a great deal of time and effort to improve the leadership capabilities and qualities throughout our company, based on strong values.

I believe if we can help our employees develop their leadership skills, we will drive improved results across all other performance indicators.

We use a measure of employee engagement to determine the health of our culture. In Australia, we saw a 2% lift in this score to 56% and an overall lift of 11% since measurement began in 2003. We believe our initiatives to address career development, diversity, flexibility and balance between work and personal commitments will help drive engagement higher over time. In addition, more than three quarters of our employees have signalled they value our focus on balancing social, environmental and financial responsibilities.

We also developed our workplace diversity program, which seeks not only to tolerate individual differences, but value them. As part of this, we increased the number of indigenous employees significantly over the previous year and also retained our status as an Employer of Choice for Women, according to the Australian Government's Equal Opportunity for Women in the Workplace Agency.

Our staff turnover is still higher than we would like, particularly in our call centres. This is something we must improve and, as a result, are considering alternatives. For example, we are piloting a scheme that brings call centre staff into branches, where they can alternate between face-to-face and phone-based customer service.

We must get better at integrating our values, our purpose, and all the ways in which we support and develop our people so this becomes part of our employees' everyday experience at IAG.

In my role as Chief Safety Officer, I am proud of the strides we have made to foster a safety culture, with a goal of zero harm for our people. Initiatives, such as our internal **besafe** program, helped contribute to a fall in the number of work hours lost due to injury during the year.

OUR CUSTOMERS

Measures of customer satisfaction, renewal and complaints are important indicators of the strength of our customer relationships. In our Australian direct personal lines, I am pleased that overall customer renewal and claims satisfaction remained high, and complaints as a percentage of policies decreased during the year.

Our focus on customers was recognised through a number of commendations during the year. CGU received accolades in the JPMorgan Deloitte General Insurance Industry Survey, while our New Zealand business was named Underwriter of the Year by the Insurance Brokers Association of New Zealand.

Our challenge is to continue to find ways to improve our customers' experience, every time they are in contact with us – an increasingly complex task given customers' constantly changing requirements and expectations.

COMMUNITY

During the year, we invested more than \$14 million in programs aimed at promoting safety at home, at work and on the road; reducing crime; and helping slow the effects of human-induced climate change. After all, working to reduce risk in the community and consequently the number of claims makes good commercial, social and common sense. Fewer risks mean customers and the broader community can avoid unnecessary hardships, and they may benefit from lower premiums too.

We also encourage our people to become actively involved in the community, with most employees able to volunteer work time for a not-for-profit organisation. We believe this enables staff to 'live the values' we share at IAG.

ENVIRONMENT

Climate change is a key risk for insurers. Increasing frequency and severity of weather-related events such as storms, cyclones, hail and drought, combined with growth in values insured, have a major impact on our business. We believe it is possible to reduce the impact of climate change through building awareness and taking immediate action. We proactively engage with government representatives, other businesses and non-government organisations to focus the public policy agenda on the importance of addressing climate change.

We are a member of the Australian Business Roundtable on Climate Change, which released a research report in April in order to advance the understanding of business risks and opportunities associated with climate change.

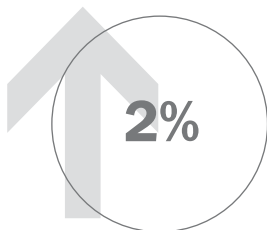
We are also committed to improving our own environmental performance, by reducing our CO₂e emissions through reduced electricity, fuel and paper consumption. We have made significant strides during the year. Now 20% of our Australian car fleet is made up of hybrid vehicles, which combine a petrol engine with an emission-free electric motor. We have introduced new energy-efficient lighting through our head office in Sydney and, in Adelaide, our employees have relocated to a specially designed energy-efficient workplace, for which the base building has been rated 5-Star by the Green Building Council of Australia.

Further information on the Group's approach to operating sustainably, as well as our performance against measures will be released in the 2006 Sustainability Report, which will be made available later this year at www.iag.com.au.



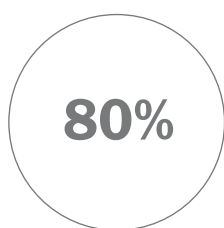
Michael Hawker
Chief Executive Officer

EMPLOYEE ENGAGEMENT



Employee Indicators	2005	2006
Head count	9,856	10,086
Staff turnover	19.5%	20.6%
Employee engagement score	54%	56%
Lost time injury frequency rate	5.3	4.9
Funding of the OH&S department	\$1.985m	\$2.125m

CUSTOMER SATISFACTION



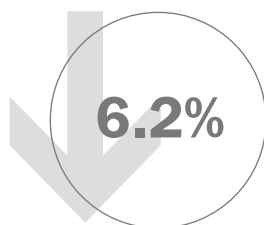
Customer Indicators	2005	2006
Business volume measure (Number of risks and policies in force)	11.9m	11.6m
Overall customer satisfaction index [^] *	81%	80%
Complaints as a percentage of policies [^]	0.018%	0.016%

FUNDS FOR COMMUNITY INVESTMENT



Community Indicators	2005	2006
Number of employee volunteer hours	5,629	7,771
Funds for community investment	\$12.3m	\$14.4m
Funds for community investment as a percentage of Group net profit attributable to shareholders [^]	1.6%	1.9%

CO₂e EMISSIONS



Environmental Indicators	2005	2006
CO ₂ e emissions	76,820 tonnes	72,035 tonnes
Recycled commingled waste	232 tonnes	302 tonnes

This page is covered by KPMG's independent review report on sustainability reporting in its Annual Report 2006.

Definitions for each indicator are found in the glossary. All sustainability indicators relate to IAG's Australian operations, unless otherwise stated.

[^] Relates to Australian direct personal lines only.

^{*} Due to a change in provider, the customer satisfaction index is based on six months' data from January to June 2006.




[^] The Group was required to adopt Australian equivalents of International Financial Reporting Standards (AIFRS) when preparing its financial reports for the year ended 30 June 2006. For comparative purposes, results for the 2005 financial year have also been restated under AIFRS.

BUSINESS OVERVIEW



A SNAPSHOT OF IAG

- IAG is the leading general insurance group in Australia and New Zealand, and has a growing presence in Asia. The Group generates annual gross written premium of more than \$6.4 billion.
- The Group insures more than \$900 billion of property. In Australia, it insures more than 5 million cars, 2 million homes, 250,000 businesses and 75,000 farms, and provides workers' compensation services to more than 200,000 employers. In New Zealand, it insures around 950,000 cars, 575,000 homes, 185,000 businesses and 235,000 rural risks.
- Customers are serviced in Australia through a network of 320 branches, franchises and country service centres throughout metropolitan, regional and rural areas as well as more than 1,000 intermediaries (brokers and authorised representatives) and, in New Zealand, through more than 40 sales centres, branches and district offices.
- About 12,000 people are employed across the Group.

REGION	WHAT WE DO	2006 FINANCIAL PERFORMANCE*	
AUSTRALIA 	<p>IAG's Australian operations – Personal Insurance, Commercial Insurance (CGU) and Business Partnerships – together distribute a range of personal and commercial insurance products.</p> <ul style="list-style-type: none"> ■ The Personal Insurance business distributes products through a network of branches, franchises and country service centres throughout metropolitan, regional and rural Australia, as well as through call centres and online. Products are distributed under the NRMA Insurance brand in NSW, QLD, ACT and TAS; SGIC in SA; SGIO in WA; and RACV in VIC. Some personal insurance products are also sold through CGU. ■ The Commercial Insurance business, CGU, sells products nationally, predominantly through CGU's network of more than 1,000 intermediaries (insurance brokers and authorised representatives). Some commercial insurance products are also sold through NRMA Insurance, SGIO and SGIC. ■ Business Partnerships partners with government bodies and the private sector to distribute a range of commercial and personal insurance products. 	Gross written premium Net earned premium Combined ratio Insurance margin	\$5,399 million \$5,041 million 86.7% 14.1%
NEW ZEALAND 	<p>IAG is the leading general insurance provider in New Zealand across both direct and intermediated channels, holding approximately 36% of the market.</p> <ul style="list-style-type: none"> ■ Insurance products are predominantly sold directly to customers under our State brand and through intermediaries (insurance brokers and agents) under our NZI brand. ■ Personal lines and commercial products are also distributed under third party brands by our corporate partners, including large financial institutions. 	Gross written premium Net earned premium Combined ratio Insurance margin	\$971 million \$892 million 88.6% 14.5%
ASIA 	<p>IAG has a growing presence in Asia, with interests in China, Malaysia, Singapore and Thailand.</p> <ul style="list-style-type: none"> ■ China: owns CAA (a roadside assistance company); and has reached preliminary agreement to invest in 24.9% of China Pacific Property Insurance Company. ■ Malaysia: owns a 30% stake in AmAssurance. ■ Singapore: regional office; agreed to acquire Alba, a specialist Asian underwriting agency and syndicate to provide reinsurance support. ■ Thailand: owns NZI Thailand (predominantly commercial insurance) and 96% of Safety Insurance (predominantly personal insurance). 	Gross written premium Net earned premium Combined ratio Insurance margin	\$65 million \$37 million 94.5% 7.4%

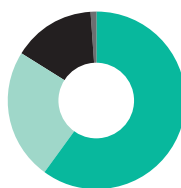
* Figures include the allocation of the Group's captive reinsurer.

IAG'S PORTFOLIO OF RISKS % OF GROSS WRITTEN PREMIUM



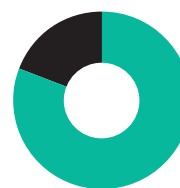
Motor	34%
Short-tail commercial	20%
Home	22%
CTP	10%
Liability	6%
Other short-tail	4%
Workers' compensation	4%

IAG'S BUSINESS OPERATIONS % OF GROSS WRITTEN PREMIUM



Australian personal lines	60%
Australian commercial lines	24%
New Zealand	15%
Asia	1%

IAG'S BUSINESS BY DURATION % OF GROSS WRITTEN PREMIUM



Short-tail	81%
Long-tail	19%

PRODUCTS

- Commercial and motor fleet
- Commercial property
- Construction and engineering
- Consumer credit
- CTP
- Directors and officers'
- Extended warranty
- Farm, crop and livestock
- Home and contents
- Home warranty
- Marine
- Motor vehicle
- Niche insurance, such as veteran, vintage and classic car, boat, caravan and travel
- Premium funding
- Professional indemnity
- Public and product liability
- Workers' compensation

BRANDS



NRMA Insurance is the brand used in NSW, QLD, ACT and TAS. The brand dates back to 1920 when it was formed as the NSW branch of the National Roads Association.



CGU is one of Australia's largest intermediary-based insurers, with a history dating back to the 1860s. IAG acquired CGU in 2003.



SGIO is the brand used in WA, where it dates back to 1926. IAG acquired SGIO from the WA Government in 1998.



SGIC is the brand used in SA, where it was established in 1971 by the SA Government. IAG acquired SGIC in 1998.



Swann Insurance sells a range of niche insurance products including consumer credit and motor vehicle-related products. IAG acquired Swann Insurance in 2003.

- Commercial and motor fleet
- Commercial liability
- Commercial property
- Construction and engineering
- Home and contents
- Income protection
- Marine
- Motor vehicle
- Niche insurance, such as pleasure craft, boat, caravan and travel
- Personal liability
- Rural and horticultural
- Surgical



NZI is a leading commercial insurer in New Zealand, with a heritage dating back to 1859. IAG acquired NZI in 2003.



State is the brand used for IAG's direct insurance business in New Zealand, and dates back to 1905. IAG acquired State in 2001.

- China – roadside assistance
- Malaysia – education, family and protection, retirement, health care, saving and investment, home protection, motor vehicle
- Thailand – commercial property, product and public liability, marine, travel, motor vehicle and fire insurance



Established in Beijing in 1995, CAA is China's largest roadside assistance provider. IAG has held a stake in CAA since 1999, which increased to 100% in 2003.



NZI is the brand used for IAG's commercial insurance business in Thailand. Established in 1985, IAG acquired and rebranded the business in 2005.



Safety Insurance provides predominantly personal insurance in Thailand. IAG has held a stake in Safety Insurance since 1998, which was increased to 96% in 2006.



AmAssurance is Malaysia's second-largest motor insurer and fifth-largest general insurer. IAG acquired a 30% interest in AmAssurance in 2006.

AUSTRALIAN OPERATIONS



David Issa
CEO, Personal Insurance

Our largest portfolios – motor, CTP and home insurance – maintained their leading market positions in Australia, despite facing challenging conditions during the year.

PERSONAL INSURANCE

Australian Personal Insurance recorded a solid result despite operating in one of the most challenging environments in the past few years.

Customer renewal in our direct personal lines portfolios remained high at about 90% during the year, and customer satisfaction remained at about 80%.

A key challenge during the 2006 financial year was sparked by the public debate in NSW between NRMA Insurance and some smash repairers about our motor repair allocation model. This debate created uncertainty for some customers.

Throughout this period, we engaged in ongoing consultation with the smash repair industry to achieve a resolution. Together with the rest of the industry, we were an active participant in the development of a voluntary code of practice governing the relationship between insurers and smash repairers nationally.

Through ongoing dialogue, we believe we are well on track to rebuilding a sustainable, long-term relationship with the smash repair industry to benefit our customers.

The most significant claims event of the year occurred on 20 March 2006, as Cyclone Larry tore through North Queensland, destroying or damaging homes, property and cars in its path.

Within 24 hours, our team arrived in the worst hit areas, processing claims and arranging temporary accommodation for customers whose homes had been severely damaged.

Once the initial emergency passed, we hosted a Help Expo that brought together builders, architects, building materials companies and other suppliers under the one roof. Nearly 800 customers attended the Expo, taking the opportunity to seek advice from service providers to help get their repairs underway as quickly as possible.

Our many programs to reduce risk in the community continued during the year. We awarded more than \$530,000 in grants to fund community projects that reduce risk in local areas. For example, the Epping Youth Development Group in Sydney was presented with a grant of \$3,000 to engage young offenders in a job skills program which aims to decrease the incidence of localised juvenile crime.

In addition, for many years we have been proud supporters of NRMA CareFlight, an emergency medical helicopter transport service. As part of this support, we are contributing \$11.2 million over three years to fund the Head Injury Retrieval Trial, which aims to reduce the severity of head injuries through the provision of rapid specialist medical assistance at the scene.

We were also involved in the development of the Lifetime Care & Support Scheme in NSW, which will ensure people severely injured in car accidents are looked after, no matter who is at fault.



HELPING KIDS STAY SAFE ON THEIR WAY TO SCHOOL

In 2003, Peta Dawe's five year old daughter was returning home from school when she accidentally hopped off her school bus at the wrong stop, and was lost for more than two hours.

Peta, an NRMA Insurance country service centre Manager in the Hunter region of NSW, was frantic.

"As any parent could imagine, finding your child in a park near dinner time, lost for two hours while trying to find her way back home, was very upsetting," Peta said.

"It made me think that students, especially younger children, need extra education around safety when they first start catching the school bus."

So NRMA Insurance joined Peta in developing a bus safety program for kindergarten children that aimed to reduce the chance of accidents happening when travelling to and from school.

The program has today been undertaken in almost 20 communities across NSW, delivering important bus and road safety information to around 5,000 students.

"NRMA Insurance is in the business of paying claims when things go wrong, so it makes sense that we help reduce the chance of incidents happening in the first place.

"The bus safety program is a great example of the way we work with the community to help people lead safer lives," Peta said.

OUR PEOPLE

The dedication of our people enables us to move beyond the mechanics of insurance to provide the kind of rapid, comprehensive response experienced by our customers in North Queensland in the wake of Cyclone Larry.

This year, our staff turnover rate was higher than we would like, particularly in our call centres. To address this, we introduced a number of programs, including the continued roll out of staff consultative committees, which bring together people from operational and management areas to ensure the thoughts and ideas of our people are heard throughout the business.

We offer four educational qualifications in 15 business streams, through an association with a range of government bodies and accreditation authorities. Currently, more than 1,000 of our employees are students.

Safety and wellbeing at work continued to be a focus. During the year, the number of workplace injuries decreased, supported by our internal health and safety program, **besafe**. We also saw an increase in the number of employees participating in health and safety training.

LOOKING FORWARD

Our key priority for the year ahead is to continue to improve our customers' experience. We will do this by focusing on:

- developing our people by embedding the values and behaviours we expect of them and giving our leaders the training they need. We believe this will help improve employee engagement, which in turn will generate improved customer experiences;
- improving the consistency of our sales and service delivery and improving our marketing effort; and
- enhancing our claims delivery.

BUSINESS PARTNERSHIPS

Our Business Partnerships division was formed in February 2006. It brought together businesses from across IAG that partner with government bodies and the private sector and has a clear focus on driving mutually beneficial results. The division encompasses:

- workers' compensation businesses in NSW and Victoria, which administer policies and manage claims as an agent of the states' WorkCover schemes;
- distribution partnerships, which provides insurance products to customers of more than 100 banks, credit unions and affinity organisations;
- Swann Insurance, which offers insurance and extended warranty products through car and motorcycle manufacturers and dealers, and consumer credit insurance through financial institutions; and
- self-insurance services and safety and risk management consulting businesses.



Jacki Johnson
CEO, Business Partnerships

The performance of our workers' compensation business improved substantially during the year, and Swann Insurance won major new contracts.



HELPING OUT WHEN HOLIDAYS TURN BAD

After a long drive in the sweltering summer heat, Barry and Margaret Wall settled into their caravan for the night, ready to take in the popular Tamworth Country Music Festival the next day.

But things took a nasty turn when Barry woke at 5am, having lost feeling down one side of his body. He was rushed to hospital where he was diagnosed as having had a mini-stroke.

"After Barry's condition stabilised, he was cleared to go home, but not to drive," Margaret said. "I had never towed the caravan before and was worried how I would get it home. In all honesty, I was tempted to just put it on the highway with a 'for sale' sign."

Margaret rang the NRMA Insurance Helpline, a free 24-hour service for customers that provides emergency advice and assistance. NRMA Insurance arranged to tow the caravan more than 400 kilometres back to the Walls' home.

Tony Iacono, who manages caravan products at NRMA Insurance, said the Helpline is designed to assist people deal with stressful situations.

"Each year, thousands of Australians drive off on holidays but unfortunately things don't always go to plan. And when people are away from home they can feel vulnerable and in need of assistance," Tony said.

"It was fantastic help at a time when we both really needed it," Margaret said.

AUSTRALIAN OPERATIONS CONTINUED

YEAR IN REVIEW

Our workers' compensation business substantially improved its performance during the year. We successfully renewed our licences in NSW and Victoria, but exited the South Australian market.

Our Victorian business exceeded key performance targets, and achieved significant improvements in its satisfaction rankings from employers and injured workers compared to last year.

We worked hard to transform our NSW workers' compensation business into a higher performing business. A new leadership team is in place and WorkCover has introduced a new remuneration model that provides greater certainty and focus on performance and results for employers and injured workers.

Our Swann Insurance business continued to perform well, winning major contracts with General Motors Holden and Honda Motorcycle & Power Equipment during the year. A new insurance sales software system was implemented, making it easier and more efficient for our partners to do business with us.

We are working hard to strengthen the profitability of our distribution partnerships business by investing in new technology and processes, and improving the engagement of our people.

OUR PEOPLE

The Business Partnerships team helps people get on with their lives after an incident or injury – this is the promise we make to our business partners and their customers. For example, we were on the ground providing emergency assistance to customers within 24 hours of when Cyclone Larry struck. To support our work in this area, we received two Victorian WorkCover Authority industry excellence awards and a \$20,000 bursary for research into work-related stress; and we will support injury management education via postgraduate courses through the Personal Injury Education Foundation.

LOOKING FORWARD

In NSW, competition will return to the workers' compensation market as the freeze on shifting business between agents lifted on 30 June 2006. In future years, competition is also likely to intensify between insurers that partner with financial institutions and motor dealers, as ongoing industry consolidation reshapes these markets.

Business Partnerships will continue to focus on driving sustainable, profitable growth by sharing knowledge, skills and experience across its businesses and with its partners to improve customer experience and performance.

CGU

CGU distributes a range of commercial, rural and personal insurance products through a network of more than 1,000 brokers and authorised representatives. CGU continued to deliver profitable returns during the year despite increased market competition and the impacts of Cyclone

Larry. The result reflects our commitment to disciplined underwriting and an unwillingness to write business at prices below the level we consider necessary to generate an adequate return on capital.

Renewal rates through the year remained high, particularly among small to medium size businesses and rural customers, a sign of the strong relationships we have with intermediaries in these segments.

Average premiums in commercial insurance reduced as the 'soft cycle' intensified during the year, coupled with the ongoing benefits of tort reform which affected the liability classes. Competition from local and international insurers increased, and was particularly strong in general liability, professional indemnity, workers' compensation and commercial property.

To position CGU for sustainable growth, we have defined our business goals to be:

- number one in small to medium size businesses, regional and brokered personal lines;
- in the top three of other markets we compete in;
- number one in claims;
- an employer of choice;
- a leader in technology; and
- a leader in innovative solutions.

During the year, we relaunched our flagship rural package, Countrypak, with significant additional benefits, made improvements to our flagship Commercial Pack, and launched a new home warranty product for owner builders.



RESEARCHING WAYS TO TREAT COMMON INJURIES

Each year, there are more than 8,000 road collisions in the ACT, which result in around 800 injury compensation claims and cost the community more than \$40 million.

Many of the injuries sustained in road collisions are minor or moderate musculoskeletal injuries, with whiplash associated disorders accounting for about 75% of these claims.

To help people return to their normal life after a car crash, NRMA Insurance has partnered with a range of organisations to research ways to improve health outcomes.

In the ACT, NRMA Insurance is involved with the ACE Study, a two-year research trial that

assesses whether a more coordinated and timely approach to the treatment of crash victims – which encourages patients to follow a plan developed by a specialist medical provider – will lead to improved health outcomes.

NRMA Insurance's Project Manager for the ACE Study, Susannah Littleton, said the current system provides the potential for excellent health outcomes. However, the study seeks to scientifically validate further improvement, which could later be used as a system for treatment of people with minor or moderate musculoskeletal injuries.

"The ACE Study has the potential to reduce the burden of injuries from car crashes – physically, emotionally and financially. It's a clear example of how we can help our community and the business at the same time," she said.

We launched Farm Risk Radar, an online tool that helps our customers identify safety risks on their farms, and also developed a similar online risk management tool for our office and motor fleet customers to be launched in the current year. These tools are offered to customers as an additional benefit of insuring with CGU, and will help us to build loyalty with both existing and potential customers.

Our commitment to superior products and services was again recognised in the annual JPMorgan Deloitte General Insurance Industry Survey. Middle market brokers voted CGU Professional Risks the nation's best underwriter for professional indemnity and directors and officers' liability insurance for the seventh consecutive year. They also voted CGU best underwriter for home insurance.

Claims performance is one of the most important satisfaction drivers for our intermediaries and their customers. Our commercial claims service is already well regarded by intermediaries, and we introduced significant changes to our personal insurance claims service during the year in response to intermediary feedback. Key changes included dedicated service teams, greater flexibility around claims settlement, and improved communication.

During the year, we launched a secure portal for our intermediaries on our website offering customised product content, news and access to business applications. We also added a new

commercial motor product to our current e-commerce suite. Overall revenue processed through e-commerce channels continued to grow.

OUR PEOPLE

Commercial and rural insurance are highly specialised, requiring in-depth product and technical knowledge, understanding of legal and regulatory frameworks and detailed knowledge of industry and customer segments. A knowledgeable and experienced team is integral to the success of our business.

To address a shortage of people skilled in these fields, we launched the CGU Academy, which offers accredited technical and product training to our people. This innovative approach will both develop our existing people and enable new entrants from other industries to fast-track a career in insurance.

LOOKING FORWARD

While weak market conditions are expected to persist, we will continue to position CGU for sustainable profit and business growth, while remaining disciplined in our underwriting and risk selection.

Our focus on business growth and retention will be achieved through improved products, services and claims management, new technology solutions and ongoing investment in developing our people.



Mario Pirone
CEO, CGU

CGU continued to deliver profitable returns during the year, despite increased market competition, and the impacts of Cyclone Larry.



LENDING FARMERS A HAND WITH SAFETY

In Australia, farm-related injuries result in more than 5,000 workers' compensation claims annually, making it one of the most dangerous workplaces in the country.

It is for this reason that CGU, Australia's largest regional and rural insurer, launched an online risk management tool in May 2006 to help farmers identify and eliminate safety hazards.

Farm Risk Radar enables farmers to self-assess their safety performance in their own time, and provides a tailored action plan to reduce the risk of farm-related injuries.

CGU's Head of Regional and Rural, John Evans, said feedback from farmers indicated that tackling important safety issues can be a challenge because of limited resources and often remote locations.

"By providing online risk assessment capability to farmers, we believe we can make a real difference to their safety and hopefully contribute to a reduction in the tragic toll of injuries on Australian farms," John said.

Farm Risk Radar is the second in a suite of online tools developed by CGU. The first was developed for smash repairers and was recognised by the United Nations Association in its World Environment Day Awards for 2005, picking up the CPA Australia Triple Bottom Line Award.

NEW ZEALAND OPERATIONS



Nick Hawkins
CEO, IAG New Zealand

Our New Zealand business delivered an insurance margin in line with the record performance achieved in the previous year.

IAG New Zealand improved performance across all key financial indicators, reflecting an emphasis on cost reduction and fewer claims.

High customer retention and satisfaction levels also helped the business to maintain momentum during the year, despite the challenge of responding to a major snowstorm in Canterbury and North Otago, and significantly heightened competition from both domestic and offshore players over the period.

We maintained our position as the country's leading insurer, with 36% of the general insurance market. Since we completed the acquisition of Mike Henry Travel Insurance in June 2006, we are now also the leading underwriter and distributor of travel insurance products across the country.

In May 2006, we acquired 51% of the mechanical warranty company DriveRight, which complements our existing motor business distributed through Swann Insurance and Janssens.

We introduced new, user-friendly contract wordings for our commercial products in motor vehicle, liability and property lines – a market first in New Zealand. Sustained improvement in customer claims satisfaction has contributed positively to the reputation of NZI and State. In recognition of this, NZI was awarded Underwriter of the Year by the Insurance Brokers Association of New Zealand in September 2005.

OUR PEOPLE

During the year, a number of programs were implemented to provide a more flexible and safe work environment and to reward strong performance. These have been embraced by our people, reflected in a recent survey which showed a 4% improvement in engagement levels.

Over the past year, more than 250 of our people participated in community volunteering programs. We also supported more than 400 employees who are in the process of attaining qualifications through the Australian and New Zealand Institute of Insurance and Finance.

We believe strongly in contributing to the development of our industry, which is why we have also supported the professional education of many of our brokers through the Insurance Brokers Association of New Zealand.

LOOKING FORWARD

Competition in the New Zealand insurance market is expected to remain vigorous, while the national economy is showing some signs of slowing and labour markets are tightening.

We believe distribution channels will better position us to execute our strategy in the current environment.

We will continue to focus on our three key business objectives: ensuring we have clear customer focus; excellence in underwriting, claims and process delivery; and ensuring our people are highly engaged.



HELPING TO EDUCATE DRIVERS ON THE DANGERS OF FATIGUE

Prevention is at the centre of IAG New Zealand's approach to sustainability. It is about treating causes rather than effects, and one of the main causes of road incidents is driver fatigue.

To help prevent road incidents, State introduced a new initiative, Driver Reviver, which aims to educate New Zealand motorists about the dangers of driver fatigue.

Rest stops are situated on busy stretches of road over long weekends and holiday periods, encouraging drivers to stop, take a break and revive themselves with free refreshments.

Over the 2006 Easter weekend, Driver Reviver stops were set up at four locations across New Zealand, with more than 3,000 cars stopping on the Easter Monday holiday.

State's Personal Sales Team Leader, David Gray, said the initiative was a great example of how we can help our community and help reduce driver fatigue road accidents.

"The reaction from those who stopped was overwhelming – they were really impressed that an insurance company would do such a thing," David said.

"It was a terrific way to target dangerous traffic spots and times of day. It has already changed the attitude of some motorists, who said they now realised they must take a break."

ASIAN OPERATIONS

We took a number of steps during the year in line with our goal to establish an Asian foothold, with our Asian businesses contributing to the Group's gross written premium and underwriting profits for the first time.

Our presence in Thailand expanded with the purchase of a general insurer in July 2005, renamed NZI Thailand, and we increased our long-held stake in Safety Insurance to 96%.

Together, these two businesses provide IAG with the fourth-largest share of the fast growing Thai insurance market, with a presence in both personal and commercial insurance.

In March 2006, we purchased a 30% stake in AmAssurance, Malaysia's second-largest motor insurer. A part of AMMB, one of Malaysia's largest banks, AmAssurance has an extensive distribution network, with a one-stop offering for financial services products to distributors, and bancassurance opportunities.

In June 2006, we agreed to acquire a newly formed Lloyd's managing agency and specialist Asian syndicate, to support the development and management of our expanding Asian portfolio allowing us to leverage reinsurance opportunities in the region.

We also established a regional office in Singapore, from which we oversee our existing interests in Malaysia, Thailand and Singapore, and search for new opportunities in the region.

In China, the Group's roadside assistance company, CAA, continued to focus on creating a high performance culture and enhancing profitability through disciplined

cost management, innovative product design and improved customer service.

In line with the Group's desire to reduce risk in the community, CAA continued to roll out its road safety campaign in conjunction with Tsinghua University. The campaign was designed to raise community awareness on topics such as wearing seat belts, braking distances, the use of child restraints and capsules, and the effects of drink-driving.

During the year, we progressed our plan to acquire 24.9% of China's second-largest insurer. Upon completion, this will provide us with an entry into one of the world's fastest growing general insurance markets.

In each of the countries in which we operate, we are building strong relationships with the prudential regulators and industry bodies, that enable us to provide valuable input into market and regulatory reform.

LOOKING FORWARD

We will continue to build our portfolio of Asian assets, both through further acquisitions and organic growth opportunities. Continued growth in market insurance premiums in excess of 10% per annum is expected in these markets, given the current low levels of penetration coupled with natural economic growth well above that of more mature markets.

Working closely with our business partners, we will focus on initiatives which leverage IAG's world class skills in underwriting and claims management as well as our partners' local knowledge and distribution capabilities, to identify and scope opportunities for growth.



Justin Breheny
CEO, Asia

Our Asian division was formed during the year with responsibility for overseeing our growing portfolio of investments in the region.



A NEW BEGINNING IN THAILAND

Early in 2006, IAG marked the renaming of its new Thai business, NZI Thailand, with an official ceremony in Bangkok. The CEO of NZI Thailand, Chris Dooley, said the new brand would quickly gain recognition, and would benefit from being part of the broader IAG stable of businesses.

"The NZI brand has a long tradition which dates back to 1859. It has been used once before in the Thai market, as well as being the brand for New Zealand's leading commercial insurer, also part of the IAG stable," Chris said.

"Being part of IAG provides the opportunity for NZI Thailand to draw on the world class capabilities of the Group in underwriting and claims management.

We are already sharing product and technology information and have seen some improvements."

IAG's CEO Asia, Justin Breheny said the acquisition of NZI Thailand was an important step in the Group's strategy to build a presence in Asia.

"With a population of more than 60 million people and strong forecast economic prospects, we long ago identified Thailand's general insurance market as having solid growth potential," Justin said.

"NZI Thailand is our second acquisition there – we have been working closely with the team at Safety Insurance since 1998 and are now pleased to be working just as closely with the team at NZI Thailand."

BOARD OF DIRECTORS



MR JA (JAMES) STRONG AO
Age 62 – Independent
Non-executive Director

Mr James Strong was appointed Chairman of IAG in August 2001. He is Chairman of the IAG Nomination, Remuneration & Sustainability Committee.

Mr Strong is Chairman of Woolworths Limited, Rip Curl Group Pty Limited and the Australia Council for the Arts. He is also a Director of the Australian Grand Prix Corporation, Dorna Sports SL and Qantas Airways Limited.

Mr Strong was Chief Executive and Managing Director of Qantas Airways Limited from 1993 to 2001. Previous positions he has held include Group Chief Executive of DB Group Limited in New Zealand, National Managing Partner and later Chairman of law firm Corrs Chambers Westgarth, Chief Executive of Trans Australian Airlines (later Australian Airlines) and Executive Director of the Australian Mining Industry Council.

Mr Strong has been admitted as a barrister and/or solicitor in various state jurisdictions in Australia.

In 2006, Mr Strong was made an Officer of the Order of Australia.

Directorships of other listed companies held in past three years

- Woolworths Limited – since 10 March 2000;
- IAG Finance (New Zealand) Limited – since 9 November 2004; and
- Qantas Airways Limited – since 1 July 2006.



MR MJ (MICHAEL) HAWKER
BSc, FAICD, FAIM, F Fin
Age 46 – Chief Executive Officer and Managing Director

Michael Hawker was appointed Managing Director and Chief Executive Officer of IAG in December 2001.

Before joining IAG, Mr Hawker was Group Executive, Business and Consumer Banking at Westpac Banking Corporation. Previous positions include Executive Director of Citibank International PLC in Europe and Deputy Managing Director of Citibank Limited in Australia. Mr Hawker was listed by Euromoney as one of the top 50 bankers under the age of 40, and one of The Australian Financial Review's True Leaders in 2004 and 2005. He was awarded the Australian Banking & Finance Magazine Millennium Banker of the Year Award in 2000, and the Best Insurance Executive Award in 2003 and 2004. In 2006, he was awarded Insurance Personality of the Year at the Australian and New Zealand Insurance Industry Awards, and Leader of the Year at the Human Capital Leadership Awards. He is a recipient of an Australian Sports Medal, having played 25 Rugby Union Internationals for the Australian Wallabies.

Mr Hawker is President of the Insurance Council of Australia; Member of the Financial Sector Advisory Council; Chairman of the Australian Business in the Community Network; Member of the Business Council of Australia; Member of the Business Roundtable for Sustainable Development; Member of the Australian Business and Arts Foundation (AbaF); and Advisory Board Member for the Police Commission of NSW. He was previously Chairman of the Australian Financial Markets Association; Director of the Australian Chamber of Commerce and Industry; Member of the Federal Treasurer's Consumer and Financial Literacy Council and an Advisory Board Member of the Australian Graduate School of Management.

Directorships of listed companies held in past three years

- IAG Finance (New Zealand) Limited – since 9 November 2004.



MS YA (YASMIN) ALLEN
BCom, FAICD
Age 42 – Independent
Non-executive Director

Ms Yasmin Allen was appointed as a Director of IAG in November 2004. She is a member of the IAG Risk Management & Compliance Committee.

Ms Allen has extensive experience in investment banking, as an equities analyst and in senior management.

Ms Allen was previously a Vice President at Deutsche Bank AG, a Director at ANZ Investment Bank in Australia, an Associate Director at James Capel UK Ltd (HSBC Group) and an analyst at Kleinwort Benson plc Investment Bank in the UK.

Ms Allen is currently a Director of Export Finance & Insurance Corporation (EFIC), Macquarie Specialised Asset Management (and the Chairperson of its Audit Committee), Film Australia (and the Chairperson of its Audit Committee), the Salvation Army Advisory Board and the Salvation Army Investment Advisory Board.

Directorships of other listed companies held in past three years

- None.



MR JF (JOHN) ASTBURY
FAICD
Age 62 – Independent
Non-executive Director

Mr John Astbury was appointed as a Director of IAG in July 2000. He is Chairman of the IAG Audit Committee and serves on the IAG Nomination, Remuneration & Sustainability Committee.

Mr Astbury is a Director of Woolworths Limited and AMP Limited. He was previously the Finance Director of Lend Lease Corporation Limited and a Chief General Manager of National Australia Bank Limited. He has a long career in banking and financial services in both the UK and Australia.

Directorships of other listed companies held in past three years

- Woolworths Limited – since 29 January 2003; and
- AMP Limited – since 1 September 2004.



MR GA (GEOFFREY) COUSINS

Age 63 – Independent
Non-executive Director

Mr Geoffrey Cousins was appointed as a Director of IAG in July 2000. He is a member of the IAG Audit Committee.

Mr Cousins has more than 26 years, experience as a company director. Mr Cousins was previously the Chairman of George Patterson Australia and is a former Director of Publishing and Broadcasting Limited, the Seven Network, Hoyts Cinemas Group and NM Rothschild and Sons Limited. He was the first Chief Executive of Optus Vision and before that held a number of executive positions at George Patterson, including Chief Executive of George Patterson Australia.

Mr Cousins is a consultant to the Prime Minister and is the Chairman of the Cure Cancer Australia Foundation.

Directorships of other listed companies held in past three years

- None.



MR ND (NEIL) HAMILTON

LLB
Age 54 – Independent
Non-executive Director

Mr Neil Hamilton was appointed as a Director of IAG in June 2000 and as a Director of Insurance Australia Limited (formerly NRMA Insurance Limited) in 1999. He is a member of the IAG Risk Management & Compliance Committee.

Mr Hamilton is the Chairman of IRESS Market Technology Limited and Integrated Group Limited. He was formerly the Chairman of Western Power Corporation.

Directorships of other listed companies held in past three years

- Integrated Group Limited – since 2 August 1999;
- IRESS Market Technology Limited – since 15 September 2000;
- Chieftain Securities Limited – from 12 June 2002 to 19 November 2004; and
- Sons of Gwalia Ltd – from 19 January 2004 to 28 January 2005.



MR RA (ROWAN) ROSS

BEC, BCom, FCPA, SF Fin
Age 57 – Independent
Non-executive Director

Mr Rowan Ross was appointed as a Director of IAG in July 2000 and acted as Chairman from April to August 2001. He is Chairman of the IAG Risk Management & Compliance Committee and serves on the IAG Nomination, Remuneration & Sustainability Committee.

Mr Ross is currently Chairman of Macquarie Capital Alliance Limited and Sydney IVF Limited. He is the former Chairman of Bankers Trust Investment Bank, former National President of the Securities Institute of Australia and former Chairman of the Sydney Dance Company and the Australian Major Performing Arts Group. Mr Ross has more than 30 year's experience in investment banking and is an Executive Director of Macquarie Bank Limited.

Directorships of other listed companies held in past three years

- IAG Finance (New Zealand) Limited – since 9 November 2004; and
- Macquarie Capital Alliance Limited – since 25 January 2005.



MR B (BRIAN) SCHWARTZ AM

FCA
Age 53 – Independent
Non-executive Director

Mr Brian Schwartz was appointed as a Director of IAG in January 2005. He is a member of the IAG Audit Committee.

Mr Schwartz is the Chief Executive of Investec Bank (Australia) Limited (effective 14 February 2005). Prior to this he was with Ernst & Young Australia (1979 – 2004), becoming its Chief Executive in 1998. He was a member of Ernst & Young's global board and Managing Partner of the Oceania region.

Mr Schwartz serves as a Trustee and Vice President of The Australian Museum; and Deputy Chairman of the Board of Football Federation Australia Limited. He was appointed a Member of the Order of Australia in 2004 for his services to business and the community.

Directorships of other listed companies held in past three years

- None.

CORPORATE GOVERNANCE

IGAG's corporate governance structure and risk management framework is designed to provide a sustainable balance between its core operating purpose (to pay claims, understand and price risk, manage costs and reduce risk) and its responsibility to provide fair and stable returns to shareholders.

IGAG'S APPROACH TO CORPORATE GOVERNANCE

The Group is committed to attaining the highest level of corporate governance to ensure the future sustainability of the organisation and to create long-term value for its shareholders. To achieve this, the company promotes a culture that rewards transparency, honesty, meritocracy, teamwork and social responsibility.

The key corporate governance practices followed by the Group and its people are summarised below. It is not an exhaustive list of all corporate governance practices in place. Copies of IGAG's Board and Board Committee charters and key corporate governance policies can be found on IGAG's website at www.igag.com.au.

International

During the past year, the Group's corporate governance framework has continued to evolve in response to changes in its operations and as a result of the Group's international expansion. This has resulted in the formation of a new committee, the International Advisory Panel (IAP), which replaces a former executive management committee, the Asia Management Advisory Council and also resulted in the appointment of Mr Justin Breheny to the new executive role of CEO, Asia.

Formation of the IAP followed a review undertaken of the Group's governance framework to assess its effectiveness to address issues that may arise in the course of the Group's international expansion, as well as to deal appropriately with an expanded Group. The review also included policies adopted by other companies which have implemented successful governance frameworks for their domestic and international operations.

The principal role of the IAP is to provide advice and support to the Group's executives to assist them, particularly in the area of culture and relationships, in the effective execution of the Group's strategy of building an international portfolio of general insurance businesses in regions and countries, outside of Australia and New Zealand in which IGAG is operating or proposing to operate.

The IAP's members are drawn from the Group's Board, senior executives and external advisors. A summary of the key responsibilities of this new Committee is provided at page 37.

Other key outcomes from the review of the Group's governance framework, which are currently being implemented, were:

- reviewing executive management committees' terms of reference for escalation thresholds for issues arising from offshore investments. A summary of these committees' roles is provided at pages 36 and 37;
- rating overseas investments by the regulatory environment, materiality, reputation and strategic importance to guide decisions around board composition, engagement, risk management and internal audit approaches;
- establishing a global people framework that defines the Group's processes for dealing with people and culture matters, including developing a code of ethics to guide business conduct and striving to build a culture that values exemplary ethical standards, honesty and transparency wherever the Group operates;
- extending the risk management strategy to incorporate international expansion, addressing, for example, risk appetite, reporting protocols and referral mechanisms for issues that impact the Group;
- establishing uniform internal audit processes and risk and reporting criteria; and
- positively influencing stakeholders of new investments to support the Group's culture that rewards transparency, honesty, meritocracy, teamwork and social responsibility.

Regulatory

The regulatory environment in which the Group conducts its business continues to have a major influence on the Group's corporate governance practices.

New prudential standards have been released by APRA on reinsurance

management; audit and actuarial reporting and valuation; risk management; fit & proper requirements; and governance for general insurers as part of APRA's Stage II General Insurance Prudential Standards. The Group is in the process of making any changes necessary to meet the standards by their effective date of 1 October 2006, and formulated plans for their implementation. The standards will enhance the Group's corporate governance framework. The documentary compliance required by APRA will also increase the Group's regulatory compliance cost burden.

Throughout the reporting period, the Group has complied with the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations.

The Group believes that active engagement with governments, regulators, industry and professional groups, ensures that the interests of the Group and its stakeholders are properly considered in the formulation of proposals to improve Australia's corporate governance, general insurance prudential regime and insurance industry practices. In this context, the Group strives for regulation that enhances, rather than stifles, competition; protects consumers; encourages efficiency; and promotes and sustains public confidence in insurers and their products.

In the past year, the Group has again actively participated in the debate to improve Australia's corporate governance regime, making submissions to federal and state government committees and enquiries, and regulators in relation to new legislation and regulation affecting the insurance industry. In addition, IGAG representatives have participated in forums, working parties and committees of domestic and overseas insurance industry associations, accounting and actuarial professional bodies to help formulate responses to proposals to improve corporate governance, prudential and financial reporting standards and practices that have particular application to the general insurance industry.

THE BOARD OF DIRECTORS

Roles and responsibilities

The Board

The Board is accountable to shareholders for the performance, operations and affairs of the Group. The Board's principal role is to govern, rather than manage, the Group. The Directors represent and serve the interests of the shareholders and collectively oversee and appraise the strategies, policies and performance of the Group.

In performing its role, the Board is mindful that the obligations of the Directors are primarily set out in the Corporations Act, the Insurance Act and general law.

The Board is responsible for oversight of the Group, and specifically:

- driving the strategic direction of the Group and approving corporate strategies;
- selecting, regularly evaluating and, if necessary, replacing the Chief Executive Officer;
- setting goals and policies for the Group including risk appetite;
- monitoring management's performance;
- appointing and, where appropriate, removing the Chief Financial Officer and the Company Secretary;
- reviewing management succession planning;
- providing advice and counsel to senior management;
- selecting and recommending appropriate candidates to the Group's shareholders for election to the Board;
- evaluating Board processes and performance of the Board as a whole, as well as contributions by individual Directors;
- monitoring financial performance and reporting;
- reviewing the adequacy of systems to comply with all laws and regulations which apply to the Group and its businesses;
- monitoring key risk areas by ensuring the implementation of a suitable risk management and internal controls framework;

- monitoring the exercise of authority delegated to the Chief Executive Officer;
- ensuring that reporting and disclosure processes include all relevant legal and commercial requirements; and
- ensuring that proper governance practices (including appropriate standards of ethical behaviour, corporate governance and social responsibility) are established and processes exist to ensure they are adhered to at all times.

The Chief Executive Officer

The Board has delegated responsibility for the day-to-day operations and administration of the Group to the Chief Executive Officer, who is responsible for:

- developing, implementing and monitoring the strategic and financial plans of the Group, in conjunction with the Board;
- ensuring the efficient and effective operation of the Group;
- ensuring the ongoing development, implementation and monitoring of the Group's risk management and internal controls framework;
- ensuring the Board is provided with accurate and clear information in a timely manner to promote effective decision-making by the Board; and
- ensuring all material matters affecting the Group are brought to the Board's attention.

The Chairman

The Chairman provides leadership to the Board and the Group. The Chairman presides at Board and general meetings of the company. The Chairman is responsible for ensuring the Board discharges its role, and works closely with the Chief Executive Officer in that regard. The roles of the Chairman and the Chief Executive Officer are separate.

The Board does not have a Deputy Chairman. However, Mr Rowan Ross has, on occasions, acted in this capacity.

Structure and composition of the Board

The company's constitution provides for a minimum of three directors and a maximum of 12 or fewer directors as determined by the Directors from time to time. The Directors have determined that, for the present, the maximum

number of directors is eight.

The Board currently comprises seven non-executive Directors and one executive Director, Mr Michael Hawker.

The Board has determined that the Board must comprise a majority of independent non-executive Directors and that the Chairman must be an independent non-executive Director.

The Board will determine whether each Director is independent, using the principles outlined in its Charter. Independence will be taken to be met when a Director is a non-executive Director and:

- is not a substantial shareholder of the company (a shareholder with 5% or more of the issued voting shares), or associated directly with a substantial shareholder of the company;
- has not within the past three years been employed as an executive of the company or any of its subsidiaries or been a Director after ceasing to hold any such employment;
- has not within the last three years been associated with, or a principal of, a material professional advisor or material consultant to the Group, or an employee materially associated with the service provided;
- is not a material supplier or customer of the Group, or an officer of or otherwise directly or indirectly associated with a material supplier or customer and has no material contractual relationship with the Group other than as a Director;
- has not served on the Board for a period which could, or could reasonably be perceived to, materially interfere with the Director's ability to act in the best interests of the Group (as determined by the Board in the case of each Director); and
- is otherwise free from any interest and any business or other relationship that could, or could reasonably be perceived to, materially interfere with the Director's ability to act in the best interests of the Group.

CORPORATE GOVERNANCE

The Directors have determined that a relationship is material where the value of goods or services provided to the Group in the past three years accounts for 5% or more of the consolidated gross revenue or consolidated expenses of either the Group or the supplier/customer's corporate group over that three-year period.

Non-executive Directors are required to confirm their independence periodically while they remain in office. All current non-executive Directors have confirmed their continued independence.

Where the Board is required to approve a transaction or arrangement with an organisation in which a Director has an interest, the relevant Director must disclose their interest and abstain from voting. Furthermore, Directors with potential conflicts do not serve on any Board Committees that are appointed to provide oversight of the implementation of transactions or arrangements, in which the other organisation plays a role.

The Board considers its size and composition annually. In doing so, Directors will consider, among other things:

- the nature, size and complexity of the Group; and
- the efficiency and effectiveness of the Board, balancing the need to have sufficient skills and expertise to fulfil the needs of the Board and all its Committees, with the need to maintain a Board size where all Directors can effectively participate and contribute.

The names of Directors in office at the date of this report, their year of appointment, their designation as a non-executive independent or executive Director and their experience, expertise, and biographical details are set out at pages 28 and 29.

The Board engages reputable recruitment consultants to assist the Board to identify suitable candidates for appointment to the Board.

Non-executive Director induction and training

The Group encourages continuing professional education for each of its Directors. All Directors are expected to remain up to date in relation to issues

affecting the Group, the general insurance industry, and their duties as Directors.

New Directors and senior executives have access to an orientation program to introduce the executive team and detail the Group's businesses. Orientation also includes site visits by new Directors as well as individual meetings with the Chief Executive Officer, Group executives and other senior management.

'101' workshops are conducted regularly to assist Directors' education on topics which include fundamentals of general insurance, reinsurance and investments. For example, in the past year, a workshop was held on strategic asset allocation for investments.

Executive Directors appointed to subsidiary and associated company boards are required to undertake a minimum level of director training and to demonstrate that they have undertaken ongoing development and training to continue to effectively and competently perform their roles as executive directors.

Tenure

It is expected that Directors will continue as Directors only for so long as they have the confidence of their fellow Board members and the confidence of the company's shareholders.

In September 2003, the Board introduced a tenure policy to apply to non-executive Directors to ensure the Board comprises Directors who collectively have the relevant experience and skills required, and assists in maintaining the independence of the Board. This policy, among other things, provided that the standard tenure for a non-executive Director would be up to seven years although the Board retained its discretion to invite Directors to stand for an additional term which may take their total tenure beyond seven years.

Since the policy was introduced, four Directors have left the Board and two new Directors have been appointed to the Board.

The Board invited three Directors, Messrs Astbury, Cousins and Ross to stand again for re-election at the company's 2005 Annual General Meeting (AGM) even though these further terms have taken their respective total individual tenures beyond seven years. As the company

would have lost three of its most experienced and capable non-executive Directors, the Board determined that it was in the best interests of the company for these Directors to remain on the Board for a further period. The Board also announced at the same time that it would review the tenure policy.

Following that review, which included a study of the policies and practices of the 50 largest companies (by reference to market capitalisation) on the ASX, the Board has agreed that the maximum tenure of a non-executive Director shall be 10 years. Tenure includes the aggregate period of service with the company as well as service on the Board of Insurance Australia Limited (formerly NRMA Insurance Limited) accrued prior to service as a director of the company.

Appointment terms

Formal appointment letters have been issued to each non-executive Director, including the Chairman, to assist individual Directors in understanding the role of the Board and the corporate governance principles adopted by the Board. The letters formally document the basis of each Director's appointment, including the standard term of their appointments and, where applicable, the cessation of further accrual of retirement benefits.

The appointment letters also provide for:

- the right of non-executive Directors to, upon providing prior notice to the Chairman, obtain independent professional financial and legal advice, at the company's expense, to assist with discharging their duties efficiently;
- measures used, and the processes to be applied, by the Board to assess the individual performance of Directors, details of which are set out in the section below; and
- the expectation that Directors will abide by the company's Code of Conduct and its Continuous Disclosure & Insider Trading policy.

Measuring the performance of Directors

The Nomination, Remuneration & Sustainability Committee conducts a formal review of the Board's performance, composition and size at least every three years.

Each Director's performance is subject to evaluation by the Chairman at least every two years, by discussion between the Chairman and the Director. Individual Directors also evaluate the Chairman's performance at least every two years. Measures of a Director's performance will include:

- contribution of the Director to Board teamwork;
- contribution to debates on significant issues and proposals;
- advice and assistance given to management;
- in the case of the Chairman's performance, the fulfilment of his/her additional role as Chairman; and
- input regarding regulatory, industry and social developments surrounding the business.

A review of individual Directors' performance was conducted in June 2005, with assistance and input from an independent board performance expert. The review process involves the completion of questionnaires by Directors and Group executives, the collation of results and discussion with individual Directors and the Board as a whole led by the Chairman.

Board operations

The Board meets formally at least nine times during the year.

In addition, the Board meets twice a year with the Group's executive team to review the company's strategic plan and to set the company's overall strategic direction. In the past year, the Board and Group Executive undertook a study trip in Europe which provided them with the opportunity to see first-hand the practices and trends in those markets which may be relevant to anticipated developments in the Group's existing markets, or which may form the basis for further investments by the Group, consistent with its long-term strategy to build a presence in key offshore growth markets.

Directors were also involved in a number of additional Board meetings for specific Group initiatives which, during the past year, principally related to investments in overseas markets.

Directors are encouraged to bring to Board meetings objective independent judgement in relation to the matters under consideration, to ask incisive, robust questions and require accurate, honest answers.

Directors' attendance at Board and Committee meetings held during the year are shown at page 41 in the Directors' Report.

As part of the operation of the Board and standing Board Committees, non-executive Directors set aside time in meetings from time to time to meet without any management representatives present. The Board also meets with the Chief Executive Officer (without other executive management present) at the commencement of each meeting. Senior management representatives frequently attend Board meetings at the Board's invitation.

Directors receive agendas, board papers and minutes in advance of meetings in hard copy or may access this information from a secure website established for this purpose.

COMPANY SECRETARY

The company has appointed two Company Secretaries who are responsible to the Board for ensuring board procedures are complied with and who also provide advice and counsel to the board in relation to the company's constitution, corporate governance, investor relations and other matters.

The qualifications and experience of IAG's Company Secretaries are set out at page 41.

STANDING COMMITTEES

The company has three standing Board Committees, each with charters and established operating procedures. Copies of the Committee charters are available at the Group's website, www.iag.com.au.

Committee processes

All standing Board Committees are required to have three members and currently comprise only independent non-executive Directors. Each Committee meets at least four times each year.

The Committees have unfettered access to Group executives, senior management and advisors. The Chief Executive Officer, Group executives and senior management are invited to meetings as required. All Directors receive Committee papers and may attend any Committee meeting.

The Chairs of the Committees give oral reports on outcomes at the next Board meeting immediately following each Committee meeting and copies of all Committee minutes are made available to the full Board.

Each Committee annually reviews fulfilment of its responsibilities under its respective charter. Performance of each Committee is reviewed at the same time as the Board conducts its review of performance.

Nomination, Remuneration & Sustainability Committee

The three members of the Nomination, Remuneration & Sustainability Committee are currently Messrs James Strong (Chairman), John Astbury and Rowan Ross.

The main responsibilities of this Committee include:

- formally reviewing Board performance, size and composition every three years, and recommending candidates for appointment to the Board;
- providing assistance to the Chairman on the review of the performance of individual Directors and making recommendations on the operation of the Board;
- making recommendations to the Board in respect of the remuneration of Non-executive Directors of the company and subsidiary boards and committees and the Chief Executive Officer as well as approval of the remuneration of the direct reports to the Chief Executive Officer;
- considering the Chief Executive Officer's performance and plans for succession, as well as reviewing management plans for executive succession;
- ensuring the Group's overall remuneration policy and approach fit the strategic goals of the Group;
- monitoring the effectiveness and integrity of, and compliance with, the Group's remuneration and human resource policies and practices;

CORPORATE GOVERNANCE

- ensuring the issues of corporate reputation, social responsibility, and the Group's commitments around safety, environment, and community and stakeholder views are appropriately considered in the context of the Group's view of its corporate purpose and strategy and the importance of corporate reputation to the delivery of sustainable value for shareholders;
- considering social, environmental and ethical impacts of the Group's business practices and setting standards for social, environmental and ethical practices; and
- reporting to the Board on all matters relevant to the Committee's responsibilities.

Audit Committee

The three members of the Audit Committee are Messrs John Astbury (Chairman), Geoffrey Cousins and Brian Schwartz. All three members have financial experience and two have accounting experience.

The main responsibilities of this Committee include:

- assisting the Board to discharge their responsibility to exercise due care, diligence and skill in relation to the integrity of the Group's internal and external financial reporting. This includes ensuring that the Group's full and half-year financial reporting is consistent with Committee members' information and knowledge and believed to be sufficient for shareholder and other stakeholders' needs;
- monitoring the application of accounting and actuarial standards, policies and practices by senior financial management when preparing full and half-year financial reports;
- assessing information from the external auditors and the internal audit function that affects the quality of external and internal financial reports;
- reviewing external auditor engagement, remuneration, independence and effectiveness;
- making recommendations to the Board on the appointment, removal and remuneration of the external auditor and monitoring his/her effectiveness;
- monitoring compliance with an agreed framework for dealing with the external

auditor's and consulting actuaries' firm for the provision of other services to ensure that such services and any relevant relationships do not compromise their objective and impartial judgement;

- meeting with the Approved Auditor, the Approved Actuary, the Head of Group Risk & Compliance and the reporting and consulting actuaries on at least an annual basis without other management being present;
- approving the internal annual audit plan proposed by Group Risk Assurance and monitoring progress against the plan;
- meeting with the Head of Group Risk Assurance on at least an annual basis without other management being present;
- monitoring the independence and effectiveness of the internal audit function and overseeing adherence to the Group Internal Audit Charter;
- making recommendations to the Board on the appointment and removal of the Head of Group Risk Assurance and monitoring his/her effectiveness; and
- reporting to the Board on all matters relevant to the Committee's responsibilities.

The Audit Committee is also empowered as the audit committee of IAG's subsidiaries that are authorised general insurers in Australia, except for Insurance Manufacturers of Australia Pty Limited, which has a separate Audit, Risk Management & Compliance Committee. In addition, the Audit Committee acts as the audit committee for IAG Finance (New Zealand) Limited, a company with debt securities listed on the ASX.

Risk Management & Compliance Committee

The three members of the Risk Management & Compliance Committee are Messrs Rowan Ross (Chairman) and Neil Hamilton and Ms Yasmin Allen.

The main responsibilities of this Committee include:

- overseeing the Group's risk management systems, practices and procedures to ensure effectiveness of risk identification and management, and compliance with internal guidelines and external requirements;

- reviewing and monitoring all material risks in the Group's risk management systems: balance sheet, market (including investment, insurance, liquidity, product, pricing, underwriting, liability, claims management and derivatives risks), credit, operational and reinsurance risks to ensure the effective management of all such risks;
- reviewing and evaluating the effectiveness of the Group's internal control systems;
- approving the internal annual audit plan proposed by Group Risk Assurance and monitoring progress against the plan;
- meeting with the Head of Group Risk & Compliance and the Group General Counsel on at least an annual basis without other management being present;
- making recommendations to the Board on the appointment and removal of the Head of Group Risk & Compliance and monitoring his/her effectiveness; and
- reporting to the Board on all matters relevant to the Committee's responsibilities.

PROMOTING ETHICAL AND RESPONSIBLE DECISION-MAKING

The Group takes ethical and responsible decision-making very seriously. It expects its employees and Directors to do the same, as reflected in its internal policies around conduct, continuous disclosure and insider trading.

Code of Conduct

The company's Code of Conduct extends to all people employed by the Group including the Directors and executive management. The Code is designed to encourage ethical and appropriate behaviour in all avenues of work, based on the following principles:

- acting honestly and openly in all dealings;
- complying with all laws and industry codes that regulate our activities;
- abiding by our rules to prevent insider trading;
- maintaining confidentiality; and
- avoiding conflicts of interest.

Code of Ethics

A Code of Ethical Business Conduct is currently being developed to provide all Group employees with a framework to make good, informed business decisions and to act on them with integrity. The Code will set out the behaviours that can be expected from every employee in the Group so that the Group's stakeholders, when interacting with Group employees, will be assured that Group employees act in a responsible, ethical, transparent and honest way wherever the Group operates.

The Code will apply to all employees of the Group's subsidiaries.

Whistleblowing

Employees are encouraged to raise any material matters of concern through the Group's management structure as part of the Group's objective of building a culture where people perform their duties in an ethical and appropriate manner.

The Group is proactive about preventing, detecting and investigating all instances of suspected serious inappropriate behaviour. ActionLine, a phone and internet reporting system hosted and monitored by an external service provider, was introduced to capture the most serious incidents of inappropriate behaviour within the organisation and to encourage employees to raise other material matters of concern that they believe have not been appropriately addressed through the Group's management structure. This can be done anonymously through the external host.

Continuous disclosure and insider trading

The company's Continuous Disclosure & Insider Trading Policy reinforces its commitment to continuous disclosure, as well as the responsibility of all employees regarding price sensitive information and insider trading.

The Policy also includes a protocol outlining how information is released to the public and provides examples of what could constitute price sensitive information and how knowledge of such information prohibits share trading.

A share trading protocol sets the framework for employee dealings in IAG securities, and aims to prevent employees from inadvertently breaching insider trading laws. The protocol specifies that Directors, Group executives and designated employees may only buy or sell IAG securities in the four week period commencing two trading days after the Group's half-year and full-year results announcements and the AGM or any other period approved by the Board, subject to not being in possession of inside information as defined by the law.

In addition, IAG Directors, Group Executives and other specified designated executives may only trade in IAG securities in these periods after they have received prior consent from the Nomination, Remuneration & Sustainability Committee and complied with any conditions on trading in IAG securities that the Committee imposes, subject again to not being in possession of inside information as defined by the law.

Directors and management are encouraged to assist in the process of the Board identifying, evaluating and reporting on matters to comply with the provisions of the Corporations Act and the ASX Listing Rules in relation to continuous disclosure so as to keep the market fully informed.

SHAREHOLDERS

In keeping with the Code of Conduct and the spirit of continuous disclosure, the Group is committed to ensuring shareholders are informed of significant developments for the Group. Regular announcements to the ASX are proactively relayed through an email messaging service to shareholders and other users who are registered to receive such emails, and are posted on the company's website, www.iag.com.au. Approximately 9,000 shareholders and other registered users currently use the email messaging service.

There are approximately 62,000 shareholders who have registered their email address to be advised when shareholder communications, including the annual and interim reports, dividend advices and holding balance statements, are available electronically.

Major investor briefings are webcast where practical and copies are retained on the website for ease of access. When conducting briefings of investors, care is taken to ensure that price sensitive information is not inadvertently communicated to market participants and is provided to all investors and market participants at the same time in accordance with the ASX Listing Rules.

Media coverage of key events is also sought as a means of delivering information to shareholders and the market. Formal communication with shareholders is also conducted via the annual report, concise annual report and interim report, and at the AGM of shareholders.

The Group is mindful of the need to adopt best practices in the drafting of notices for general meetings and other communications with shareholders to ensure that its notices of meetings are honest, accurate, informative and not misleading.

Electronic proxy voting helps to facilitate ease and timeliness of lodgement by shareholders of their voting on resolutions to be put to general meetings.

Shareholders are encouraged to attend general meetings and ask questions of the Chairman and the Board.

The external auditor attends general meetings and is available to answer shareholders' questions concerning the conduct of the audit, the preparation and content of the auditor's report, the accounting policies adopted and audit independence.

Shareholders may raise any issues or concerns at any time by contacting the company. Shareholders should email their questions or comments to investor.relations@iag.com.au or write to the Chairman or Company Secretary at Insurance Australia Group Limited, Level 26, 388 George Street, Sydney NSW 2000.

CORPORATE GOVERNANCE

RISK MANAGEMENT

Managing risk is at the heart of ensuring IAG’s ongoing sustainability and delivery of value to shareholders. The Group’s risk management framework is based on the interaction of the oversight structure, internal policies, key risk management processes and culture.

Oversight structure

A number of key forums and executives oversee the Group’s management of risk. These are summarised in the diagram below and detailed in approved charters and role descriptions.

The roles and composition of the executive management committees are detailed as follows:

Operational Review Meeting (ORM)

ORM is responsible for:

- reviewing corporate strategies and the performance of the Group and its business units compared to budgets, forecasts and corporate plans;
- monitoring the Group’s operational risk;
- authorising capital allocation to major projects within financial delegation limits approved by the Board;

- reviewing the Group’s performance in the areas of health, safety, environment and community performance; and
- reviewing human resource performance and reward strategies.

ORM is now also responsible for monitoring operational, financial and community risks which have the potential to manifest themselves in severe reputation damage. These responsibilities were formerly undertaken by a separate executive management committee, the Reputation Committee. This committee is still convened by ORM where significant issues warrant a more particular focus and development of reputation risk mitigation strategies.

Asset & Liability Committee (ALCo)

The role of ALCo is to allow the Group’s senior management to:

- formulate recommendations for the Board concerning issues related to capital management and risk management, including credit risk and asset allocation;
- oversee implementation of Board policies concerning risk and capital management;

- oversee the ongoing implementation of, and compliance with, the Group’s Risk Management Strategy (RMS) including the Group’s reinsurance management strategy; and
- report to the Risk Management & Compliance Committee concerning compliance with, and the effectiveness of, the RMS.

Its members include Mr Michael Hawker (Chairman) and the Group’s executives with operational and financial roles and other key senior management with responsibility for finance, treasury, actuarial, investment and reinsurance functions.

Underwriting & Pricing Policy Committee (UPPCo)

The role of UPPCo is to provide the Group’s senior management with a forum in which to:

- establish or modify the Group’s pricing principles and framework;
- determine and monitor Group underwriting standards; and
- monitor Group insurance risk accumulations and Group reinsurance requirements.

Its members include Mr Michael Hawker (Chairman) and the Group’s executives with operational and financial roles and other key senior management with responsibility for insurance strategy, pricing, underwriting, actuarial and reinsurance functions.



International Advisory Panel (IAP)

The IAP is responsible for:

- assisting with the preparation and updating of cultural and business risk assessments on market participants in which the Group has or is contemplating making an investment;
- developing relationships with and an understanding of the key shareholders/owners, Directors, heads of business, regulators and other government representatives relevant to proposed and ongoing investments by the Group; and
- providing advice on the Group's international operations as requested by the Board or by panel members.

Its members include Messrs James Strong (Chairman), Neil Hamilton, Michael Hawker and Brian Schwartz, selected Group Executives and two external members, Mr Ian Brown, former Deputy Chief Executive Officer of the company, and Mr Ian Buchanan, Senior Advisor to and former Regional Chairman of Booz Allen Hamilton New Zealand, Australia and South East Asia.

Internal policies

Together with the Codes of Conduct and Ethical Business Conduct and the Continuous Disclosure and Insider Trading Policy, the RMS details the Group's principles, risk appetite, key controls and monitoring processes for managing the risks outlined in the diagram 'IAG's Risk Categories' below.

The main aim of the RMS is to describe the risk management frameworks within the Group. The RMS is a primary input to, and evolves with, IAG's corporate strategy. It is a statement of minimum acceptable standards for managing the full spectrum of risks associated with pursuing corporate objectives and fulfilling the Group's purpose.

The RMS is reviewed annually by the Board and, if considered appropriate, updated consistent with APRA prudential standards.

Key risk management processes

Management employs the following key processes to meet, as well as monitor, the requirements of the Group's RMS.

Management assurance framework

This is a framework of self-assessment questions posed to, and answered by, management relating to the effectiveness of risk management processes and internal controls. The answers support the Chief Executive Officer, Chief Financial Officer and Board declarations on risk management, internal control and external financial reporting.

Risk profiling

Each business unit identifies, assesses and designs controls for risks to achieving business objectives.

Risk reporting

Reporting on risk management initiatives and issues is supplied to:

- the ORM by each Business Unit;
- the key management committees (ie ALCo and UPPCo) relating to the specific risks that these bodies oversee;
- each meeting of the IAG Risk Management & Compliance Committee and the IAG Audit Committee; and
- regulators, where relevant and appropriate.

Internal audit

Internal independent reviews of key risk areas, processes, projects and management assertions about risk management and internal control are undertaken by the internal audit function (Group Risk Assurance). This function reports to the Chief Risk Officer and the IAG Audit Committee.

Independent auditor's reviews

External independent reviews of key financial risk areas, processes and issues are provided by the independent auditor.



IAG's Risk Categories

CORPORATE GOVERNANCE

Culture

The Board and management actively promote a culture of honesty, transparency, teamwork, meritocracy, and social responsibility, and encourage early and open communication of risk. To facilitate this culture, access is provided to the Chief Executive Officer, and the Chairs of the Board, Audit and Risk Management & Compliance Committees.

In particular, the Group has established:

- mechanisms for rapid escalation of important matters to relevant executives and/or Board members;
- performance incentives for management aimed at encouraging a proactive risk management culture; and
- the whistleblowing process through ActionLine.

COMMUNITY AND ENVIRONMENT

The Group recognises that its business has an impact on the community, the environment and the wider economy, and believes it must operate in a way that responds to these impacts effectively to meet its commitments to shareholders, customers and employees.

As such, the Group acknowledges that the sustainability of its businesses is directly tied to the sustainability of the communities in which it operates. The Group's purpose and values have been built on the premise that returns to shareholders will be enhanced by conducting business in a way that creates value for society across environmental, social and economic dimensions.

Social responsibility is a basic foundation for the way the Group operates. The Group is committed to ensuring it has appropriate policies and agreed practices to guide its actions, including employee practices, conduct in the marketplace, environmental care, governance and ethical conduct, occupational health and safety (OH&S), human rights and community involvement.

The company provides information on its social, economic and environmental performance against a series of indicators through its annual Sustainability Report, which is available at www.iag.com.au. A selection of these indicators is included in this report. In addition, the Group's Statement of Commitment to Community, Safety and the Environment is available on the website.

Ongoing stakeholder dialogue is a key element that drives the Group's community-based initiatives. After inviting key community leaders in 2004/05 to participate in a survey about social issues and the role of insurance in addressing those issues, in July 2005 the company produced a report entitled "We're Listening" on the key findings from the survey (the report is available at www.iag.com.au). Almost 80% of survey respondents said working to secure safer roads, homes and workplaces for Australians is the most important challenge facing their community, which is indeed the focus of the Group's community programs and advocacy. Ongoing feedback from stakeholder surveys will be used by the Group to ensure it remains focused on issues perceived most critical by the community. A follow-up survey is under way.

In addition, in 2006 the Group convened an Expert Community Advisory Committee in Australia. The Committee's mandate is to provide the Board and executive with advice on economic, social, environmental and cultural issues that may impact the Group's standing within the communities in which it operates. The Committee is an independent panel made up of individuals who represent a range of community interests and professional experience and expertise, as well as a mix of geographical areas. Their advice and comments are being considered and integrated into the Group's decision-making processes.

The Group acknowledges that its social impact also occurs indirectly through its suppliers, vendors and contractors. Accordingly, it has established Supplier Selection Guidelines which set minimum standards on social and environmental issues that must be met by contractors of services and suppliers for the purchase, hire or lease of equipment and materials. In addition to providing guidelines, the Group also supports its suppliers by providing tools that help assess and manage social and environmental risk.

REMUNERATION FRAMEWORK

The Group's approach to compensation arrangements for all employees, including non-executive Directors and executives, is based on ensuring that the Group can attract and retain the best people to drive corporate performance and deliver fair returns to shareholders.

Details of the Group's remuneration policies for its non-executive Directors and executives, the relationship of these policies to IAG's performance and details of the remuneration paid to the non-executive Directors and to relevant executives are disclosed in the Remuneration Report commencing on page 45.

FINANCIAL REPORT

CONTENTS

Five Year Financial Summary	40	Balance Sheets	61	Directors' Declaration	129
Directors' Report	41	Statements of Recognised Income and Expense	62	Independent Audit Report on Financial Report	130
Lead Auditor's Independence Declaration	59	Cash Flow Statements	63	Independent Review Report on Sustainability Reporting	131
Income Statements	60	Notes to the Financial Statements	64		

FIVE YEAR FINANCIAL SUMMARY

for the year ended 30 June

The financial information for the 2006 and 2005 years has been prepared under AIFRS. All financial information prior to 2005 was prepared under previous Australian Accounting Standards.

Insurance Australia Group Five Year Performance	2006 \$m	2005 \$m	2004 \$m	2003 \$m	2002 \$m
Gross written premium	6,435	6,673	6,427	5,150	3,558
Gross earned premium	6,537	6,561	6,265	4,885	3,448
Reinsurance expense	(405)	(417)	(402)	(249)	(253)
Net earned premium	6,132	6,144	5,863	4,636	3,195
Net claims expense	(3,900)	(4,090)	(3,815)	(3,363)	(2,425)
Underwriting expenses	(1,699)	(1,624)	(1,500)	(1,074)	(628)
Underwriting profit	533	430	548	199	142
Investment income on asset backing insurance liabilities	310	516	244	372	136
Insurance profit	843	946	792	571	278
Investment income from equity holders and external funds	537	500	508	(76)	(291)
Financial services revenue	–	–	70	30	37
Other operating revenue	218	179	216	177	173
Share of net profit of associate	2	–	–	–	–
Life insurance business expenses	–	–	(52)	(11)	–
Finance costs	(86)	(69)	(57)	(46)	(46)
Corporate and administration expenses	(265)	(258)	(268)	(267)	(242)
Amortisation of goodwill and intangibles	(14)	(13)	(118)	(81)	(43)
Non-recurring items ²	–	–	61	–	33
Profit / (loss) before income tax	1,235	1,285	1,152	297	(101)
Income tax (expense) / credit	(373)	(357)	(346)	(80)	18
Net profit / (loss)	862	928	806	217	(83)
Net (profit) / loss attributable to minority interests	(103)	(117)	(141)	(64)	58
Net profit / (loss) attributable to equity holders of Insurance Australia Group Limited	759	811	665	153	(25)
Ordinary equity holders' equity (\$ million)	3,491	3,378	2,999	3,036	2,133
Total assets (\$ million)	16,972	17,102	16,291	16,470	11,307
Business volume (in thousands)	13,891	14,204	14,052	13,334	8,671
Premium growth					
– Gross written	(3.6%)	3.8%	24.8%	44.7%	11.3%
– Net earned	(0.2%)	4.8%	26.5%	45.1%	15.1%
Key ratios¹					
Loss ratio	62.9%	66.5%	65.1%	72.5%	75.9%
Expense ratio	28.0%	26.3%	25.6%	23.2%	19.7%
Combined ratio	90.9%	92.8%	90.7%	95.7%	95.6%
Insurance margin ³	14.1%	15.5%	13.5%	12.3%	8.7%
After tax return on ordinary equity ⁴	22.1%	24.5%	21.1%	5.1%	(1.2%)
Share information					
Dividends per ordinary share – fully franked (cents)	42.00	26.50	22.00	11.50	10.50
Basic earnings per ordinary share (cents)	47.87	49.31	37.87	8.65	(1.78)
Ordinary share price at 30 June (\$) (ASX code: IAG)	5.35	6.01	5.00	3.40	3.15
5.80% Reset preference share price at 30 June (\$) (IAGPA)	101.80	103.90	104.70	107.94	100.10
4.51% Reset preference share price at 30 June (\$) (IAGPB)	98.50	99.05	98.35	100.10	n/a
Reset exchangeable securities price at 30 June (\$) (IANG)	100.00	99.00	n/a	n/a	n/a
Issued ordinary share capital (million shares)	1,595	1,594	1,591	1,683	1,301
Issued reset preference share capital (million shares)	6	6	6	6	4
Market capitalisation (ordinary shares) at 30 June (\$ million)	8,533	9,582	7,954	5,722	4,100
Net tangible asset backing per ordinary share (\$)	1.22	1.18	0.96	0.84	1.15

1 The key insurance ratios for 2005 and 2006 are based on a reclassification of the underwriting result. This involved the reclassification of the financial performance of the IAG Group's captive insurer by allocating the result of the captive from reinsuring the IAG Group's consolidated operations back to those businesses on a basis which reflects the profit or loss it earned from those businesses. The adjustments are summarised in the "Operating and financial review" section of the Directors' Report.

2 This includes profit on disposal of NRMA Building Society Limited of \$45 million and "Share the Future" litigation expenses of \$12 million in 2002 and the profit on disposal of ClearView retirement services businesses of \$61 million in 2004.

3 Insurance margin is a ratio of insurance profit over net earned premium.

4 Net profit / (loss) attributable to ordinary equity holders to average ordinary equity holders' equity.

DIRECTORS' REPORT

The Directors present their report together with the financial report of Insurance Australia Group Limited and the consolidated financial report of the Insurance Australia Group for the year ended 30 June 2006 and the audit report thereon.

The following terminology is used throughout the financial report:

- IAG, Parent or Company – Insurance Australia Group Limited.
- IAG Group, Group or Consolidated entity – the Consolidated entity consists of Insurance Australia Group Limited and its subsidiaries.

DIRECTORS OF INSURANCE AUSTRALIA GROUP LIMITED

The names and details of the Company's Directors in office at any time during or since the end of the financial year are as follows. Directors were in office for this entire period unless otherwise stated.

CHAIRMAN

Mr JA (James) Strong appointed in August 2001

OTHER DIRECTORS

Ms YA (Yasmin) Allen appointed in November 2004

Mr JF (John) Astbury appointed in July 2000

Mr GA (Geoffrey) Cousins appointed in July 2000

Mr ND (Neil) Hamilton appointed in June 2000

Mr RA (Rowan) Ross appointed in July 2000

Mr B (Brian) Schwartz appointed in January 2005

Mr MJ (Michael) Hawker appointed in December 2001

Particulars of Directors' qualifications and experience are set out on pages 28 and 29.

SECRETARIES OF INSURANCE AUSTRALIA GROUP LIMITED

The name and details of the Company's secretaries at any time during or since the end of financial year are as follows:

Ms AB (Anne) O'Driscoll FCA, ANZIIIF (Fellow), GAICD

Ms Anne O'Driscoll was appointed to the position of Company Secretary in July 2002. Before this appointment, Ms O'Driscoll held a number of senior positions in the IAG Group, including the position of General Manager, Finance. Currently, Ms O'Driscoll is also the Head of Investor Relations & Capital Planning of IAG.

Mr GD (Glenn) Revell BCom, MBus, FCPA, FCIS, GAICD

Mr Revell was appointed Group Company Secretary in August 2006. Before this appointment, Mr Revell held the position of company secretary in the IAG Group. Prior to joining IAG, he held the position of General Manager Corporate Affairs & Company Secretary of Howard Smith Limited for eight years.

MEETINGS OF DIRECTORS

The number of meetings each Director was eligible to attend and actually attended during the financial year is summarised as follows:

	BOARD OF DIRECTORS		AUDIT COMMITTEE		NOMINATION, REMUNERATION & SUSTAINABILITY COMMITTEE		RISK MANAGEMENT & COMPLIANCE COMMITTEE		IAG BOARD SUB-COMMITTEE	
Total number of meetings held	16		5		5		10		4	
Directors	A	B	A	B	A	B	A	B	A	B
Mr JA Strong	16	16	–	–	5	5	–	–	3	3
Ms YA Allen	16	16	–	–	–	–	10	10	1	1
Mr JF Astbury	16	15	5	4	5	4	–	–	–	–
Mr GA Cousins*	16	13	5	5	–	–	–	–	–	–
Mr ND Hamilton	16	15	–	–	–	–	10	10	–	–
Mr RA Ross	16	15	–	–	5	4	10	10	1	1
Mr B Schwartz	16	15	5	5	–	–	–	–	–	–
Mr MJ Hawker	16	15	–	–	–	–	–	–	4	4

A Meetings eligible to attend as a member.

B Meetings attended as a member.

* Mr GA Cousins was granted a leave of absence by the Board from 23 May 2006 to 31 July 2006.

DIRECTORS' REPORT

PRINCIPAL ACTIVITIES

The principal continuing activities of the IAG Group are the underwriting of general insurance and related corporate services and investing activities.

OPERATING AND FINANCIAL REVIEW

OPERATING RESULT FOR THE YEAR

The IAG Group's net profit after tax for the year was \$862 million (2005 – \$928 million). After adjusting for minority interests in the IAG Group result, net profit attributable to equity holders of the Company was \$759 million (2005 – \$811 million). The current year result has been determined based on the adoption of the Australian equivalents of the International Financial Reporting Standards and where applicable, the prior year information has been updated to reflect this change. Notes 1 and 38 of the financial statements provide detailed information on the accounting policies applied and the resultant impact on the prior year financial performance and financial position.

The following discussion includes analysis that is affected by a reclassification of the financial performance of the IAG Group's captive insurer, by allocating the profit (or loss) earned by the captive from reinsuring the IAG Group's consolidated operations back to those businesses on a basis which reflects the profit (or loss) it earned from those businesses. The adjustments are summarised in the following table:

	2006			2005		
	Financial statements \$m	Captive financial performance \$m	Adjusted financial performance \$m	Financial statements \$m	Captive financial performance \$m	Adjusted financial performance \$m
Premium revenue	6,537	–	6,537	6,561	–	6,561
Reinsurance expense	(405)	(162)	(567)	(417)	(53)	(470)
Net earned premium	6,132	(162)	5,970	6,144	(53)	6,091
Net claims expense	(3,900)	145	(3,755)	(4,090)	42	(4,048)
Underwriting expenses	(1,699)	25	(1,674)	(1,624)	19	(1,605)
Underwriting profit	533	8	541	430	8	438
Net investment income on assets backing insurance liabilities	310	(8)	302	516	(8)	508
Insurance profit	843	–	843	946	–	946

UNDERWRITING RESULT

The IAG Group produced an underwriting profit before investment income on technical reserves of \$541 million (2005 – \$438 million). The underwriting profit is affected by interest rate movements which change the discount rate applicable to claims reserves. In 2006, this resulted in a decrease in claims expense by \$107 million compared to an increase in claims expense of \$88 million in 2005. This resulted in a decrease in the loss ratio to 62.9% (2005 – 66.5%) and the combined ratio to 90.9% (2005 – 92.8%). The increase in the expense ratio to 28.0% (2005 – 26.3%) was mainly attributable to an adverse fire service levy adjustment due to under collection in the first half of the financial year (due to the adoption of ICA rates) and a higher allowance for anticipated assessment for the second half of the financial year. Excluding the impact of movement in interest rates on claims expense, the underlying loss ratio improved to 64.7% (2005 – 65.0%) while the combined ratio worsened to 92.7% (2005 – 91.4%) reflecting the increased expense ratio.

The insurance profit of \$843 million (2005 – \$946 million), which is considered to be a sound insurance trading result, equated to an insurance margin of 14.1% (2005 – 15.5%). This margin was achieved despite challenging market conditions including the effect of Cyclone Larry.

(a) Australian personal lines insurance operations

The personal lines insurance operations produced an insurance margin of 12.6% for the financial year (2005 – 15.5%). The decline in the insurance margin is directly attributable to the impact of Cyclone Larry as well as the competitive price pressures in all segments and additional expense related to fire service levies. Despite these competitive pressures and the reduction of insurance margin, the business has regained positive momentum with renewal rates higher than they have been for two years and new business volumes recovering. The improved performance is directly related to the initiatives implemented to address the issues arising from the public debate with the Motor Traders Association in the first half of the financial year and selective pricing adjustments.

Gross written premiums decreased by 3.0% to \$3,860 million (2005 – \$3,978 million) due to strong competition.

(b) Australian commercial lines insurance operations

The commercial lines insurance operations produced an insurance margin of 18.0% for the financial year (2005 – 16.1%). The increase in the margin over the prior year was due to a strong performance in the long tail classes of liability and workers' compensation and consequent reserve releases. These were significantly offset by deterioration in the claims experience of the short tail commercial portfolio (including the impact of Cyclone Larry) and additional expense related to fire service levies.

Gross written premiums decreased by 9.1% to \$1,539 million (2005 – \$1,694 million) due to strong competition in a softening rate environment.

Fee based income produced a profit of \$8 million (2005 – loss of \$14 million). The significant turn around was due to improved profitability in the non-risk workers' compensation schemes. The premium funding business also continued to generate profits.

(c) International insurance operations

New Zealand insurance operations:

The New Zealand insurance operations produced an insurance margin of 14.5% for the financial year (2005 – 14.4%). The insurance profit was adversely impacted by a snowstorm in June 2006 in the South Island which incurred around \$18 million of gross claims. Nevertheless, a strong insurance result was still achieved in the face of slowing economic growth and strong competition in a concentrated market.

DIRECTORS' REPORT

Gross written premiums decreased by 3.0% to \$971 million (2005 – \$1,001 million), the reduction being entirely attributable to the depreciation of the New Zealand dollar. In New Zealand dollar terms, the New Zealand operations achieved growth in gross written premium of around 0.5%.

Thailand insurance operations:

The IAG Group acquired IAG Insurance (Thailand) Ltd (formerly Royal and Sun Insurance Alliance (Thailand) Ltd) on 4 July 2005 and Safety Insurance Public Company Limited on 31 March 2006. Gross written premium for the date of acquisition to 30 June 2006 was \$65 million with a combined ratio of 95.2%. The IAG Group has identified and implemented initiatives to capitalise on growth relevant to the Thailand insurance market, including introducing new products, skills, technology and distribution strategies.

AmAssurance, Malaysia:

On 10 March 2006, IAG completed its acquisition of a 30% stake in AmAssurance. The agreement includes a right to increase the IAG Group's holding to 40% by March 2008 and an option, subject to regulatory approval, to increase to 49% over time. The increase is likely to occur if the business needs more capital to support its expansion whether organically or through acquisition.

Under the principles of equity accounting, IAG recognised 30% of AmAssurance's profit as a share of profits from associates in the income statement. This amounted to \$2 million for the quarter ended 30 June 2006.

Captive reinsurer:

The Captive acts solely as the IAG Group's reinsurer assuming risk from other parts of the business and obtaining reinsurance protections for the IAG Group in the open market. The insurance result decreased by \$133 million due to a loss of \$56 million in the financial year. This was mainly driven by losses from Cyclone Larry in tandem with the IAG Group's decision to accept higher catastrophe retention levels, facilitated in part through the issue of contingent capital in the form of reset exchangeable securities by the IAG Group in January 2005. As previously discussed, the Captive's financial performance has been allocated to the Australian personal and commercial lines, the New Zealand and Thailand insurance operations.

(d) Corporate and investments

Investment income on corporate and equity holders' funds (net of investment expenses) increased by 7.4% to \$537 million. The increase was due to the strong investment performance by all the major asset classes, particularly Australian equities, in the current financial year. The net corporate expenses have increased by \$6 million or 4.2% to \$148 million. This increase was mainly attributable to the increase in borrowing costs by \$17 million in the current financial year due to the reclassification of reset preference shares as debt under AIFRS, offset to some extent by the netting off of interest on the reset exchangeable securities against portfolio investment income. This was offset by a decrease in amortisation of intangibles by \$5 million and a decrease in other fee based business expenses of \$6 million.

REVIEW OF FINANCIAL CONDITION

(a) Financial position

Assets:

The total assets of the IAG Group as at 30 June 2006 are \$16,972 million (2005 – \$17,102 million). The decrease is mainly attributable to the payment of a special dividend in June 2006 and an increase in income taxes paid resulting in a reduction in total investments.

Liabilities:

The total liabilities of the IAG Group as at 30 June 2006 are \$13,301 million (2005 – \$12,599 million) with the major component being general insurance liabilities of \$10,430 million (2005 – \$10,426 million). The increase in liability is mainly attributable to the:

- reclassification of \$550 million of reset preference shares (issued by IAG in 2002 and 2003) as an interest-bearing liability from 1 July 2005 on transition to AIFRS. Previously under AGAAP they were classified as equity; and
- reclassification of minority interests in unitholder funds as liability from 1 July 2005 on transition to AIFRS. Previously under AGAAP these were classified as minority interests in equity.

The increases were offset to some extent by decreases in current tax liabilities and employee benefits provisions. The decrease in current tax liabilities was mainly attributable to a significant increase in PAYG payments during the year and the settlement of income tax payable for the 2005 financial year. The decrease in employee benefits provisions was mainly attributable to actuarial gains on the defined benefit plan during the financial year.

Equity:

Equity was impacted by the following activities during the year:

Increase:

- net profit of \$862 million.

Decrease:

- reclassification of reset preference shares and minority interests in unitholder funds to liability (see comment in liabilities above); and
- payment of dividends of \$647 million.

(b) Cash from operations

Cash flows from operating activities:

Cash flows from operating activities have decreased by 58% to \$387 million. The decrease is mainly attributable to a decrease in premiums received and an increase in gross claims paid. Other factors contributing to the decrease were:

- an increase in reinsurance expense paid due to an advance reinsurance payment in June 2006;
- timing of income tax paid which resulted in the 2006 cash flows including instalments for two years;
- an increase in interest payments due to the reclassification of reset preference shares to liabilities; and
- an increase in other operating payments due to commencement of superannuation contributions in June 2005 (as a result of the cessation of the contribution holiday in the IAG & NRMA Superannuation Plan) and increase in fire service levies.

The decrease was offset to some extent by the increase in reinsurance and other recoveries received which includes recoveries on an aggregate excess of loss cover.

Cash flows from investing activities:

Cash inflows from investing activities have increased by \$1,018 million to \$822 million. The increase is largely attributable to the higher level of redemption of investments in 2006 to fund the surplus capital fund in light of acquisitions in Thailand and Malaysia, as well as increased dividend and income tax payments. In addition there was a net redemption of units in IAG controlled trusts by minority interests.

Cash flows from financing activities:

Cash outflows from financing activities have increased by \$245 million to \$937 million. This increase is attributable to:

- \$205 million in additional dividends paid in the 2006 financial year;
- net redemptions of units in IAG controlled trusts of \$136 million in the year compared with \$128 million in the prior year;
- the repayment of \$46 million of NZ senior term notes during the financial year; and
- the purchase of treasury shares.

There was no issue of reset exchangeable securities ("RES") during the year. In the prior year, the issue of RES and the investment of the proceeds from RES in the Portfolio involved a net outflow of \$13 million, mainly attributable to the transaction costs associated with the issue.

(c) Capital adequacy / minimum capital requirements

The IAG Group minimum capital requirement ("MCR") multiple, calculated by applying APRA standards for individual licensed insurers to the consolidated results, is 1.83 times MCR as at 30 June 2006 (2005 – 2.00 times MCR). The multiple remains above the IAG Group's current benchmark multiple of 1.55 times MCR.

Further information on the IAG Group's result and review of operations can be found in the 30 June 2006 Investor Report on the Company's website, www.iag.com.au.

DIRECTORS' REPORT

LIKELY DEVELOPMENTS

Insurance and investment operations are, by their nature, volatile due to the exposure to natural disasters and industry cycles and thus profit predictions are difficult.

The IAG Group expects to grow and diversify its earnings in the 2007 financial year and:

- generate gross written premium growth of 5 – 10%, including acquisitions;
- deliver a return on equity ("ROE") of at least 1.5 times the weighted average cost of capital ("WACC") on a normalised basis; and
- maintain its strong balance sheet and prudent reserving philosophy.

The organic growth expectation takes account of:

- leveraging the IAG Group's current competitive position and positive momentum in direct motor and home insurance;
- reduced premium in New South Wales compulsory third party ("CTP") due to changes in the scheme structure which result in lower premiums;
- the soft cycle in commercial insurance in Australia and New Zealand; and
- ongoing strong growth in the IAG Group's Thai subsidiaries.

Acquisitive growth is likely to be sourced in Asia and Europe. Delivering on ROE at least 1.5 times WACC is considered achievable based on:

- continued focus on cost management including leveraging the capacity in the existing business to write additional business at marginal additional cost;
- maintaining pricing discipline for premiums;
- being disciplined in the price paid for acquisitions; and
- continued active capital management.

Delivery of these returns is also subject to not incurring any large losses or catastrophes beyond the IAG Group's normal allowances and experiencing no major falls in bond values.

DIVIDENDS

Details of dividends paid or declared by the Company are set out in note 9.

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

Significant changes in the state of affairs of IAG Group during the financial year were as follows:

- On 9 December 2005, the IAG Group announced that it had agreed to acquire a 30% interest in a general insurer in Malaysia, AmAssurance Berhad, for approximately A\$69 million (MYR 193 million);
- On 30 March 2006, the IAG Group announced that it has completed its tender offer for shares in Thailand for Safety Insurance Public Company Limited ("Safety"). As a result, the IAG Group has acquired approximately 96.1% which has increased from 21.6% since its initial investment in 1998;
- On 12 April 2006, IAG announced a special fully franked dividend of 12.5 cents per shares to be paid to its shareholders on 26 June 2006. This payment is in line with its commitment to return \$200 million in surplus capital to shareholders by 30 June 2006;

- On 15 June 2006, IAG announced it agreed to acquire a newly-formed Lloyd's managing agency and specialist Asian syndicate to support the development and management of its expanding Asian business. The businesses operate as Alba Group Pte Limited and have been newly established. The syndicate has access to all markets in which Lloyd's is licensed. The terms of the acquisition are confidential but neither the purchase price nor the capital required in the first two years from completion is material to the IAG Group. A letter of credit was issued in support of the IAG Group's participation. The terms of the acquisition are subject to final regulatory approval from the relevant regulatory authorities in Singapore and the United Kingdom.

EVENTS SUBSEQUENT TO REPORTING DATE

Details of matters subsequent to the end of the financial year are set out in note 39. These include:

- declaration of final dividend of 16 cents per ordinary share; and
- progress of negotiations with a China based general insurance business.

OFFICERS WHO WERE PREVIOUSLY PARTNERS OF THE AUDITORS

The following person is currently an officer of the IAG Group and was a partner of KPMG, the Company's auditor, at a time when KPMG was the auditor of the Company:

- Mr NB Hawkins: Chief Executive Officer – IAG New Zealand (left KPMG in October 2001).

NON-AUDIT SERVICES

During the financial year, KPMG has performed certain other services for the IAG Group in addition to their statutory duties.

The Directors have considered the non-audit services provided during the financial year by KPMG and, in accordance with written advice provided by resolution of the Audit Committee, are satisfied that the provision of those non-audit services by the Company's auditor is compatible with, and did not compromise, the auditor independence requirements of the Corporations Act 2001 for the following reasons:

- all non-audit assignments were approved in accordance with the process set out in the IAG Audit Committee Charter ("Charter") on the agreed framework for engaging auditors for non-audit services; and
- the non-audit services provided do not undermine the general principles relating to auditor independence as set out in Professional Statement F1 Professional independence of the Institute of Chartered Accountants in Australia and CPA Australia, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act is included in the directors' report.

The level of fees for non-audit services amount to approximately 27.8% of total audit fees (refer to note 5 of the financial statements for further details on costs incurred on individual non-audit assignments).

DIRECTORS' REPORT

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

The lead auditor's independence declaration is set out on page 59 and forms part of the directors' report for the year ended 30 June 2006.

INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

The Company's constitution contains an indemnity in favour of every person who is or has been:

- (a) a Director of the Company;
- (b) a secretary of the Company or of a subsidiary of the Company; or
- (c) a person making or participating in making decisions that affect the whole or a substantial part of the business or Company or of a subsidiary of the Company; or
- (d) a person having the capacity to affect significantly the financial standing of the Company or of a subsidiary of the Company.

The indemnity applies to liabilities incurred by the person in the relevant capacity (except a liability for legal costs). That indemnity also applies to legal costs incurred in defending or resisting certain legal proceedings. The indemnity does not apply where the Company is forbidden by statute or, if given, would be made void by statute. In addition, the Company has granted deeds of indemnity to certain current and former Directors and secretaries and members of senior management of the Company and its subsidiaries and associated companies. Under these deeds, the Company indemnifies, to the maximum extent permitted by the law, the former or current Directors or secretaries or members of senior management against liabilities incurred by the person in the relevant capacity. The indemnity does not apply where the liability is owed to the Company or any of its subsidiaries or associated companies, or (in general terms) where the liability arises out of a lack of good faith, willful misconduct, gross negligence, reckless misbehavior or fraud.

Under each deed, the Company is also effectively required to maintain and pay the premiums on a contract of insurance covering the current or former Directors or members of senior management against liabilities incurred in respect of the relevant office. The insurance must be maintained until the seventh anniversary after the date when the relevant person ceases to hold office. Disclosure of the insurance premiums and the nature of liabilities covered by such insurance is prohibited by the relevant contract of insurance.

ENVIRONMENTAL REGULATION

The IAG Group's operations are subject to environmental regulations under either Commonwealth or State legislation. These regulations do not have a significant impact on the IAG Group's operations. The Board of Directors believes that the IAG Group has adequate systems in place for the management of its environmental requirements and is not aware of any breach of those environmental requirements as they apply to the IAG Group.

REMUNERATION REPORT

This report outlines the Board's policy in relation to, and details of, the remuneration of IAG key management personnel ("KMP") being, the IAG Directors (including the Chief Executive Officer and Managing Director) and the senior executives having the greatest authority and responsibility for planning, directing and controlling the activities of the IAG Group, including the five executives receiving the highest remuneration during the financial year.

It is important to note that the Company's Non-executive Directors are specifically required to be included as key management personnel in accordance with the accounting standard AASB 124 *Related Party Disclosures*. However, the Non-executive Directors do not consider that they are part of "management".

The term "remuneration" used in the remuneration report has the same meaning as compensation as prescribed in the accounting standard AASB 124.

This report provides the disclosures which meet the remuneration reporting requirements of the Corporations Act 2001 and the accounting standard AASB 124.

NOMINATION, REMUNERATION & SUSTAINABILITY COMMITTEE

The role and responsibilities of the Nomination, Remuneration & Sustainability Committee ("Committee" or "NRSC") are set out in the Committee's charter which is available at www.iag.com.au. The key responsibilities of the NRSC in relation to remuneration are to:

- (a) provide assurance to the Board relating to the effectiveness, integrity and compliance of the Company's remuneration policies and practices; and
- (b) ensure the overall remuneration policy and approach fits the strategic goals of IAG.

The Chief Executive Officer ("CEO"), Group Executive Culture & Reputation and Head of Human Resources regularly attend Committee meetings and assist the Committee in its deliberations.

The Committee receives reports from Mercer Human Resources Consulting and various other consultants on remuneration for executives and directors. Mallesons Stephen Jaques provides legal advice to the Committee as required.

REMUNERATION REPORT – AUDITED INFORMATION

A. EXECUTIVES

1. EXECUTIVE REMUNERATION POLICY

IAG's approach to executive remuneration is to ensure that IAG can attract and retain the best people and reward performance in line with returns delivered to shareholders. Building and retaining a high quality management team has enabled IAG to achieve superior long term performance.

The principles that underpin IAG's approach to executive remuneration are that:

- the quantum and mix of remuneration is sufficiently competitive to attract and retain a high calibre executive team;
- remuneration practices are consistent with IAG's values;
- the mix of fixed and variable remuneration reflects the impact of each executive position on IAG's short term and long term results;
- remuneration levels take account of both external market practice and internal relativities; and
- measures of performance are based on a balanced scorecard with a focus on the delivery of sustainable value to our shareholders.

IAG aims to set base pay around the market median and total potential reward (which includes short and long term incentives) between the median and the 75th percentile depending on individual performance and contribution to the IAG Group's results. Market positioning is determined by reference to a number of comparator groups, being: the largest 50 companies in the S&P / ASX 100 index; financial services companies that are among the largest 50 companies in the S&P / ASX 100 index and companies in the S&P / ASX 100 index with a market capitalisation of between 50% and 200% of IAG's capitalisation.

2. EXECUTIVE REMUNERATION STRUCTURE

Executive remuneration consists of four components:

- base salary
- superannuation
- short term incentives
- long term incentives

DIRECTORS' REPORT

REMUNERATION REPORT – AUDITED INFORMATION (CONTINUED)

A. EXECUTIVES (CONTINUED)

2. EXECUTIVE REMUNERATION STRUCTURE (CONTINUED)

(a) Base salary

Base salary is defined as the total value of components that make up an executive's salary. Components are cash, salary sacrifice items such as superannuation, cars or parking and any related taxes. Base salary is determined by a review of job size, internal relativities and market benchmarking. Mercer Human Resources Consulting provides advice on job responsibility and market benchmarking. The comparator groups for market benchmarking are the largest 50 companies in the S&P / ASX 100 index, financial services companies that are among the largest 50 companies in the S&P / ASX 100 index and companies in the S&P / ASX 100 index with a market capitalisation of between 50% and 200% of IAG's capitalisation. Base salary is targeted at the median of the market. Unless there has been a significant change in job responsibility, increases in base salary generally do not exceed external market movements.

(b) Superannuation

Executives are defined contribution members of the IAG & NRMA Superannuation Plan. Employer superannuation contributions are 13% of base salary. This contribution rate is consistent with the contribution provided to other employees of IAG.

(c) Short term incentives

Executives have the opportunity to earn a short term incentive payment based on both IAG's performance and achievement of individual goals.

IAG uses a balanced scorecard for setting goals and measuring performance. This ensures that assessment of performance is viewed holistically and assists the development of a sustainable business that meets the performance expectations of IAG's shareholders, stakeholders and the communities in which it conducts its business.

The balanced scorecard sets goals under the following broad categories:

- financial
- customer
- people
- risk
- community / environment

At the commencement of each financial year, IAG and individual goals are set for each executive. The goals set are stretch goals and are designed to encourage executives to strive for exceptional performance. At the end of the financial year the amount of any incentive payment is determined based on measured achievement against those goals and a review of the executive's overall performance by the CEO and NRSC. The NRSC reviews the performance of the CEO and makes a recommendation to the Board in relation to any incentive payment for the CEO.

The following table is a summary of IAG's key goals for the current year:

Category	Goal	Reason Chosen	Method of Assessment	Outcome
Finance	Group insurance margin target	Measures the profitability of the core business of IAG	Comparison of achievement against target	Not met
Customer	Improvement across customer satisfaction measures	Meeting or exceeding customer expectations is a key part of establishing and maintaining a competitive advantage	Outcome of customer satisfaction surveys and measurement of customer retention rates compared to outcomes from previous years	Met
Risk	Improvement in risk management behaviours	Positive risk management behavior in relation to prevention, detection and recovery from operational risks and issues is critical for a sustainable business	Increased employee awareness of risk prevention, detection and recovery compared to target set at the start of the year	Partially met ⁽¹⁾
People management	Employee engagement score target	Measures how engaged employees are with IAG's purpose, strategy and goals	Outcome of annual employee survey compared to target set at the start of the year	Partially met ⁽¹⁾
People management	Reduction in employee turnover	A solid employee base is critical for growing IAG's business for the benefit of customers, shareholders and the wider community	Comparison of outcome achieved against target set at the start of the year	Not met
Community / environment	Reduction in workers' compensation claims per million hours worked	A safe work environment and the well being of employees is vital for growing IAG's business for the benefit of customers, shareholders and the wider community	Comparison of reduction achieved against target set at the start of the year	Partially met ⁽¹⁾

(1) Where a goal is partially met, there has been improvement in performance but the stretch goal has not been met.

The methods of assessment have been selected as they can be objectively measured and verified.

Actual short term incentive payments made to executives for the year ended 30 June 2006 reflect the degree of achievement against these goals and the degree of achievement against each individual executive's goals.

DIRECTORS' REPORT

(d) Long term incentives – Equity based remuneration

IAG utilises long term incentives to create a link between the delivery of value to shareholders, financial performance and rewarding and retaining employees. IAG's program for delivering long term incentives is its Performance Award Rights ("PARs") Plan. Note 30(a) of the financial statements sets out further details of the PARs Plan.

PARs are rights over issued shares held by a trustee. The rights are granted at no cost to executives and may be exercised for a nominal price if a performance hurdle related to IAG's Total Shareholder Return ("TSR") is met or if some specified events occur, such as a takeover bid for the Company. During the year PARs were issued to executives. Previously IAG delivered long term incentives using its Performance Share Rights ("PSRs") Plan with the last issue to the executives on 5 March 2002. Note 30(b) of the financial statements sets out further details of the PSRs Plan.

Details of the terms of allocations made to executives under IAG's long term incentive plans, including those allocations that at the date of this report are not exercisable, are summarised below:

Plan	PARs Plan 2002 / 2003 – Series 1	PARs Plan 2003 / 2004 – Series 2	PARs Plan 2004 / 2005 – Series 3	PARs Plan 2005 / 2006 – Series 4
Grant Date	24/12/2002	22/09/2003 10/12/2003 26/03/2004	17/09/2004 30/11/2004	19/09/2005 30/11/2005 22/03/2006
Performance Period Definition ⁽ⁱ⁾	3 – 5 years from Grant Date	3 – 5 years from Base Date ⁽ⁱⁱ⁾	3 – 5 years from Base Date ⁽ⁱⁱ⁾	3 – 5 years from Base Date ⁽ⁱⁱ⁾
TSR Performance Condition	IAG TSR compared to a Peer Group of companies. The Peer Group comprises the companies in the S&P / ASX 100 index with such inclusions and exclusions as the Board may determine.			
Vesting Schedule	< 50th percentile – 0% vesting = 50th percentile – 50% vesting >=75th percentile – 100% vesting The percentage of PARs which vest and become exercisable increases proportionately where IAG's performance ranks between the 50th and 75th percentile			
Performance Hurdle Test Schedule	Quarterly – Last trading day of each calendar quarter in performance period	Quarterly – Last trading day of each calendar quarter in performance period	Quarterly – Last trading day of each calendar quarter in performance period	Quarterly – Last trading day of each calendar quarter in performance period
1st Test Day	30/12/2005	29/09/2006	28/09/2007	30/09/2008
Last Test Day	28/09/2007	30/06/2008	30/06/2009	30/06/2010
Last Exercise Date (Continuing employees only)	24/12/2012	22/09/2013 10/12/2013 26/03/2014	17/09/2014 30/11/2014 30/03/2015	19/09/2015 30/11/2015 22/03/2016
Plan Exercise Status	Partially exercisable ⁽ⁱⁱⁱ⁾	Not exercisable	Not exercisable	Not exercisable

Notes:

(i) The performance period will be shortened if the employee ceases employment with the IAG Group due to redundancy or in other special circumstances.

(ii) The Base Date is the date which is the second trading day after the date on which IAG's financial results for the twelve month period ending on the 30 June that immediately precedes the Grant Date are announced to the ASX.

(iii) 56% of Series 1 PARs are exercisable.

3. RELATIONSHIP BETWEEN EXECUTIVE REWARD AND IAG'S PERFORMANCE

A significant component of executive remuneration is "at risk" which ensures a direct link between IAG's performance and reward for executives. For further details of the percentage of "at risk" remuneration, refer to the table in section 6.

The payment of short-term incentives is directly linked to IAG's performance over the previous year based on a balanced scorecard of measures, which includes a measure of the profitability of IAG's core business. Non-financial measures are also used as they are lead indicators of delivering future value for shareholders. For the 2005 / 2006 future the IAG key goals were partially met. This will determine the portion of an executive's short term incentive payment that is linked to IAG's goals.

The use of the balanced scorecard to assess and reward executive performance has assisted IAG to deliver superior returns for shareholders since listing in August 2000:

	Year ended 30 June 2001	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004	Year ended 30 June 2005	Year ended 30 June 2006
Closing share price (\$)	3.40	3.15	3.40	5.00	6.01	5.35
Dividends paid (cents)	10.00	10.50	11.50	22.00	26.50	42.00
Earnings per share (cents)*	9.40	(1.78)	8.65	37.87	49.31	47.87
Normalised net profit after tax (\$ million)*	178	294	360	434	601	542

* Amounts in 2005 and 2006 have been measured under Australian equivalent to International Financial Reporting Standards ("AIFRS"). All amounts prior to 2005 were measured under previous Australian Accounting Standards.

DIRECTORS' REPORT

REMUNERATION REPORT – AUDITED INFORMATION (CONTINUED)

A. EXECUTIVES (CONTINUED)

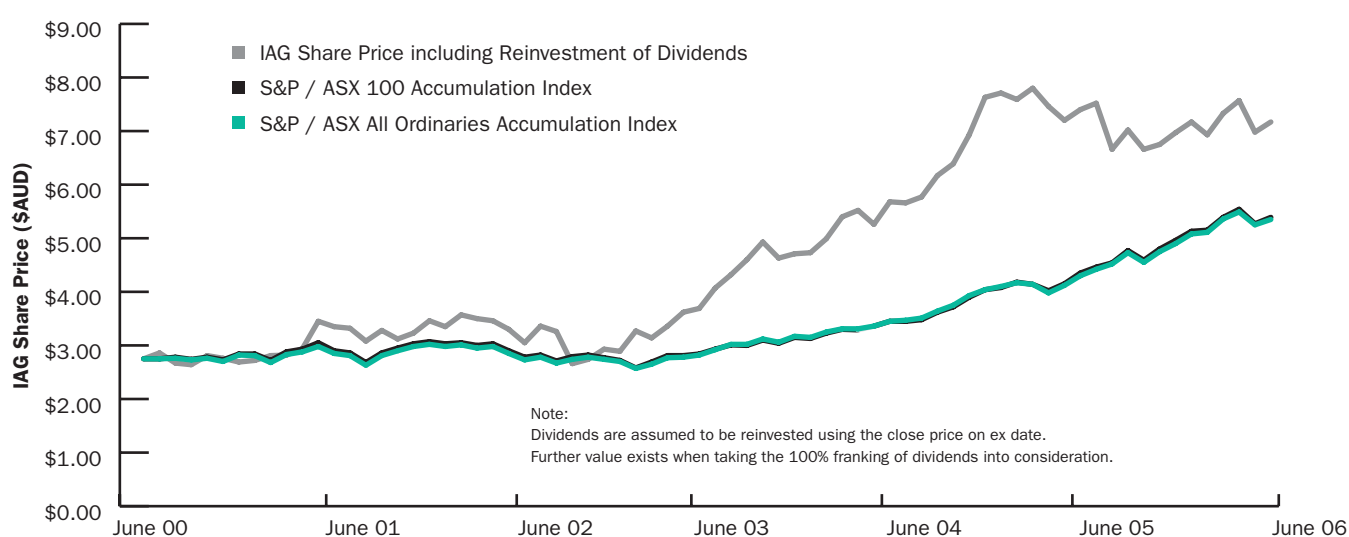
3. RELATIONSHIP BETWEEN EXECUTIVE REWARD AND IAG'S PERFORMANCE (CONTINUED)

IAG's long term incentive plans provide a direct link between return to shareholders over a 3 to 5 year period and executive reward. IAG's TSR measured from March 2003 until January 2006 was at the 53rd percentile compared to the TSR of companies in the S&P / ASX 100 index. As a result of this, 56% of PARs issued to executives in December 2002 became exercisable for IAG shares.

Grants of PARs to executives are based on an assessment of each executive against a range of factors including the executive's performance, their strategic impact and leadership capability. This process strengthens the link between individual executive reward outcomes and the creation of value for shareholders.

IAG's share price performance from the period since IAG's listing in August 2000 is shown in the following graph:

IAG Historical Share Price Performance – Since Listing



4. SERVICE AGREEMENTS

During the year the following persons were the executives identified as key management personnel, with the greatest authority and responsibility for planning, directing and controlling the activities of the IAG Group:

Name	Current title
Mr MJ Hawker	Chief Executive Officer and Managing Director
Mr JP Breheny ⁽ⁱ⁾	Chief Executive Officer – Asia
Mr AM Coleman	Chief Risk Officer and Group Actuary
Mr NB Hawkins ⁽ⁱⁱ⁾	Chief Executive Officer – IAG New Zealand
Mr DA Issa ⁽ⁱⁱ⁾	Chief Executive Officer – Personal Insurance
Ms JS Johnson ⁽ⁱⁱ⁾	Chief Executive Officer – Business Partnerships
Ms CF McLoughlin ⁽ⁱⁱⁱ⁾	Group Executive – Strategy
Ms SJ Mostyn	Group Executive – Culture & Reputation
Mr MJ Pirone	Chief Executive Officer – CGU
Mr J van der Schalk ^(iv)	Chief Executive Officer – Asset Management & Reinsurance
Mr G Venardos	Chief Financial Officer

(i) Mr JP Breheny, joined the IAG Group as Chief Executive Officer – Asia, on 20 March 2006.

(ii) On 8 February 2006, IAG announced a new structure for its operations. This led to a change in the executive team structure. Mr DA Issa has held his current position since this time and previously held the position of Chief Information Officer. Mr NB Hawkins and Ms JS Johnson were appointed to their roles on 1 March 2006 and 13 February 2006 respectively.

(iii) Ms CF McLoughlin, joined the IAG Group on 2 August 2005 and her current position is Group Executive – Strategy.

(iv) On 26 May 2006 Mr Jan van der Schalk was appointed to the role of Chief Executive Officer – Asset Management & Reinsurance following Mr RJ Jackson leaving the IAG Group.

Mr IF Brown retired on 31 December 2005. Mr DRA Pearce left on 31 August 2005, Mr DJP Smith left on 8 February 2006 and Mr RJ Jackson left on 26 May 2006.

DIRECTORS' REPORT

All service agreements for executives are unlimited in term but may be terminated by written notice from either party or by IAG making a payment in lieu of notice. The service agreements outline the components of remuneration paid to executives and require the remuneration of executives to be reviewed annually. The service agreements do not require IAG to increase base salary, pay a short term incentive or offer a long term incentive in any given year.

Name	Notice period, Company	Notice period, Employee	Termination provisions	Additional payment if IAG invokes a restraint clause
Mr MJ Hawker	12 months	6 months	12 months base salary, plus payment for annual leave, long service leave and short-term incentive that would have accrued had termination not occurred.	6 months base salary
Mr JP Breheny	12 months	3 months	12 months base salary	–
Mr AM Coleman	12 months	3 months	12 months base salary	6 months base salary
Mr NB Hawkins	12 months	3 months	12 months base salary	–
Mr DA Issa	12 months	3 months	12 months base salary	–
Ms JS Johnson	12 months	3 months	12 months base salary	–
Ms CF McLoughlin	6 months	2 months	6 months base salary	–
Ms SJ Mostyn	12 months	3 months	12 months base salary	–
Mr MJ Pirone	12 months	3 months	12 months base salary	6 months base salary
Mr J van der Schalk	12 months	3 months	12 months base salary	–
Mr G Venardos	12 months	3 months	12 months base salary	6 months base salary

Executives are employed by Insurance Australia Group Services Pty Limited, except for Mr NB Hawkins who is employed by IAG New Zealand Limited.

(a) Retrenchment

In the event of retrenchment, the executives listed above (except for Mr MJ Hawker) are entitled to the greater of:

- (i) the written notice or payment in lieu of notice as provided in their service agreement; or
- (ii) the retrenchment benefits due under the relevant company retrenchment policy.

For Mr MJ Hawker, the retrenchment payment is in accordance with the termination provisions set in the table above.

(b) Company retrenchment policy

On retrenchment, employees with less than 25 years service will receive:

- (i) at least eight weeks notice or payment in lieu of notice (calculated on the employee's base salary); and
- (ii) three weeks base salary for each year of continuous service to a maximum of 75 weeks base salary.

The minimum benefit that can be received is 11 weeks base salary and the maximum benefit that can be received is 83 weeks base salary.

On retrenchment, employees with 25 or more years of service or who are over 45 years of age will receive:

- (i) at least twelve weeks notice or payment in lieu of notice (calculated on the employee's base salary); and
- (ii) three weeks base salary for each year of continuous service to a maximum of 75 weeks base salary.

The minimum benefit that can be received is 15 weeks base salary and the maximum benefit that can be received is 87 weeks base salary.

(c) Termination of employment without notice and without payment in lieu of notice

The employment of the executives may be terminated without notice or payment in lieu of notice in some circumstances. Generally, this could occur where the executive: is charged with a criminal offence that is capable of bringing the organisation into disrepute; is declared bankrupt; breaches a provision of their employment agreement; is guilty of serious and willful misconduct; or unreasonably fails to comply with any material and lawful direction given by the Company.

(d) Termination of employment with notice or payment in lieu of notice

The employment of the executives may be terminated at any time by the Company with notice or payment in lieu of notice (which also includes a pro rata short term incentive earned but not paid). The amount of notice the Company must provide or the payment in lieu of notice is specified above.

DIRECTORS' REPORT

REMUNERATION REPORT – AUDITED INFORMATION (CONTINUED)

A. EXECUTIVES (CONTINUED)

5. REMUNERATION DETAILS

(a) Remuneration of executives for the IAG Group for 2006

	SHORT-TERM EMPLOYMENT BENEFITS						POST-EMPLOYMENT BENEFITS		OTHER LONG-TERM EMPLOYMENT BENEFITS		TERMINATION BENEFITS	SHARE-BASED PAYMENT	TOTAL
	Cash Salary ⁽¹⁾	Non-monetary benefits ⁽²⁾	Base salary (Sub-total of ⁽¹⁾ & ⁽²⁾)	Annual leave accruals ⁽³⁾	Short term incentives ⁽⁴⁾	Other ⁽⁵⁾	Super-annuation ⁽⁶⁾	Retirement benefits	Long service leave accruals ⁽⁷⁾	Long term incentive plan ⁽⁸⁾		Value of PSRs / PARs granted ⁽⁹⁾	
2006	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000
<i>Executives (including Executive Director):</i>													
Mr MJ Hawker	1,201	23	1,224	15	632	-	164	-	23	-	-	982	3,040
Mr JP Breheny ⁽ⁱ⁾	172	-	172	16	76	-	22	-	1	-	-	21	308
Mr AM Coleman	613	8	621	44	367	-	81	-	14	-	-	213	1,340
Mr NB Hawkins ⁽ⁱ⁾	187	-	187	12	84	25	25	-	2	-	-	52	387
Mr DA Issa	571	8	579	22	331	-	75	-	11	-	-	187	1,205
Ms JS Johnson ⁽ⁱ⁾	149	6	155	22	94	-	19	-	7	-	-	21	318
Ms CF McLoughlin ⁽ⁱ⁾	428	7	435	12	195	-	57	-	3	-	-	49	751
Ms SJ Mostyn	511	8	519	41	336	-	67	-	10	-	-	211	1,184
Mr MJ Pirone	558	59	617	16	395	-	80	-	20	-	-	203	1,331
Mr J van der Schalk ⁽ⁱ⁾	38	1	39	2	17	-	5	-	1	-	-	9	73
Mr G Venardos	654	61	715	29	393	-	91	-	20	-	-	247	1,495
<i>Executives who ceased as key management personnel during the year:</i>													
Mr IF Brown	324	22	346	39	225	-	47	-	41	-	-	136	834
Mr RJ Jackson	573	73	646	10	351	-	84	-	23	-	650	176	1,940
Mr DRA Pearce	71	10	81	(1)	17	-	11	-	6	-	820	117	1,051
Mr DJP Smith	436	-	436	41	545	100	59	-	5	-	970	195	2,351
Total remuneration	6,486	286	6,772	320	4,058	125	887	-	187	-	2,440	2,819	17,608

(i) These executives were all newly appointed to the executive team during this financial year. Therefore, the remuneration information provided in the table above relates to the period from the date of their appointment to the executive team to 30 June 2006. The balances are calculated based on the proportion of the year that they were key management personnel.

Refer to section (c) below for details of notes (1) to (9) referencing in the above table 5(a).

DIRECTORS' REPORT

(b) Remuneration of executives for the IAG Group for 2005

	SHORT-TERM EMPLOYMENT BENEFITS						POST-EMPLOYMENT BENEFITS		OTHER LONG-TERM EMPLOYMENT BENEFITS		TERMINATION BENEFITS	SHARE-BASED PAYMENT	TOTAL
	Cash Salary ⁽¹⁾	Non-monetary benefits ⁽²⁾	Base salary (Sub-total of ⁽¹⁾ & ⁽²⁾)	Annual leave accruals ⁽³⁾	Short term incentives ⁽⁴⁾	Other ⁽⁵⁾	Super-annuation ⁽⁶⁾	Retirement benefits	Long service leave accruals ⁽⁷⁾	Long term incentive plan ⁽⁸⁾		Value of PSRs / PARs granted ⁽⁹⁾	
2005	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000
<i>Executives (including Executive Director):</i>													
Mr MJ Hawker	1,151	36	1,187	18	1,270	–	157	–	18	–	–	614	3,264
Mr IF Brown	566	161	727	(16)	342	–	94	–	24	–	–	127	1,298
Mr AM Coleman	583	7	590	(31)	434	–	77	–	12	–	–	145	1,227
Mr DA Issa	508	7	515	1	476	–	67	–	7	–	–	125	1,191
Mr RJ Jackson	554	78	632	2	402	–	82	–	27	275	–	109	1,529
Ms SJ Mostyn	478	7	485	31	366	–	63	–	7	–	–	167	1,119
Mr DRA Pearce	441	48	489	(9)	230	–	63	–	12	–	–	110	895
Mr MJ Pirone	520	66	586	7	520	–	75	–	15	–	–	135	1,338
Mr DJP Smith	582	–	582	46	202	130	77	–	5	–	–	135	1,177
Mr G Venardos	619	48	667	50	451	–	86	–	19	–	–	171	1,444
<i>Executives who ceased as key management personnel during the year:</i>													
Ms KL Baylis	92	24	116	3	76	–	15	–	(6)	–	462	141	807
Mr LF Power	66	8	74	(1)	88	–	5	–	10	–	600	38	814
Mr RJ Wagstaffe	77	6	83	6	10	–	6	–	10	–	–	38	153
Total remuneration	6,237	496	6,733	107	4,867	130	867	–	160	275	1,062	2,055	16,256

Refer to section (c) below for details of notes (1) to (9) referencing in the above table 5(b).

(c) Details of notes (1) to (9) used in tables in sections 5(a) and (b)

- (1) Salary represents amounts paid in cash during the financial year.
- (2) Non-monetary benefits are valued in accordance with the cost to IAG for provision of cars, parking and related fringe benefits tax on a salary sacrifice basis.
- (3) Annual leave accruals as determined in accordance with AASB 119 *Employee Benefits*.
- (4) Short term incentive to be settled for the current performance period accrual and prior performance periods over or under accruals. Executives may elect to receive some of their short term incentive in the form of IAG shares rather than cash through participation in the Bonus Equity Share Plan, which vests immediately and is valued in accordance with the market value of IAG shares at grant date. Refer to note 29(c) for details.
- (5) Represents an accommodation allowance in New Zealand.
- (6) Superannuation includes the employer's contributions (2005 – the amount included the first 11 months contributions which was recognised on a deemed basis as the employer was on a contribution holiday).
- (7) Long service leave accruals as determined in accordance with AASB 119 *Employee Benefits*.
- (8) Long term incentive to be settled in cash from the 2002 / 2003 IMA long term incentive plan (only relevant to Mr Jackson). The amount in the 2005 table represented the 2005 performance period accrual and prior performance periods over or under accruals.
- (9) An allocated portion of Performance Share Rights ("PSRs" – related to unissued shares) and unvested Performance Award Rights ("PARs" – related to issued shares) is included in the total remuneration disclosure above. To determine these values the Monte Carlo model has been applied. The valuation takes into account the exercise price of the PSRs / PARs, life of the PSRs / PARs, current price of IAG shares, expected volatility of the IAG share price, expected dividends, risk free interest rate, the performance of the shares in the Peer Group of companies, early exercise and non transferability, and turnover.

DIRECTORS' REPORT

REMUNERATION REPORT – AUDITED INFORMATION (CONTINUED)

A. EXECUTIVES (CONTINUED)

6. AT RISK REMUNERATION

Total remuneration for executives is comprised of “at risk” and “not at risk” remuneration. Base salary and superannuation is “not at risk”, while short term incentives and long term incentives are “at risk”.

(a) Details of total remuneration that is “at risk”

Name	Total remuneration \$000	Short term incentives \$000	Long term incentives (IMA LTI / PSRs / PARs) \$000	Percentage of remuneration at risk ⁽¹⁾ %	Percentage of option / right remuneration %
2006					
Mr MJ Hawker	3,040	632	982	53	32
Mr JP Breheny	308	76	21	31	7
Mr AM Coleman	1,340	367	213	43	16
Mr NB Hawkins	387	84	52	35	13
Mr DA Issa	1,205	331	187	43	16
Ms JS Johnson	318	94	21	36	7
Ms CF McLoughlin	751	195	49	32	7
Ms SJ Mostyn	1,184	336	211	46	18
Mr MJ Pirone	1,331	395	203	45	15
Mr J van der Schalk	73	17	9	36	12
Mr G Venardos	1,495	393	247	43	17
2005					
Mr MJ Hawker	3,264	1,270	614	58	19
Mr IF Brown	1,298	342	127	36	10
Mr AM Coleman	1,227	434	145	47	12
Mr DA Issa	1,191	476	125	50	10
Mr RJ Jackson	1,529	402	384	51	7
Ms SJ Mostyn	1,119	366	167	48	15
Mr DRA Pearce	895	230	110	38	12
Mr MJ Pirone	1,338	520	135	49	10
Mr DJP Smith	1,177	202	135	29	11
Mr G Venardos	1,444	451	171	43	12

(1) Reductions in the percentage of remuneration “at risk” from 2005 to 2006 are largely the result of lower actual short term incentives being awarded in 2006.

(b) Short term incentives

The portion of the short term incentives that either vested or were forfeited during the year cannot be determined as no maximum or target amount is set. Executives may be paid a short term incentive based on IAG's performance and their own performance. The amount of short term incentives paid to an executive is recommended by the CEO and approved by the NRSC. The amount of short term incentives paid to the CEO is recommended by the NRSC and approved by the Board.

(c) Long term incentives

For the year ended 30 June 2006, 56% of PARs issued to the eligible executives in December 2002 are exercisable. There was no forfeited PARs because the person did not meet the service and performance criteria. No part of the forfeited rights are payable in future years.

It is not practical to provide an estimate of the maximum possible total value of long term incentives that may vest in future years for any PARs issued up to 30 June 2006 because the value is directly linked to the IAG share price at the time of vesting. The minimum possible total value of long term incentives is zero.

7. LONG TERM INCENTIVES – PARs AND PSRs

Rights under the PARs Plan and PSRs Plan were issued by the IAG Group and used as long term incentives. Refer to sections 2(d) for further details.

The following sections provided details movements in PARs and PSRs for each executive during the financial year ended 30 June 2006.

(a) PARs

(i) Details of PARs granted

The IAG Group has issued PARs to the executives during the financial year for nil consideration. Each executive who participates in the plan becomes eligible to receive an ordinary share per PAR, by paying the exercise price of \$1 per tranche of PARs exercised, subject to a specific performance hurdle being met. Refer to section 2(d) for details of the performance hurdle.

DIRECTORS' REPORT

Following are details of the number of PARs granted to each executive during the financial year ended 30 June 2006:

	Grant date	Date first exercisable	Last expiry date	Value per PAR at grant date \$	PARs granted during the year Number
Mr MJ Hawker	30/11/2005	30/09/2008	30/11/2015	2.596	600,000
Mr JP Breheny	22/03/2006	30/09/2008	22/03/2016	3.150	100,000
Mr AM Coleman	19/09/2005	30/09/2008	19/09/2015	3.187	90,000
Mr NB Hawkins	*	*	*	*	*
Mr DA Issa	19/09/2005	30/09/2008	19/09/2015	3.187	83,500
Ms JS Johnson	*	*	*	*	*
Ms CF McLoughlin	19/09/2005	30/09/2008	19/09/2015	3.187	80,000
Ms SJ Mostyn	19/09/2005	30/09/2008	19/09/2015	3.187	80,000
Mr MJ Pirone	19/09/2005	30/09/2008	19/09/2015	3.187	90,000
Mr J van der Schalk	*	*	*	*	*
Mr G Venardos	19/09/2005	30/09/2008	19/09/2015	3.187	100,000
<i>Executives who ceased as key management personnel during the year:</i>					
Mr IF Brown	—	—	—	—	—
Mr RJ Jackson	19/09/2005	30/09/2008	19/09/2015	3.187	90,000
Mr DRA Pearce	—	—	—	—	—
Mr DJP Smith	19/09/2005	30/09/2008	19/09/2015	3.187	80,000
					1,393,500

* All PARs granted prior to Mr Hawkins', Ms Johnson's and Mr van der Schalk's appointment to their executive role are excluded.

(ii) Movements in total number of PARs on issue by each executive

	PARs on issue 1 July 2005 Number	PARs granted during the year Number	PARs exercised during the year ⁽²⁾ Number	PARs lapsed during the year Number	PARs on issue 30 June 2006 Number	PARs vested and exercisable 30 June 2006 Number
Mr MJ Hawker	1,200,000	600,000	(168,000)	—	1,632,000	—
Mr JP Breheny	—	100,000	—	—	100,000	—
Mr AM Coleman	258,195	90,000	(54,176)	—	294,019	—
Mr NB Hawkins	168,456 ⁽¹⁾	—	—	—	168,456	—
Mr DA Issa	223,177	83,500	(47,675)	—	259,002	—
Ms JS Johnson	87,300 ⁽¹⁾	—	(5,972)	—	81,328	—
Ms CF McLoughlin	—	80,000	—	—	80,000	—
Ms SJ Mostyn	214,307	80,000	(45,508)	—	248,799	—
Mr MJ Pirone	239,881	90,000	(47,675)	—	282,206	—
Mr J van der Schalk	149,004 ⁽¹⁾	—	—	—	149,004	22,753
Mr G Venardos	305,048	100,000	(66,745)	—	338,303	—
Total	2,845,368	1,223,500	(435,751)	—	3,633,117	22,753
<i>Executives who ceased as key management personnel during the year:</i>						
Mr IF Brown	221,716	—	—	—	221,716	45,508
Mr RJ Jackson	161,451	90,000	—	—	251,451	—
Mr DRA Pearce	196,232	—	—	—	196,232	49,029
Mr DJP Smith	238,167	80,000	(48,560)	—	269,607	—
Total	817,566	170,000	(48,560)	—	939,006	94,537

(1) This balance represents the PARs held by Mr Hawkins, Ms Johnson and Mr van der Schalk at the date of appointment as executive.

(2) \$1 per tranche of PARs is payable to exercise. Nil remains unpaid per issued share acquired. For each PAR exercised, one ordinary IAG share was issued.

DIRECTORS' REPORT

REMUNERATION REPORT – AUDITED INFORMATION (CONTINUED)

A. EXECUTIVES (CONTINUED)

7. LONG TERM INCENTIVES – PARs AND PSRs (CONTINUED)

(b) PSRs

The PSRs Plan was closed for issuing further PSRs from the financial year ended 30 June 2003. Following is a summary of the movements in total number of PSRs on issue by each executive:

	PSRs on issue 1 July 2005 Number	PSRs exercised during the year ⁽²⁾ Number	PSRs lapsed during the year Number	PSRs on issue 30 June 2006 Number	PSRs vested and exercisable 30 June 2006 Number
Mr MJ Hawker	60,000	(60,000)	–	–	–
Ms SJ Mostyn	68,670	(68,670)	–	–	–
Mr J van der Schalk	40,000 ⁽¹⁾	–	–	40,000	40,000

(1) This balance represents the PSRs held by Mr van der Schalk at the date of appointment as executive.

(2) The exercise price was \$1 per tranche of PSRs. Nil remains unpaid per issued share acquired. For each PSR exercised, one ordinary IAG share was issued.

(c) Analysis of movements in PARs and PSRs

Following is a summary of the movement during the financial year, by value, of PARs and PSRs by each executive:

	Total value of PARs granted during the year ⁽¹⁾ \$000	Total value of PSRs exercised during the year ⁽²⁾ \$000	Total value of PARs exercised during the year ⁽³⁾ \$000	Total value PARs and PSRs that lapsed during the year ⁽⁴⁾ \$000	Total of ⁽¹⁾ to ⁽⁴⁾ \$000
Mr MJ Hawker	1,558	338	918	–	2,814
Mr JP Breheny	315	–	–	–	315
Mr AM Coleman	287	–	296	–	583
Mr NB Hawkins	*	*	*	*	*
Mr DA Issa	266	–	259	–	525
Ms JS Johnson	*	*	*	*	*
Ms CF McLoughlin	255	–	–	–	255
Ms SJ Mostyn	255	366	246	–	867
Mr MJ Pirone	287	–	260	–	547
Mr J van der Schalk	*	*	*	*	*
Mr G Venardos	319	–	362	–	681
Total	3,542	704	2,341	–	6,587
<i>Executives who ceased as key management personnel during the year:</i>					
Mr IF Brown	–	–	–	–	–
Mr RJ Jackson	287	–	–	–	287
Mr DRA Pearce	–	–	–	–	–
Mr DJP Smith	255	–	265	–	520
Total	542	–	265	–	807

Notes:

(1) The value of PARs granted in the year is the fair value of the PARs calculated at grant date using a Monte Carlo model. The total value of the PARs granted is included in the table above. This amount is allocated to remuneration over the vesting period (ie in years 30 June 2006 to 30 June 2010).

(2) The PSRs and PARs exercised during the year by the executives were issued to them on 13 December 2001, 5 March 2002 and 24 December 2002. The respective values at grant date were allocated to their remuneration during the three years' vesting period between 30 June 2002 to 30 June 2006. PSRs and PARs are exercisable only if a performance hurdle is reached in relation to IAG's TSR.

The value of PSRs and PARs exercised during the year is calculated as the weighted average of the prices at which IAG shares were traded over 5 days before and including date of exercise after deducting the \$1 exercise price per tranche of PSRs exercised.

(3) No PARs or PSRs lapsed during the year.

(4) Related parties of executives cannot participate in the PARs or PSRs Plans.

* The above table excludes all PARs and PSRs movement prior to the date when Mr Hawkins, Ms Johnson and Mr van der Schalk were appointed to their executive roles.

DIRECTORS' REPORT

B. NON-EXECUTIVE DIRECTORS

1. REMUNERATION POLICY

The principles that underpin IAG's approach to remuneration for Non-executive Directors are that remuneration should be:

- sufficiently competitive to attract and retain a high calibre of Non-executive Director; and
- consistent with IAG's values.

The aggregate limit of remuneration is approved by shareholders and is currently \$2 million per annum. The aggregate annual remuneration is inclusive of employer superannuation contributions paid by IAG on behalf of Non-executive Directors.

The Board has agreed that each Non-executive Director should take a minimum of 20% and up to a maximum of 90% of their annual base fee (at the time shares are allocated), on a fee sacrifice basis, in the form of IAG shares provided under the Non-Executive Directors' Share Plan, which was approved by shareholders on 13 November 2002. IAG shares are purchased by the trustee on market and allocated to directors in December each year. Non-executive Directors may elect to restrict the disposal of these shares for a minimum period of one year and up to 10 years or until the Director retires. No other equity-based remuneration is available to Non-executive Directors.

The current elements of Non-executive Director remuneration are:

Board / committee	Role	Fee
IAG Board	Chairman	\$360,000 (includes committee fees*)
	Director	\$120,000
Audit Committee	Chairman	\$30,000
	Member	\$15,000
Risk Management & Compliance Committee	Chairman	\$30,000
	Member	\$15,000
Nomination, Remuneration & Sustainability Committee	Member	\$15,000

* The Chairman does not receive additional fees for serving on the Nomination, Remuneration & Sustainability Committee or for serving as a director of IAG Re Limited. The Chairman is, however, paid a fee for his role as Chairman of Insurance Manufacturers of Australia Pty Limited, a 70% owned subsidiary of IAG.

In addition, IAG pays a superannuation contribution of 9% of a Director's fees into a superannuation fund nominated by the Director. Directors' fees and superannuation contributions are paid monthly.

IAG has a Non-executive Directors' Expenses policy. Under this policy IAG reimburses expenses reasonably incurred by Directors in connection with the discharge of their duties.

2. INCREASE TO DIRECTORS' FEES

Following a review of the remuneration of Non-executive Directors, taking into account the remuneration paid to the Non-executive Directors of the 50 largest companies in the S&P / ASX 100 index and market movements in directors fees, the Board has determined that fees payable to Non-executive Directors should be increased with effect from 1 July 2006 as follows:

Board / committee	Role	Fee
IAG Board	Chairman	\$390,000 (includes committee fees*)
	Director	\$130,000
Audit Committee	Chairman	\$32,500
	Member	\$16,250
Risk Management & Compliance Committee	Chairman	\$32,500
	Member	\$16,250
Nomination, Remuneration & Sustainability Committee	Member	\$16,250

3. PERFORMANCE

Directors' performance is subject to evaluation by the Chairman at least every two years, by discussion between the Chairman and the individual Director. In these discussions, the individual Directors also evaluate the Chairman's performance. Performance measures for Directors considered by the Chairman and Board include:

- contribution of the Director to Board teamwork;
- contribution to debates on significant issues and proposals;
- advice and assistance given to management;
- in the case of the Chairman's performance, the fulfilment of his or her additional role as Chairman; and
- input regarding regulatory, industry and social developments surrounding the business.

The Nomination, Remuneration & Sustainability Committee has responsibility for coordinating the Board's review of the Chairman's performance.

DIRECTORS' REPORT

REMUNERATION REPORT – AUDITED INFORMATION (CONTINUED)

B. NON-EXECUTIVE DIRECTORS (CONTINUED)

4. REMUNERATION DETAILS

(a) Remuneration of Non-executive Directors for 2006

	SHORT-TERM BENEFITS		POST-EMPLOYMENT BENEFITS		OTHER LONG-TERM EMPLOYMENT BENEFITS	TERMINATION BENEFITS	SHARE-BASED PAYMENT	TOTAL
2006	Board fees received as cash \$000	Committee fees \$000	Super-annuation \$000	Retirement benefits \$000	\$000	\$000	Board fees received as IAG shares \$000	\$000
Mr JA Strong ⁽ⁱ⁾	352	–	47	–	–	–	168	567
Ms YA Allen	98	15	12	–	–	–	22	147
Mr JF Astbury	98	45	15	–	–	–	22	180
Mr GA Cousins	98	15	12	–	–	–	22	147
Mr ND Hamilton	20	15	12	–	–	–	100	147
Mr RA Ross	64	45	15	–	–	–	56	180
Mr B Schwartz	87	15	12	–	–	–	33	147
Total remuneration	817	150	125	–	–	–	423	1,515

Note:

(i) Board fees for Mr Strong included \$160,000 for his service as Chairman of the Board of Insurance Manufacturers of Australia Pty Limited ("IMA").

(b) Remuneration of Non-executive Directors for 2005

	SHORT-TERM BENEFITS		POST-EMPLOYMENT BENEFITS		OTHER LONG-TERM EMPLOYMENT BENEFITS	TERMINATION BENEFITS	SHARE-BASED PAYMENT	TOTAL
2005	Board fees received as cash \$000	Committee fees \$000	Super-annuation \$000	Retirement benefits \$000	\$000	\$000	Board fees received as IAG shares \$000	\$000
Mr JA Strong ⁽ⁱ⁾	280	–	39	–	–	–	150	469
Ms YA Allen ⁽ⁱⁱ⁾	52	8	6	–	–	–	12	78
Mr JF Astbury	80	30	12	–	–	–	20	142
Mr GA Cousins	80	12	10	–	–	–	20	122
Ms DG Fisher ⁽ⁱⁱⁱ⁾	18	4	4	259	–	–	18	303
Mr ND Hamilton ^(iv)	10	19	11	–	–	–	90	130
Ms AJ Keating ^(v)	29	8	4	250	–	–	7	298
Mr RA Ross	50	30	12	–	–	–	50	142
Mr B Schwartz ^(vi)	37	6	5	–	–	–	13	61
Total remuneration	636	117	103	509	–	–	380	1,745

Notes:

(i) Board fees for Mr Strong included \$130,000 for his service as Chairman of the Board of IMA.

(ii) Ms Allen was appointed to the Board on 10 November 2004.

(iii) Ms Fisher retired from the Board on 10 November 2004.

(iv) Board fees for Mr Hamilton included \$7,000 for his services as Director of Mutual Community General Proprietary Limited ("MCGI"), a 51% owned controlled entity of IAG.

(v) Ms Keating retired from the Board on 10 November 2004. During the period, Board fees for Ms Keating included \$4,000 for her services as Director of MCGI.

(vi) Mr Schwartz was appointed to the Board on 1 January 2005.

5. RETIREMENT BENEFITS

IAG decided to freeze the operation of the Non-executive Director retirement benefit scheme adopted by IAG in 2001 with effect from 1 September 2003.

The terms of the retirement benefits scheme provided for:

- Any Non-executive Director of IAG who had completed five years' continuous service with the IAG (including service with any subsidiaries) at the date of retirement, a retirement benefit equivalent to the last three years' Directors' fees, employer superannuation contributions, committee fees and fees for extra services received from IAG and its subsidiaries.
- A pro-rata retirement benefit for Non-executive Directors who have completed at least three years' service but less than five years' service at the date of their retirement, based on a specified formula.

DIRECTORS' REPORT

(c) No retirement benefit to be paid to a Non-executive Director who had served for a period of less than three years.

IAG determined that the frozen retirement benefits would be calculated as follows:

- (a) Non-executive Directors joining the Board from 1 September 2003 would have no retirement benefit;
- (b) For each Non-executive Director as at 31 August 2003 who had served a minimum of three years, the retirement benefit was assessed as if they had retired at 31 August 2003; and
- (c) For a Non-executive Director with less than three years of service at 31 August 2003, a retirement benefit was assessed as if they had three years of service as at that date, and then reduced on a pro-rata basis based on their uncompleted period of service as a proportion of three years. The retirement benefit was not subsequently payable to such a Non-executive Director if they had less than three years of service as a Non-executive Director at the date of their retirement.

The following table sets out the frozen retirement benefits of the remaining Directors who held office on 31 August 2003 and who have continued in office since then:

Name	Retirement benefit \$000
Mr JA Strong	295
Mr JF Astbury	184
Mr GA Cousins	169
Mr ND Hamilton	248
Mr RA Ross	232

On retirement, Directors may also be entitled to be paid a benefit from their company funded superannuation. Such a benefit would be in addition to the Director's frozen retirement benefit.

No amounts have been accrued in the accounts of the IAG Group for the frozen retirement benefits of the remaining Directors who held office on 31 August 2003 and who have continued in office since, as the Board has not exercised its discretion to pay these retirement benefits.

C. OTHER BENEFITS

Remuneration does not include premiums paid by IAG for an insurance contract covering current and former Directors' and executives' liabilities and legal expenses incurred in respect of the relevant office, as the insurance policies do not specify premiums paid in respect of individual Directors and executives and the terms of contract specifically prohibited the disclosure of the premium paid. Insurance products provided by the IAG Group are also available to all directors and executives on the same terms and conditions available to other employees.

D. EQUITY AND DEBT INSTRUMENT DISCLOSURE

1. HOLDING OF ORDINARY SHARES

(a) The relevant interest of each key management personnel and their related parties in ordinary shares of IAG

	Shares held at the beginning of the year	Shares granted as remuneration during the year	Shares received on exercise of PSRs	Shares received on exercise of PARs	Net movement of shares due to other changes ⁽²⁾	Total shares held at the end of the year	Shares held nominally at the end of the year ⁽¹⁾
Mr JA Strong	225,547	33,918	–	–	–	259,465	247,382
Ms YA Allen	3,437	4,522	–	–	–	7,959	7,959
Mr JF Astbury	51,772	4,522	–	–	9,400	65,694	55,611
Mr GA Cousins	171,689	4,522	–	–	–	176,211	26,211
Mr ND Hamilton	80,744	20,351	–	–	173	101,268	96,278
Mr RA Ross	154,100	11,306	–	–	–	165,406	62,849
Mr B Schwartz	3,906	6,783	–	–	–	10,689	10,689
Mr MJ Hawker	1,150,059	–	60,000	168,000	–	1,378,059	–
Mr JP Breheny	–	–	–	–	–	–	–
Mr AM Coleman	65,896	–	–	54,176	(58,020)	62,052	54,176
Mr NB Hawkins	–	–	–	–	24,332 ⁽³⁾	24,332	–
Mr DA Issa	–	–	–	47,675	(47,675)	–	–
Ms JS Johnson	–	–	–	5,972	–	5,972	–
Ms CF McLoughlin	–	–	–	–	–	–	–
Ms SJ Mostyn	16,083	–	68,670	45,508	–	130,261	–
Mr MJ Pirone	31,388	–	–	47,675	–	79,063	11,432
Mr J van der Schalk	–	–	–	–	–	–	–
Mr G Venardos	38,289	–	–	66,745	5,746	110,780	27,632

DIRECTORS' REPORT

REMUNERATION REPORT – AUDITED INFORMATION (CONTINUED)

D. EQUITY AND DEBT INSTRUMENT DISCLOSURE (CONTINUED)

1. HOLDING OF ORDINARY SHARES (CONTINUED)

(a) The relevant interest of each key management personnel and their related parties in ordinary shares of IAG (continued)

	Shares held at the beginning of the year	Shares granted as remuneration during the year	Shares received on exercise of PSRs	Shares received on exercise of PARs	Net movement of shares due to other changes ⁽²⁾	Total shares held at the end of the year	Shares held nominally at the end of the year ⁽¹⁾
<i>Executives who ceased employment during the year:</i>							
Mr IF Brown	253,691	36,920	–	–	(2,530)	*	*
Mr RJ Jackson	7,351	–	–	–	–	*	*
Mr DRA Pearce	7,806	–	–	–	(6,738)	*	*
Mr DJP Smith	129,591	–	–	48,560	(54,511)	*	*

(1) Nominally held shares are included in the column headed total shares held at the end of the year. These shares are held by the key management personnel's related parties, inclusive of domestic partner, dependents and entities controlled, jointly controlled or significantly influenced by the key management personnel.

(2) Net movement of shares relate to acquisition and disposal transactions by the key management personnel and their related parties during the year. It includes any opening balances of shares held by key management personnel who were appointed during the year.

(3) This balance represents the shares held by Mr Hawkins at the date of appointment as executive.

* These key management personnel ceased employment during the financial year. Information on shares held only disclosed up to the date of their cessation.

(b) The relevant interest of each Director and their related party in ordinary shares of IAG in accordance with the Corporations Act 2001

FOR SECTION 205G OF THE CORPORATIONS ACT 2001		
	Shares held directly at the end of the year ⁽¹⁾	Shares held indirectly at the end of the year ⁽¹⁾⁽²⁾
Mr JA Strong	12,083	198,819
Ms YA Allen	–	7,959
Mr JF Astbury	10,083	55,611
Mr GA Cousins	150,000	26,211
Mr ND Hamilton	4,990	96,278
Mr RA Ross	102,557	59,952
Mr B Schwartz	–	10,689
Mr MJ Hawker	1,378,059	–

(1) This represents the relevant interest of each Director in ordinary shares issued by the Company, as notified by the Directors to the Australian Stock Exchange in accordance with section 205G of the Corporations Act 2001. Trading in IAG shares is covered by the restrictions which limit the ability of an IAG Director to trade in the shares of the IAG Group where they are in a position to be aware, or are aware, of price sensitive information.

(2) These shares are held by the Director's related parties, inclusive of entities controlled, jointly controlled or significantly influenced by the Directors.

2. HOLDINGS OF RESET PREFERENCE SHARES

No key management personnel had any interest in reset preference shares at any time during the financial year.

3. HOLDINGS OF RESET EXCHANGEABLE SECURITIES

In respect of the relevant interest of each key management personnel in reset exchangeable securities ("RES") of IAG Finance (New Zealand) Limited, other than Mr Hawker, no other person held any RES directly or through their related party.

FOR SECTION 205G OF THE CORPORATIONS ACT 2001						
	RES held at the beginning of the year	Net movement of RES due to other changes	Total RES held at the end of the year	RES held nominally at the end of the year ⁽¹⁾	RES held directly at the end of the year ⁽²⁾	RES held indirectly at the end of the year ⁽²⁾
Mr MJ Hawker	1,000	–	1,000	1,000	–	1,000

(1) Nominally held RES are included in the column headed total RES held at the end of the year. These RES are indirectly held by key management personnel's related parties.

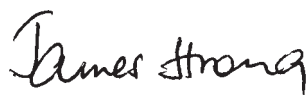
(2) This represents the relevant interest of each Director in RES issued by IAG Finance (New Zealand) Limited, as notified by the Directors to the Australian Stock Exchange in accordance with section 205G of the Corporations Act 2001. Trading in RES is covered by the IAG Group's Continuous Disclosure & Insider Trading Policy.

DIRECTORS' REPORT

ROUNDING OF AMOUNTS

Unless otherwise stated, amounts in the financial report and Directors' report have been rounded to the nearest million dollars. The Company is of a kind referred to in the class order 98 / 100 dated 10 July 1998 issued by the Australian Securities & Investments Commission. All rounding has been conducted in accordance with that class order.

Signed at Sydney this 25th day of August 2006 in accordance with a resolution of the Directors.



James Strong
Director



Michael Hawker
Director

LEAD AUDITOR'S INDEPENDENCE DECLARATION

UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

To: the Directors of Insurance Australia Group Limited

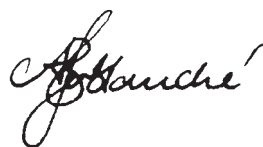
I declare that both the Firm and I were and remain independent in accordance with professional rules and statutory requirements on auditor independence in relation to the audit for the financial year ended 30 June 2006 ("the audit").

To the best of my knowledge and belief, in relation to the audit there have been:

- (a) no contraventions of the auditor independence requirements of the Corporations Act 2001 other than contraventions (relating to minor matters rectified within seven days and reported to the Directors) covered by ASIC Class Order 05 / 910; and
- (b) no contraventions of any applicable code of professional conduct in relation to the audit.



KPMG



Dr Andries B Terblanché

Partner

Sydney

25th August 2006

INCOME STATEMENTS

for the year ended 30 June 2006

		PARENT		CONSOLIDATED	
	Notes	2006 \$m	2005 \$m	2006 \$m	2005 \$m
Premium revenue	3	–	–	6,537	6,561
Reinsurance expense	4	–	–	(405)	(417)
Net premium revenue(i)		–	–	6,132	6,144
Claims expense	4	–	–	(4,466)	(4,750)
Reinsurance and other recoveries	3	–	–	566	660
Net claims expense(ii)	11	–	–	(3,900)	(4,090)
Acquisition costs	4	–	–	(1,081)	(1,070)
Other underwriting expenses	4	–	–	(395)	(377)
Fire service levies	4	–	–	(223)	(177)
Underwriting expenses(iii)		–	–	(1,699)	(1,624)
Underwriting profit(i) + (ii) + (iii)		–	–	533	430
Investment income on assets backing insurance liabilities	3	–	–	329	525
Investment expenses on assets backing insurance liabilities	4	–	–	(19)	(9)
Insurance profit		–	–	843	946
Investment income on equity holders' funds	3	746	585	576	518
Other income	3	3	–	218	179
Share of net profit of associate	3	–	–	2	–
Finance costs	4	(57)	–	(86)	(69)
Corporate, administration and other expenses	4	–	–	(298)	(289)
Net income attributable to minority interests in unitholders' funds	4	–	–	(20)	–
Profit before income tax		692	585	1,235	1,285
Income tax credit / (expense)	6	10	2	(373)	(357)
Profit for the year		702	587	862	928
Profit for the year attributable to:					
Equity holders of the Parent		702	587	759	811
Minority interests		–	–	103	117
Profit for the year		702	587	862	928

		CONSOLIDATED	
	Notes	2006 cents	2005 cents
Basic earnings per ordinary share	8	47.87	49.31
Diluted earnings per ordinary share	8	47.59	49.00

The above income statements should be read in conjunction with the notes to the financial statements.

BALANCE SHEETS

as at 30 June 2006

		PARENT		CONSOLIDATED	
	Notes	2006 \$m	2005 \$m	2006 \$m	2005 \$m
Assets					
Cash and cash equivalents	25	1	1	718	456
Investments	15	–	–	9,929	10,370
Premium receivable		–	–	1,652	1,710
Trade and other receivables	16	1	–	764	827
Receivables from related bodies corporate	34	160	215	4	–
Current tax assets		–	–	1	4
Loans to related bodies corporate	34	–	5	–	–
Reinsurance and other recoveries receivable on outstanding claims	12	–	–	908	883
Inventories		–	–	–	2
Prepayments		–	–	25	38
Deferred levies and charges		–	–	126	105
Deferred reinsurance expense		–	–	221	194
Deferred acquisition costs	13	–	–	591	621
Deferred tax assets	17	1	–	159	131
Property, plant and equipment	18	–	–	257	259
Investment in joint ventures and associates	28	–	–	74	8
Intangible assets	19	–	–	57	31
Investment in subsidiaries	27	4,795	4,617	–	–
Goodwill	20	–	–	1,486	1,463
Total assets		4,958	4,838	16,972	17,102
Liabilities					
Trade and other payables	21	2	1	743	721
Reinsurance premiums payable		–	–	166	195
Payables to related bodies corporate	34	84	73	–	–
Restructuring provision	22	–	–	10	11
Current tax liabilities		63	140	83	193
Loans from related bodies corporate	34	313	184	–	–
Unexpired risk liability		–	–	11	–
Unearned premium liability	14	–	–	3,503	3,586
Minority interest in unitholders' funds		–	–	305	–
Lease provision		–	–	21	21
Employee benefits provision	29	–	–	207	229
Deferred tax liabilities	17	–	–	40	24
Outstanding claims liability	11	–	–	6,916	6,840
Interest-bearing liabilities	23	547	–	1,296	779
Total liabilities		1,009	398	13,301	12,599
Net assets		3,949	4,440	3,671	4,503
Equity					
Share capital	24(a)	3,263	3,802	3,263	3,802
Treasury shares held in trust	24(b)	–	–	(40)	(34)
Reserves	24(c)	–	–	(6)	7
Retained earnings	24(d)	686	638	274	142
Parent interest	24	3,949	4,440	3,491	3,917
Minority interests	24(e)	–	–	180	586
Total equity	24	3,949	4,440	3,671	4,503

The above balance sheets should be read in conjunction with the notes to the financial statements.

STATEMENTS OF RECOGNISED INCOME AND EXPENSE

for the year ended 30 June 2006

	Notes	PARENT		CONSOLIDATED	
		2006 \$m	2005 \$m	2006 \$m	2005 \$m
Income and expenses recognised directly in equity during the year, net of tax					
Actuarial gains / (losses) on defined benefit plans		–	–	21	(1)
Net movement in foreign currency translation reserve		–	–	(9)	(1)
Net movement in hedging reserve		–	–	(5)	–
Vesting of share based remuneration		–	–	(1)	–
Total net income and (expense) recognised directly in equity		–	–	6	(2)
Profit for the year		702	587	862	928
Total recognised income and expense for the year		702	587	868	926
Total recognised income and expense for the year attributable to:					
Equity holders of the Parent		702	587	765	809
Minority interests	24(e)	–	–	103	117
Total recognised income and expense for the year		702	587	868	926
Effect of changes in accounting policies made as part of the transition to AIFRS					
Income and expenses recognised directly in equity on 1 July 2005, net of tax					
Initial recognition of AIFRS adjustments directly to retained earnings at 1 July 2005, net of tax					
– Adjustment to valuation of investments		–	–	1	–
– Amortisation of reset preference shares transaction costs		(6)	–	(6)	–
– Accrual for distribution on reset preference shares		(1)	–	(1)	–
Initial recognition of AIFRS adjustments directly to reserves at 1 July 2005, net of tax					
– Recognition of hedging reserve, net of tax		–	–	(5)	–
	38	(7)	–	(11)	–
Net AIFRS adjustments at 1 July 2005 attributable to:					
Equity holders of the Parent		(7)	–	(10)	–
Minority interests		–	–	(1)	–
	38	(7)	–	(11)	–

Other movements in equity arising from transactions with equity holders acting in their capacity as equity holders are set out in note 24.

The above statements of recognised income and expense should be read in conjunction with the notes to the financial statements.

CASH FLOW STATEMENTS

for the year ended 30 June 2006

	Notes	PARENT		CONSOLIDATED	
		2006 \$m	2005 \$m	2006 \$m	2005 \$m
Cash flows from operating activities					
Premium received		–	–	6,530	6,610
Reinsurance and other recoveries received		–	–	589	452
Claims costs paid		–	–	(4,423)	(4,179)
Reinsurance expense paid		–	–	(434)	(394)
Dividends received		745	585	85	93
Interest and trust distributions received		–	–	415	412
Finance costs paid		(29)	–	(82)	(62)
Income taxes refunded		–	–	8	4
Income taxes paid		(300)	(154)	(497)	(315)
Other operating receipts		280	–	1,051	1,036
Other operating payments		–	–	(2,855)	(2,736)
Net cash flows from operating activities	25(b)	696	431	387	921
Cash flows from investing activities					
Net cash flows on acquisition of subsidiaries	26(a)	–	–	(92)	(7)
Dividend received from pre-acquisition profit of subsidiary		412	–	–	–
Proceeds from disposal of investments and property, plant and equipment		–	–	19,503	19,987
Outlays for investments and property, plant and equipment acquired		(590)	(60)	(18,591)	(20,137)
Repayment of premium funding loans		–	–	448	375
Advances of premium funding loans		–	–	(446)	(414)
Net cash flows from investing activities		(178)	(60)	822	(196)
Cash flows from financing activities					
Outlays for purchase of treasury shares		–	–	(19)	(13)
Proceeds from issue of trust units		–	–	1,152	2,035
Outlays for redemption of trust units		–	–	(1,288)	(2,163)
Proceeds from issue of reset exchangeable securities, net of transaction costs		–	–	–	537
Outlays to acquire Portfolio (see note 1(ff))		–	–	–	(550)
Proceeds from other borrowings inclusive of costs		129	71	–	9
Repayment of borrowings		–	–	(46)	(9)
Dividends paid to IAG equity holders		(647)	(442)	(647)	(442)
Dividends paid to minority interests		–	–	(89)	(96)
Net cash flows from financing activities		(518)	(371)	(937)	(692)
Net movement in cash held		–	–	272	33
Effects of exchange rate changes on balances of cash held in foreign currencies		–	–	(10)	(1)
Cash and cash equivalents at the beginning of the financial year		1	1	456	424
Cash and cash equivalents at the end of the financial year	25(a)	1	1	718	456

The above cash flow statements should be read in conjunction with the notes to the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

INDEX

For ease of reference we provide here an index of the notes to the financial statements showing those relevant to the financial statements of the Consolidated entity and those relevant to the financial statements of the Parent.

NOTES	Page reference if applicable	
	CONSOLIDATED	PARENT
1	Summary of significant accounting policies	65
2	Critical accounting estimates and judgements	72
3	Analysis of income	73
4	Analysis of expenses	73
5	Remuneration of auditors	75
6	Income tax	76
7	Segment reporting	76
8	Earnings per share	78
9	Dividends	79
10	Insurance contracts risk management	80
11	Claims	82
12	Reinsurance and other recoveries on outstanding claims	87
13	Deferred acquisition costs	88
14	Unearned premium liability	89
15	Investments	89
16	Trade and other receivables	90
17	Deferred tax assets and liabilities	90
18	Property, plant and equipment	91
19	Intangible assets	92
20	Goodwill	92
21	Trade and other payables	93
22	Restructuring provision	93
23	Interest-bearing liabilities	94
24	Reconciliation of total equity	96
25	Notes to the cash flow statements	98
26	Acquisitions and disposals of businesses	99
27	Details of subsidiaries	101
28	Details of joint ventures and associates	103
29	Employee benefits	104
30	Share based remuneration	104
31	Superannuation	107
32	Commitments	110
33	Contingencies	110
34	Related party disclosures	111
35	Financial risk management	115
36	Capital management	120
37	Net tangible assets	123
38	Explanation of transition to Australian equivalents to International Financial Reporting Standards	123
39	Events subsequent to reporting date	128

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Insurance Australia Group Limited ("Company", "Parent" and "IAG") is a publicly listed company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is Level 26, 388 George Street, Sydney, NSW 2000. The consolidated financial report of the Company for the year ended 30 June 2006 comprises the Company and its subsidiaries (referred to as "Consolidated entity" and "IAG Group").

This general purpose financial report was authorised by the Board of Directors for issue on 25 August 2006.

(a) Statement of compliance

This general purpose financial report for the year ended 30 June 2006 has been prepared in accordance with the Corporations Act 2001, Australian equivalents to International Financial Reporting Standards ("AIFRS"), other authoritative pronouncements of the Australian Accounting Standards Board and the Australian Stock Exchange Listing Rules.

The financial reports were prepared in accordance with Australian Generally Accepted Accounting Principles ("Australian GAAP") for all periods up to and including the year ended 30 June 2005. From 1 July 2005, the financial reports are required to be prepared in accordance with AIFRS effective for the year ended 30 June 2006. The date of transition to AIFRS was 1 July 2004, which is the start of the comparative period.

Reconciliations and explanations of the impact of the transition from Australian GAAP to AIFRS on the financial position and financial performance of the Parent and the Consolidated entity are provided in note 38.

International Financial Reporting Standards ("IFRS") refer to the overall framework of standards and pronouncements approved by the International Accounting Standards Board ("IASB"). IFRS forms the basis of AIFRS being the Australian accounting standards adopted by the Australian Accounting Standards Board. This financial report of the Parent and the Consolidated entity comply with IFRS.

The current IFRS standard for insurance contracts does not include a comprehensive set of recognition and measurement criteria. The IASB continues to work on a project to issue a standard that does include such criteria. Until the issuance of that standard, the financial reports of insurers in different countries that comply with IFRS may not be comparable in terms of the recognition and measurement of insurance contracts.

(b) Basis of preparation of the financial report

The significant accounting policies adopted in the preparation of this financial report are set out below. The accounting policies adopted in the preparation of this financial report have been consistently applied by all entities in the Consolidated entity. The policies have been applied consistently to all periods presented in the financial report and in preparing the opening AIFRS balance sheet at 1 July 2004 for the purposes of transition to AIFRS, except for policies relating to the standards discussed in note 1(b)(ii) for which comparatives have not been restated. These financial statements have been prepared on the basis of historical cost principles, as modified by certain exceptions noted in the financial report, with the principal exceptions for the Consolidated entity being the measurement of all investments and derivatives at fair value and the measurement of the outstanding claims liability and related reinsurance and other recoveries at present value.

The presentation currency used for the preparation of these financial reports is Australian dollars.

The balance sheet is prepared using the liquidity format in which the assets and liabilities are presented broadly in order of liquidity. The assets and liabilities comprise both current amounts (expected to be recovered or settled within twelve months after the reporting date) and non-current amounts (expected to be recovered or settled more than twelve months after the reporting date). For those assets and liabilities that comprise both current and non-current amounts, information regarding the amount of the item that is expected to be outstanding longer than twelve months is included within the relevant note to the financial statements.

(i) Australian accounting standards issued but not yet effective

As at the date of this financial report, there are a number of new and revised accounting standards on issue with mandatory application dates after the end of this current reporting period. Of these, the following standards have been early adopted:

- AASB 119 *Employee benefits* (issued December 2004) and AASB 2004 – 3. These standards made available two additional options for accounting for defined benefit obligations one of which was selected by the IAG Group. Refer note 1(z).

The standards that have not been early adopted and that are relevant to current operations are:

- AASB 2005 – 4 restricting the use of the fair value option in AASB 139. This standard had no financial impact.
- AASB 7 *Financial Instruments: Disclosures* applicable for the first time to the 30 June 2008 financial report. This standard was issued in conjunction with AASB 2005 – 10 which makes a number of consequential amendments to other standards arising from the issue of AASB 7. The changes will impact only on annual financial report disclosures.
- AASB 2005 – 9 which deals with the treatment of financial guarantee contracts and deals with the issue where an insurance product meets the definition of an insurance contract and a financial guarantee contract. This amendment is not expected to have a significant, if any, financial impact.

(ii) First time adoption of AIFRS

This is the first annual financial report to be prepared in accordance with AIFRS. AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* has been applied in preparing these financial statements. There are several recognition and measurement differences between Australian GAAP and AIFRS. Preparation of this AIFRS compliant financial report has required amendment of certain accounting policies, changes to certain valuation methodologies, and reporting of certain information in a different manner than was the case under the previous Australian GAAP financial reports. Comparative figures have been restated to reflect these adjustments except for several exceptions noted below.

In preparing this financial report, certain elections have been made in relation to transitional provisions within AASB 1 which offer exemption from presenting comparative information or applying AIFRS retrospectively. The most significant impact arises from the exemption from presenting comparative information in accordance with AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 139 *Financial Instruments: Recognition and Measurement* and AASB 1023 *General Insurance Contracts*. Comparative information for financial instruments and insurance contracts has been prepared on the basis of the previous accounting policies. The differences between the accounting policies applied are provided below in notes 1(i), 1(n), 1(q), and 1(bb) with additional information disclosed in note 38. The AIFRS adjustments applicable for the first time from 1 July 2005 represent a change in accounting policy made in accordance with the provisions of AASB 1.

Upon transition to AIFRS the general principle is that the financial reports must be prepared as if the new standards had always been applied. However, in addition to exempting companies from the requirement to restate comparatives for particular standards, AASB 1 grants certain exemptions from the full requirements of AIFRS. The following first time adoption elections have been made:

Business combinations – The accounting treatment for business combinations transacted prior to 1 July 2004 has not been restated.

Share based payments – The AIFRS requirements have not been retrospectively applied to share based payments granted prior to 7 November 2002 and / or that vested prior to 1 January 2005.

Property, plant and equipment – The fair value of the property held as at 30 June 2004 has been used as the deemed cost of that property but the original cost has been used for plant and equipment.

Foreign currency translation reserve – The foreign currency translation reserve was not reset to zero.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(b) Basis of preparation of the financial report (continued)

(ii) First time adoption of AIFRS (continued)

Insurance contracts – Certain disclosure requirements, principally relating to the disclosure of assumptions, the sensitivities of those assumptions, and claims development tables, have not been applied to prior periods.

Fair value measurement of financial instruments – The first time adoption relief from the retrospective application of 'Day One' recognition requirements has not been applied.

Financial instruments options – Financial instruments have been designated to the various classifications available under AIFRS as follows:

- Investments – classified as "fair value through profit or loss";
- Receivables – classified as "loans and receivables"; and
- Payables and interest-bearing liabilities – classified as "amortised cost".

(iii) Voluntary changes in accounting policies

There have been no voluntary changes in accounting policies made during the year other than those relating to the transition to AIFRS as referred to in note 1(b)(ii) and as disclosed in note 38.

(iv) Reclassifications of comparatives

Certain items have been reclassified from the Consolidated entity's prior period's financial reports to conform to the current period's presentation: capitalised transaction costs on interest-bearing liabilities previously presented as prepayments are now presented together with the liabilities (reclassification as at 30 June 2005 of \$16 million); the value of the interest rate swap forming part of the hedge on the US subordinated term notes previously presented as a payable is now presented together with the liability (reclassification as at 30 June 2005 of \$2 million); the net value of corporate treasury derivatives previously offset against payables is now included in trade and other receivables (reclassification as at 30 June 2005 of \$3 million); reinsurance and other recoveries on paid claims previously presented together with reinsurance and other recoveries receivable on outstanding claims is now presented in trade and other receivables; reinsurance premiums payable previously included within trade and other payables is now presented separately on the balance sheet; and the value of an unlisted equity investment is now included in investment in joint ventures and associates (reclassification as at 30 June 2005 of \$5 million).

(v) Rounding

Amounts in this financial report have been rounded to the nearest million dollars, unless otherwise stated. The Parent is the kind of company referred to in the class order 98 / 100 dated 10 July 1998 issued by the Australian Securities & Investment Commission. All rounding has been conducted in accordance with that class order.

(c) Principles of consolidation

(i) Subsidiaries

Consolidation is the incorporation of the assets and liabilities of the Parent and all subsidiaries as at the reporting date and the results of the Parent and all subsidiaries for the period then ended as if they had operated as a single entity. The balances and effects of intragroup transactions are eliminated from the consolidation. Subsidiaries are those entities controlled by the Parent. Control exists when one company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control is presumed to exist when more than half of the voting power of an entity is owned either directly or indirectly. In assessing control, potential voting rights that are exercisable or convertible are taken into account. Where an entity either began or ceased to be controlled during the financial year, the results are included only from the date control commenced or up to the date control ceased.

The financial statements of all subsidiaries are prepared for consolidation for the same reporting period as the Parent, using consistent accounting policies. The financial statements of entities

operating outside Australia that maintain accounting records in accordance with overseas accounting principles are adjusted where necessary to comply with the significant accounting policies of the Consolidated entity.

Where a subsidiary is less than wholly-owned, the equity interests held by external parties are presented separately as minority interests on the consolidated balance sheet, except where the subsidiary is a trust or similar entity for which the core equity is presented as a liability (this is the case with the IAG Asset Management Wholesale Trusts that are subsidiaries, refer note 27) in which case the third party interest is presented separately on the consolidated balance sheet as a liability.

(ii) Associates

Associates, those entities over which significant influence is exercised and which are not intended for sale in the near future, are accounted for using equity accounting principles. Significant influence is presumed to exist where between 20 per cent and 50 per cent of the voting rights of an entity are held, but can also arise where less than 20 per cent is held through active involvement and influencing policy decisions affecting the entity. The investment in associates is initially recognised at cost (fair value of consideration provided plus directly attributable costs) and is subsequently adjusted for the post-acquisition change in the investor's share of net assets of the investee (generally referred to as the equity method of accounting). The investor's share of the profit or loss of the investee is included in the profit or loss of the Consolidated entity and disclosed as a separate line in the income statement. Distributions received reduce the carrying amount of the investment and are not included as dividend revenue of the Consolidated entity. Movements in the total equity of the investee that are not recognised in the profit or loss of the investee are recognised directly in equity of the Consolidated entity and disclosed in the statement of recognised income and expense. The investments are reviewed annually for impairment.

Where an entity either began or ceased to be an associate during the financial year, the investment is equity accounted from the date significant influence commenced, up to the date significant influence ceased.

The financial statements of associates are adjusted where necessary to comply with the significant accounting policies of the Consolidated entity.

When the investor's share of losses exceeds its interest in the investee, the carrying amount of the investment is reduced to nil and recognition of further losses is discontinued except to the extent that the investor has incurred obligations or made payments, on behalf of the investee.

SIGNIFICANT ACCOUNTING POLICIES RELATED TO GENERAL INSURANCE CONTRACTS

All of the general insurance products and reinsurance products on offer, or utilised, meet the definition of an insurance contract (a contract under which one party, the insurer, accepts significance insurance risk from another party, the policyholder, by agreeing to compensate the policyholder if a specified uncertain future event, the insured event, adversely affects the policyholder) and none of the contracts contain embedded derivatives or are required to be unbundled. Insurance contracts that meet the definition of a financial guarantee contract are accounted for as insurance contracts. This means that all of the general insurance products are accounted for in the same manner.

(d) Premium revenue

Premium revenue comprises amounts charged to policyholders (direct premiums) or other insurers (inwards reinsurance premium) for insurance contracts. Premium includes fire service levies, but excludes stamp duties and taxes collected on behalf of third parties, including the goods and services tax. Premium is recognised as earned from the date of attachment of risk (generally the date a contract is agreed to) over the period of the related insurance contracts in accordance with the pattern of the incidence of risk expected under the contracts. The pattern of the risks underwritten is generally matched by the passing of time. Premium for unclosed business (business written close to reporting date where attachment of risk is prior to reporting date and there is insufficient information to accurately identify the business) is brought

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

to account based on previous years' experience with due allowance for any changes in the pattern of new business and renewals. The unearned portion of premium is recognised as an unearned premium liability on the balance sheet.

Premium receivable is recognised at the amount due and is normally settled between 30 days and 12 months. The recoverability of premium receivable is assessed and provision is made for impairment based on objective evidence and having regard to past default experience. Premium receivable is presented on the balance sheet net of any provision for impairment.

(e) Outwards reinsurance

Premium ceded to reinsurers is recognised as an expense in accordance with the pattern of reinsurance service received. Accordingly, a portion of outwards reinsurance premium is treated as a prepayment and presented as deferred reinsurance expense on the balance sheet at the reporting date.

(f) Claims

The outstanding claims liability is measured as the central estimate of the present value of expected future payments relating to claims incurred at the reporting date with an additional risk margin to allow for the inherent uncertainty in the central estimate. The liability is measured based on the advice of / valuations performed by, or under the direction of, the Approved Actuary. The expected future payments include those in relation to claims reported but not yet paid or not yet paid in full, claims incurred but not enough reported ("IBNER"), claims incurred but not reported ("IBNR") and the anticipated direct and indirect claims handling costs. The liability is discounted to present value using a risk free rate.

Claims expense represents claim payments adjusted for the movement in the outstanding claims liability.

The estimation of the outstanding claims liability involves a number of key assumptions and is the most critical accounting estimate. All reasonable steps are taken to ensure that the information used regarding claims exposures is appropriate. However, given the uncertainty in establishing the liability, it is likely that the final outcome will be different from the original liability established. Changes in claims estimates are recognised in profit or loss in the year in which the estimates are changed.

(g) Reinsurance and other recoveries

Reinsurance and other recoveries received or receivable on paid claims and on outstanding claims liabilities (notified and not yet notified) are recognised as income. Recoveries receivable on paid claims are presented as part of trade and other debtors net of any provision for impairment based on objective evidence for individual receivables. All recoveries receivable on outstanding claims liabilities are measured as the present value of the expected future receipts calculated on the same basis as the outstanding claims liability. Reinsurance does not relieve the originating insurer of its liabilities to policyholders and is presented separately on the balance sheet.

(h) Acquisition costs

Costs associated with obtaining and recording general insurance contracts are referred to as acquisition costs. These costs include advertising expenses, commissions or brokerage paid to agents or brokers, premium collection costs, risk assessment costs and other administrative costs. Such costs are capitalised where they relate to the acquisition of new business, are presented as deferred acquisition costs, and are amortised on the same basis as the earning pattern of the premium over the period of the related insurance contracts. The balance of the deferred acquisition costs at the reporting date represents the capitalised acquisition costs relating to unearned premium.

(i) Liability adequacy test

The liability adequacy test is an assessment of the carrying amount of the unearned premium liability and is conducted at each reporting date. If current estimates of the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current general insurance contracts, plus an additional risk margin to reflect the inherent uncertainty in the central estimate, exceed the unearned premium liability less related intangible assets and related deferred acquisition costs, then the unearned premium liability is deemed to be deficient. The test is performed at the level of

a portfolio of contracts that are subject to broadly similar risks and that are managed together as a single portfolio. Any deficiency arising from the test is recognised in profit or loss with the corresponding impact on the balance sheet recognised first through the write down of any related intangible assets and then the related deferred acquisition costs, with any remaining balance being recognised on the balance sheet as an unexpired risk liability.

Prior to 1 July 2005 (refer to note 38 for further details)

Prior to the introduction of the liability adequacy test with effect from 1 July 2005, a recoverability test was performed on the carrying amount of deferred acquisition costs. Deferred acquisition costs were measured at the lower of cost and recoverable amount through the conduct of a loss recognition test such that when the sum of the expected future claims and associated settlements costs, in relation to business written to the reporting date, exceeded related unearned premium, the deferred acquisition costs were written down to recoverable amount and the write down was recognised as an expense. This test was conducted at the reporting entity level. The conduct of the test did not result in a write down of deferred acquisition costs for the financial year ended 30 June 2005.

(j) Levies and charges

Levies and charges, for which the amount paid does not depend on the amounts collected, as is the case with fire service levies in Australia, are expensed on the same basis as the recognition of premium revenue. The portion relating to unearned premium is treated as a prepayment and presented as deferred levies and charges on the balance sheet. A liability for levies and charges payable is recognised on business written to the reporting date. Other levies and charges that are simply collected on behalf of third parties are not recognised as income or expense in profit or loss.

SIGNIFICANT ACCOUNTING POLICIES APPLICABLE TO OTHER ACTIVITIES

(k) Fee based revenue

Fee based revenue is brought to account on an accruals basis being recognised as revenue on a straight line basis in accordance with the passage of time as the services are provided.

(l) Leases

All leases entered into are operating leases, where the lessor retains substantially all the risks and benefits of ownership of the leased items. The majority of the lease arrangements are entered into as lessee for which the lease payments are recognised as an expense on a straight line basis over the term of the lease. Certain sub-lease arrangements are entered into as the lessor for which the lease payments are recognised as revenue on a straight line basis over the term of the lease.

Lease incentives relating to the agreement of a new or renewed operating lease are recognised as an integral part of the net consideration agreed for the use of the leased asset. Operating lease incentives received are initially recognised as a liability, are presented as trade and other payables, and are subsequently reduced through recognition in profit or loss as an integral part of the total lease expense (lease payments are allocated between rental expense and reduction of the liability) on a straight line basis over the period of the lease.

(m) Taxation

(i) Income tax

Income tax on the result for the year comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates for each jurisdiction, and any adjustment to tax payable in respect of previous financial periods. Deferred tax expense is the change in deferred tax assets and liabilities between the reporting periods.

Deferred tax assets and liabilities are recognised using the balance sheet method for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes, except in the following circumstances when no deferred tax asset or liability is recognised:

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(m) Taxation (continued)

(i) Income tax (continued)

- temporary differences if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit or loss;
- temporary differences between the carrying amount and tax bases of investments in subsidiaries where it is probable that the differences will not reverse in the foreseeable future; and
- temporary differences relating to goodwill that is not deductible for tax purposes.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at reporting date. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

(ii) Tax consolidation

The Parent and its Australian resident wholly-owned subsidiaries adopted the tax consolidation legislation with effect from 1 July 2002 and are therefore taxed as a single entity from that date. The Parent entity is the head entity within the tax-consolidated group.

Current tax expense / income and deferred tax assets and liabilities arising from temporary differences of the members of the tax-consolidated group are recognised in the separate financial statements of the members of the tax-consolidated group using the 'separate taxpayer within group' approach by reference to the carrying amounts in the separate financial statements of each entity and the tax values applying under tax consolidation.

Any current tax liabilities (or assets) and deferred tax assets arising from unused tax losses of the subsidiaries are assumed by the head entity in the tax-consolidated group and are recognised as amounts receivable / (payable) from / (to) other entities in the tax-consolidated group in conjunction with any tax funding arrangement amounts (refer below). Any difference between these amounts is recognised by IAG as an equity contribution or distribution.

IAG recognises deferred tax assets arising from unused tax losses of the tax-consolidated group to the extent that it is probable that future taxable profits of the tax-consolidated group will be available against which the asset can be utilised.

Nature of tax funding arrangements and tax sharing arrangements

The head entity, in conjunction with members of the tax-consolidated group, has entered into a tax funding arrangement which sets out the funding obligations of members of the tax-consolidated group with respect to tax amounts. The tax funding arrangements require payments to / from the head entity equal to the current tax liability / (asset) assumed by the head entity and any tax loss deferred tax assets (associated with tax losses of the wholly-owned subsidiaries) assumed by the head entity. This results in the head entity recognising an intercompany receivable / (payable) equal in amount to the tax liability / (asset) assumed. The intercompany amount receivable / (payable) is at call.

Contributions to fund the current tax liabilities are payable as per the tax funding arrangement and reflect the timing of the head entity's obligation to make payments for tax liabilities to the relevant tax authorities.

The head entity, in conjunction with members of the tax-consolidated group, has also entered into a tax sharing agreement. The tax sharing agreement provides for the determination of the allocation of income tax liabilities between the entities of the tax-consolidated group should the head entity default on its tax payment obligations. No amounts have been recognised in the financial statements in respect of this agreement as payment of any amounts under the tax sharing agreement is considered remote.

(iii) Goods and services tax

Revenue, expenses and assets are recognised net of the amount of goods and services tax ("GST"), except where the amount of GST incurred is not recoverable from the Australian Taxation Office ("ATO"). In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of expense.

Receivables and payables are stated inclusive of GST. The net amount of GST recoverable from, or payable to, the ATO is included as part of other receivables and payables on the balance sheet. Cash flows are included in the cash flow statement on a gross basis. The GST components of cash flows arising from investing and financing activities, which are recoverable from, or payable to, the ATO are classified as operating cash flows.

(n) Investments

Investments comprise assets held to back insurance liabilities (also referred to as technical reserves) and assets that represent equity holders' funds. Segregated portfolios are maintained for those assets. All investments are managed and performance evaluated on a fair value basis for both external and internal reporting purposes in accordance with a documented risk management strategy.

All investments are designated as fair value through profit or loss upon initial recognition. They are initially recorded at fair value (being the cost of acquisition excluding transaction costs) and are subsequently remeasured to fair value at each reporting date. Changes in the fair value from the previous reporting date (or cost of acquisition excluding transaction costs if acquired during the financial period) are recognised as realised or unrealised investment gains or losses in profit or loss. Purchases and sales of investments are recognised on a trade date basis, being the date on which a commitment is made to purchase or sell the asset. Transaction costs for purchases of investments are expensed as incurred and presented in the income statement as investment expenses on assets backing insurance liabilities and corporate, administration and other expenses for investments that represent equity holders' funds. Investments are derecognised when the rights to receive future cash flows from the assets have expired, or have been transferred, and substantially all the risks and rewards of ownership have transferred.

For securities listed in an active market, fair value is determined by reference to published bid price quotations. For unlisted securities, and for securities listed in a market that is not active, fair value is determined using valuation techniques based on current economic conditions and with reference to observable market data. For trust securities this generally means using the redemption price provided by the trustee. The most common valuation technique used for other unlisted investments is reference to the fair values of recent arm's length transactions involving the same instruments or other instruments that are substantially the same. An alternative valuation technique that is used for a small number of investments is discounted cash flow analysis.

Investment revenue, comprising dividends, trust distributions and interest, is brought to account on an accruals basis. Revenue on investment in equity securities and property trusts is deemed to accrue on the date the dividends / distributions are declared, which for listed equity securities is deemed to be the ex-dividend date. Dividend revenue from Australian equities is received net of any franking credits.

Prior to 1 July 2005 (refer to note 38 for further details)

Prior to 1 July 2005, all investments were initially recorded at fair value (being the cost of acquisition including transaction costs) and were subsequently remeasured to net market value (fair value less anticipated disposal costs) at each reporting date. Changes in the net market value from the previous reporting date (or cost of acquisition, if acquired during the financial period) were recognised as unrealised investments gains or losses in profit or loss. This included all derivatives used in relation to investment activities. Market values were determined using last sale price information.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

(o) Investment in subsidiaries

Investment in subsidiaries is initially recognised at cost (fair value of consideration provided plus directly attributable costs) and are subsequently carried in the Parent's financial statements at the lower of cost and recoverable amount. Costs incurred in investigating and evaluating an acquisition up to the point of formal commitment to an acquisition are expensed as incurred. Income from these investments, comprising dividends and trust distributions, are brought to account on an accruals basis. Dividend revenue is accrued on the date the dividends are declared.

(p) Investment in joint ventures and associates

Investment in joint ventures and associates is initially recognised at cost (fair value of consideration provided plus directly attributable costs) by the entity holding the ownership interest, including attributed goodwill, and is subsequently carried in the entity's financial statements at the lower of cost and recoverable amount.

(q) Derivatives

A variety of derivatives are used for the sole purpose of managing risk exposures. Derivatives are not held for speculative purposes.

Derivatives are initially recognised at fair value (generally the transaction price; the fair value of the consideration given or received) on the date a derivative contract is entered into and are subsequently remeasured to fair value at each reporting date. Fair value is generally determined using the current bid price for derivatives presented as assets and the current ask price for derivatives presented as liabilities. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. Transaction costs for purchases of derivatives are expensed as incurred and presented in the income statement as investment expenses on assets backing insurance liabilities and corporate, administration and other expenses for assets representing equity holders' funds.

(i) Investment operations

All of the derivatives managed in conjunction with the investment operations are recognised on the balance sheet (presented together with the underlying investments) at fair value with movements in fair value being recognised as part of investment income in profit or loss. The fair value is determined by reference to current market quotes or generally accepted valuation principles. None of the derivatives are designated for hedge accounting. This matches the accounting for the derivatives with the accounting for the underlying investments.

(ii) Corporate treasury operations

Derivatives are used to hedge exposure to foreign currency and interest rate movements in relation to corporate treasury transactions, including borrowings. While there are a number of economic hedges in place, only a small number of these transactions have been selected for hedge accounting. Where hedge accounting is not applied the derivative and the hedged item are recognised and measured independently as if there was no hedging relationship with the derivative being recognised on the balance sheet at fair value with movements in fair value being recognised in profit or loss. The derivatives are classified as assets and presented as receivables when the fair value is positive, or as liabilities and presented as payables when the fair value is negative, except for cross currency swaps relating to borrowings, which are presented together with the borrowings.

The most commonly used derivative for which hedge accounting is not applied are forward foreign exchange contracts which are entered into to hedge foreign currency exposures recognised on the balance sheet. The forward foreign exchange contracts are recognised on the balance sheet at fair value being the net amounts receivable or payable under the contracts and the associated deferred gains or losses. When recognised, the net receivables or payables are translated using the foreign currency exchange rate current at reporting date.

(iii) Hedge accounting

Where derivatives are designated for hedge accounting, they are classified as either: (i) hedge of the change in fair value of recognised assets or liabilities or firm commitments ("fair value hedge"); (ii) hedge of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction ("cash flow hedge"); (iii) hedge of a net investment in a foreign operation ("net investment hedge"). Hedge accounting may be applied to derivatives designated as hedging instruments provided certain criteria are met. Certain transactions have been designated as either a cash flow hedge or a net investment hedge.

To qualify for hedge accounting, at the inception of the hedge and throughout its life, each hedge must be expected to be highly effective (prospective effectiveness). Actual effectiveness (retrospective effectiveness) in the range of 80 per cent to 125 per cent must also be demonstrated on an ongoing basis. At the inception of a hedging relationship, the relationship between the hedging instruments and hedged items is documented, as well as the risk management objective and strategy for undertaking the hedge.

Cash flow hedge – The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in reserves as part of equity. Any gain or loss relating to an ineffective portion is immediately recognised in profit or loss.

When the forecast transaction that is hedged results in the recognition of a financial asset or a financial liability, the associated gains and losses that had been deferred in equity are transferred into profit or loss in the same period or periods during which the asset acquired or liability assumed affects profit or loss. When the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the associated gains and losses that had been deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

More specifically, derivatives are used to hedge a forecast acquisition of a business only when the derivative is expected to reduce exposure to the risks being hedged, is designated prospectively so that it is clear when a forecast transaction has or has not occurred, and it is probable the forecast transaction will occur. Hedge accounting is applied where such hedges meet the hedge accounting requirements. Gains or losses on the derivative arising up to the date of the forecast transaction, together with any costs arising at the time of entering into the derivative, are deferred and included in the measurement of the transaction (typically cost of acquisition of a business). Any gains or losses on the derivative after the transaction date are recognised in profit or loss. If the transaction does not occur as anticipated, the costs are immediately expensed.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity until the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to profit or loss.

Net investment hedge – Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity while the gain or loss relating to the ineffective portion is immediately recognised in profit or loss. Gains and losses accumulated in the equity reserve are recognised in profit or loss upon the disposal of the foreign operation.

Prior to 1 July 2005 (refer to note 38 for further details)

Prior to 1 July 2005 instruments subject to hedge accounting under AIFRS were accounted for on an accruals basis under Australian GAAP

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(r) Trade and other receivables

Trade and other receivables are stated at the amounts to be received in the future and are presented net of any provision for impairment. The recoverability of debts is assessed on an ongoing basis and provision for impairment is made based on objective evidence and having regard to past default experience. The impairment charge is recognised in profit or loss. Debts which are known to be uncollectible are written off.

(s) Property, plant and equipment

Property, plant and equipment is initially recorded at cost which is the fair value of consideration provided plus incidental costs directly attributable to the acquisition (for land and buildings held as at 30 June 2004, the fair value at that date is used as the deemed cost as allowed upon first time adoption of AIFRS). The cost of plant and equipment that is located on certain leased premises is increased by the present value of the estimated future cost for dismantling and removing the items when the relevant alterations are made to the premises.

All items of property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment charges. Items other than land are depreciated using the straight line method at rates based on the expected useful lives of the assets taking into account estimated residual values. Depreciation rates and residual values are reviewed annually and any changes are accounted for prospectively. The depreciation rates used currently for each class of asset are as follows:

- Buildings 2 – 5%
- Motor vehicles 12.5 – 20%
- Other plant and equipment 6.67 – 40%

The carrying amount of each class of property, plant and equipment is reviewed each reporting date by determining whether there is an indication that the carrying value of a class may be impaired. If any such indication exists, the item is tested for impairment by comparing the recoverable amount of the asset or its cash generating unit to the carrying value. An impairment charge is recognised whenever the carrying value exceeds the recoverable amount. Impairment charges are recognised in profit or loss and may be reversed where there has been an indication that the loss may no longer exist and / or a change in the estimates used to determine the recoverable amount.

The net gain or loss on disposal of items of property, plant and equipment is recognised in profit or loss and is calculated as the difference between the carrying amount of the asset at the time of disposal and the net proceeds on disposal including transaction costs and other expenses associated with the disposal.

(t) Intangible assets

(i) Acquired intangible assets

Acquired intangible assets are initially recorded at their cost at the date of acquisition being the fair value of the consideration provided plus incidental costs directly attributable to the acquisition. Intangible assets with finite useful lives are amortised on a straight line basis over the estimated useful lives of the assets being the period in which the related benefits are expected to be realised (shorter of legal duration and expected economic life). Amortisation rates and residual values are reviewed annually and any changes are accounted for prospectively. The amortisation rates used currently for each class of asset are as follows:

- Contractual arrangements 10 – 20%
- Other intangible assets 20%

The carrying amount of intangible assets with finite useful lives is reviewed each reporting date by determining whether there is an indication that the carrying value may be impaired. If any such indication exists, the item is tested for impairment by comparing the recoverable amount of the asset or its cash generating unit to the carrying value. Where the recoverable amount is determined by the value in use, the projected net cash flows are discounted using a pre-tax discount rate.

For assets with indefinite useful lives, the recoverability of the carrying value of the assets is reviewed for impairment at each reporting date, or more frequently if events or changes in circumstances indicate that it might be impaired. An impairment charge is recognised whenever the carrying value exceeds the recoverable amount. Impairment charges are recognised in profit or loss and may be reversed where there has been a change in the estimates used to determine the recoverable amount.

(ii) Software development expenditure

Software development expenditure that meets the criteria for recognition as an intangible asset is capitalised on the balance sheet and amortised over its expected useful life, subject to impairment testing. Costs incurred in researching and evaluating a project up to the point of formal commitment to a project are treated as research costs and are expensed as incurred. Only software development projects with total budgeted expenditure of more than \$2 million are considered for capitalisation. Smaller projects and other costs are treated as maintenance costs, being an ongoing part of maintaining effective computer systems, and are expensed as incurred.

All such capitalised costs are deemed to have an expected useful life of three years unless it can be clearly demonstrated for a specific project that the net benefits are to be generated over a longer period. The capitalised costs are amortised on a straight line basis over the period following completion of a project or implementation of part of a project. The recoverability of the carrying amount of the asset is assessed in the same manner as for acquired intangible assets with finite useful lives.

(u) Goodwill

Business combinations are accounted for using the acquisition method. Business combinations occur when control is obtained over an entity or business. Goodwill represents the excess of the purchase consideration plus incidental costs over the fair value of the net identifiable assets and contingent liabilities acquired and is presented net of any impairment charges. If the cost of acquisition is less than the fair value of the net identifiable assets and contingent liabilities acquired, the difference is recognised immediately in profit. Goodwill arising on acquisitions dated prior to 1 July 2004 has been carried forward on the basis of its deemed cost being the net carrying amount as at 1 July 2004 measured in accordance with the accounting standards relevant at that time (refer to note 38 for further details).

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

Where the initial accounting for a business combination is determined only provisionally by the first reporting date after acquisition date, the business combination is accounted for using those provisional values. Any subsequent adjustments to those provisional values are recognised within twelve months of the acquisition date and are applied effective from the acquisition date.

Where a business combination is achieved in stages (commonly referred to as a step acquisition), each exchange transaction is treated separately, using the cost of the transaction and the fair value information at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. Before qualifying as a business combination, a transaction may qualify as an investment in an associate (refer note 1(c)). With investments in joint ventures and associates, where control is not obtained, the goodwill is included in the carrying amount of the investment in the joint venture and associate, rather than being presented as a separate asset.

Goodwill is allocated to cash generating units (the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets) for the purpose of impairment testing, principally based on how goodwill is monitored by management. The recoverability of the carrying value of the goodwill allocated to each cash generating unit is tested for

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

impairment at each reporting date, or more frequently if events or changes in circumstances indicate that it might be impaired, by determining the present value (using a pre-tax discount rate that reflects the current market assessments of the risks specific to the cash generating unit) of projected net cash flows based on the five year business plans approved by management. Net cash flows beyond the five year period are extrapolated based on growth rates relevant to the asset / business which are consistent with long-term industry averages. Where the carrying value exceeds the recoverable amount, an impairment charge is recognised in profit or loss and cannot subsequently be reversed.

At the date of disposal of a business, attributed goodwill is included in the share of net assets used in the calculation of the gain or loss on disposal.

Acquisitions and disposals (where control is retained) of minority interests are treated as transactions between equity holders. Therefore, any difference between the acquisition cost of the minority interest and the carrying amount of the minority interest is recognised as an increase or decrease in equity.

(v) Trade and other payables

Trade and other payables are carried at cost, which is the fair value of the consideration to be paid in the future for goods and services received.

(w) Restructuring provision

A restructuring provision is recognised for the expected costs associated with restructuring where there is a detailed formal plan for restructure and a demonstrated commitment to that plan. The provision is based on the direct expenditure to be incurred which is both directly and necessarily caused by the restructuring, including termination benefits, decommissioning of information technology systems and exiting surplus premises, and does not include costs associated with on-going activities. The adequacy of the provision is reviewed regularly and adjusted if required. Revisions in the estimated amount of a restructuring provision are reported in the period in which the revision in the estimate occurs. The provision is discounted using a pre-tax discount rate where the effect of the time value of money is material.

(x) Lease provision

Certain of the operating leases for property require that the land and / or building be returned to the lessor in its original condition, however, the related operating lease payments do not include an element for the cost this will involve. The present value of the estimated future cost for the plant and equipment to be removed and the premises to be returned to the lessor in its original condition are recognised as a lease provision when the relevant alterations are made to the premises. The costs are capitalised as part of the cost of plant and equipment and then depreciated over the useful lives of the assets (refer note 1(s)).

(y) Onerous contracts provision

A provision is recognised for onerous contracts when the expected benefits to be derived from a contract are lower than the unavoidable cost of meeting the obligations under the contract.

(z) Employee benefits

(i) Wages and salaries, annual leave and sick leave

Liabilities for wages and salaries (including bonuses), annual leave and sick leave are recognised at the nominal amounts unpaid at the reporting date using remuneration rates that are expected to be paid when these liabilities are settled, including on-costs. A liability for sick leave is considered to exist only when it is probable that sick leave taken in the future will be greater than entitlements that will accrue in the future.

(ii) Long service leave

A liability for long service leave is recognised as the present value of estimated future cash outflows to be made in respect of services provided by employees up to the reporting date. The estimated future cash outflows are discounted using interest rates on national government guaranteed securities which have terms to maturity that match, as closely as possible, the estimated future cash outflows. Factors which affect the estimated future cash outflows such as expected future salary increases, experience of employee departures and period of service, are incorporated in the measurement.

(iii) Share based incentive arrangements

Share based remuneration is provided in different forms to eligible employees and IAG directors. All of the arrangements are equity settled share based payments. The fair value at grant date (the date at which the employer and the employee have a shared understanding of the terms and conditions of the arrangement) is determined for each equity settled share based payment using a valuation model which excludes the impact of any non-market vesting conditions. This fair value does not change over the life of the instrument. At each reporting date during the vesting period (the period during which related employment services are provided), and upon the final vesting or expiry of the equity instruments, the total accumulated expense is revised based on the fair value at grant date and the latest estimate of the number of equity instruments that are expected to vest based on non-market vesting conditions only (vesting conditions other than employee turnover are excluded), and taking into account the expired portion of the vesting period. Changes in the total accumulated expense from the previous reporting date are recognised in profit or loss with a corresponding movement in an equity reserve. Upon exercise of the relevant instruments, the balance of the share based remuneration reserve relating to those instruments is transferred within equity.

The different treatment of market and non-market vesting conditions means that if an equity instrument does not vest because a participant ceases relevant employment then the accumulated expense charged in relation to that participant is reversed, but if an equity instrument does not vest only because a market condition is not met, the expense is not reversed (this is relevant only to the Performance Award Rights Plan).

Arrangements granted prior to 7 November 2002 (refer to note 38 for further details)

The AIFRS expense treatment has not been retrospectively applied to share based payments granted prior to 7 November 2002 and / or that vested prior to 1 January 2005 as permitted under the transitional provisions for first time adoption of AIFRS. This principally means that the new requirements have not been applied to the Performance Share Rights Plan.

To satisfy obligations under the various share based remuneration plans, shares are generally bought on market at or near grant date of the relevant arrangement and held in trust. Previously under Australian GAAP the cost of acquiring the shares was recorded as a prepayment and then expensed in full, generally over the period during which the employees provided related services.

(iv) Superannuation

Contributions are made to various superannuation plans, both defined contribution and defined benefit plans, in accordance with their governing rules and, for defined benefit superannuation plans, recommendations from their respective actuaries, which are designed to ensure that each plan's funding provides sufficient assets to meet its liabilities over the longer term.

For defined contribution plans, obligations for contributions are recognised in profit or loss as they become payable. For defined benefit plans, the net financial position of the plans is recognised on the balance sheet and the movement in the net financial position is recognised in profit or loss, except for actuarial gains and losses (experience adjustments and changes in actuarial assumptions), which are recognised directly in retained earnings.

(aa) Provision for dividends

Provision for dividends is made in respect of all types of share capital where the dividends are declared on or before the reporting date but have not yet been distributed at that date.

(bb) Interest-bearing liabilities and finance costs

Interest-bearing liabilities are initially recognised at fair value less transaction costs that are directly attributable to the transaction. After initial recognition the liabilities are carried at amortised cost using the effective interest method.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(bb) Interest-bearing liabilities and finance costs (continued)

Finance costs include interest, which is accrued at the contracted rate and included in payables, amortisation of transaction costs which are capitalised, presented together with the borrowings, and amortised over the life of the borrowings or a shorter period if appropriate, and amortisation of discounts or premiums (the difference between the original proceeds, net of transaction costs, and the settlement or redemption value of borrowings) over the term of the liabilities. Where interest payments are hedged, they are recognised as finance costs net of any effect of the hedge.

Prior to 1 July 2005 (refer to note 38 for further details)

Prior to 1 July 2005, the reset preference shares, now presented as interest-bearing liabilities, were treated as equity and formed part of share capital. The transaction costs associated with the capital raising were recognised directly in equity as a reduction in the proceeds of the instruments. The distributions, now treated as interest, were treated as dividends and so recognised only when declared.

(cc) Foreign currency

(i) Functional and presentation currency

Items included in the financial records of each of the entities within the Consolidated entity are measured using the currency of the primary economic environment in which the entity operates (the functional currency). For nearly all entities, this is the local currency of the country in which it operates. The financial statements are presented in Australian dollars, which is the functional and presentation currency of the Parent and the presentation currency of the Consolidated entity.

(ii) Translation of foreign currency transactions

Foreign currency transactions are translated into the functional currency for each of the entities within the Consolidated entity using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at reporting date, are translated to Australian dollars using reporting date exchange rates. Resulting exchange differences are recognised in profit or loss except for those relating to foreign operations and hedging transactions as per (iii) and (iv) below.

(iii) Translation of the financial results of foreign operations

The financial position and performance of foreign operations with a functional currency other than Australian dollars are translated into the presentation currency for inclusion in the consolidated financial statements. The assets and liabilities are translated using reporting date exchange rates while equity items are translated using historical rates. Items from the income statement are translated using weighted average rates for the reporting period. Exchange differences arising from the translations are recorded directly in equity in the foreign currency translation reserve. Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate.

On the disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the foreign currency translation reserve relating to that foreign operation is recognised in profit or loss.

(iv) Hedge transactions

Derivatives are used to hedge the foreign exchange risk relating to certain transactions. Refer to note 1(q)(iii) for details of the relevant accounting policies.

(dd) Earnings per share

(i) Basic earnings per share

Basic earnings per share is determined by dividing the profit or loss attributable to equity holders of the Parent, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of shares of the Parent on issue during the reporting period, net of treasury shares held in trust.

(ii) Diluted earnings per share

Diluted earnings per share is determined by dividing the profit or loss attributable to equity holders of the Parent used in the calculation of basic earnings per share, adjusted for relevant costs associated with dilutive potential ordinary shares, by the weighted average number of ordinary shares and dilutive potential ordinary shares.

(ee) Treasury shares held in trust

Ordinary shares of IAG that are controlled for accounting purposes by share based remuneration trusts that are subsidiaries of the Consolidated entity, are presented on the balance sheet as treasury shares held in trust. The shares are measured at cost (total amount paid to acquire the shares including directly attributable costs), and are presented as a deduction from equity until they are otherwise dealt with. No gain or loss is recognised in profit or loss on the sale, cancellation or reissue of the shares. The shares are derecognised as treasury shares held in trust when the shares vest or are released to the participant.

(ff) Reset exchangeable securities

Reset exchangeable securities ("RES") were initially measured at fair value (which was equivalent to the face value) less transaction costs incurred in issuing the securities. On the balance sheet, the RES liability is offset against the investments purchased ("Portfolio") from the proceeds of RES, as there is a legal right of set-off and it is the intention that the Portfolio and the RES liability would be settled simultaneously. Transaction costs are capitalised, presented together with interest-bearing liabilities, and are amortised over five years from the date of issue. Interest expense on the RES is brought to account on an accruals basis and payable quarterly subject to the terms of issue. The interest expense on the RES is offset against the interest income generated from the Portfolio in the income statement.

NOTE 2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In the process of applying the significant accounting policies, certain critical accounting estimates and assumptions are used, and certain judgements are made.

The estimates and related assumptions are based on experience and other factors that are considered to be reasonable, the results of which form the basis for judgements about the carrying values of assets and liabilities. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised, and the future periods if relevant.

The areas where the estimates and assumptions involve a high degree of judgment or complexity and are considered significant to the financial statements, listed together with reference to the notes to the financial statements where more information is provided, are:

■ Insurance contracts related:

- Claims, refer note 11;
- Reinsurance and other recoveries on outstanding claims, refer note 12; and
- Liability adequacy test, refer note 14(b).

There are other amounts relating to insurance contracts that are based on allocation methodologies supported by assumptions (eg deferred acquisition costs; which costs in the shared services model (refer note 4) are related to the acquisition of general insurance contracts and so eligible for deferral). The estimates relate to past events, do not incorporate forward looking considerations, and do not change from year to year.

■ Other

- Goodwill and intangible assets impairment testing, refer notes 19 and 20;
- Share based remuneration, refer note 30; and
- Defined benefit superannuation arrangements, refer note 31.

The accounting judgements made during the year that did not involve estimations, including determination of the existence of control when entities are not wholly-owned and the classification of leases as either operating or finance leases, are considered to have had no significant impact on the amounts recognised in the financial report (2005 – none).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 3. ANALYSIS OF INCOME

	PARENT		CONSOLIDATED	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m
(a) General insurance revenue				
Direct gross written premium	–	–	6,434	6,674
Movement in unearned premium liability	–	–	102	(112)
Direct premium revenue	–	–	6,536	6,562
Inwards reinsurance premium revenue	–	–	1	(1)
Premium revenue	–	–	6,537	6,561
Reinsurance and other recoveries revenue	–	–	566	660
Total general insurance revenue	–	–	7,103	7,221
(b) Investment income				
Dividend revenue	745	585	87	96
Interest revenue	–	–	375	394
Trust revenue	–	–	33	15
Total investment revenue	745	585	495	505
Changes in net fair values of investments				
– Realised net gains and (losses)	1	–	162	205
– Unrealised net gains and (losses)	–	–	248	333
Total investment income	746	585	905	1,043
Represented by:				
Investment income on assets backing insurance liabilities	–	–	329	525
Investment income on equity holders' funds	746	585	576	518
	746	585	905	1,043
(c) Other income				
Fee based revenue	–	–	218	178
Other revenue	3	–	–	–
Net gain on disposal of property, plant and equipment	–	–	–	1
Total other income	3	–	218	179
(d) Share of net profit of associate	–	–	2	–
Total income	749	585	8,228	8,443

NOTE 4. ANALYSIS OF EXPENSES

(a) Expenses as presented in the income statement				
Reinsurance expense	–	–	405	417
Claims expense	–	–	4,466	4,750
Acquisition costs	–	–	1,081	1,070
Other underwriting expenses	–	–	395	377
Fire service levies	–	–	223	177
Investment expenses on assets backing insurance liabilities	–	–	19	9
Finance costs	57	–	86	69
Net income attributable to minority interests in unitholders' funds*	–	–	20	–
Corporate, administration and other expenses	–	–	298	289
Total expenses	57	–	6,993	7,158

* This item has been treated differently in the current reporting period following the election to not restate comparatives for certain accounting standards as allowed upon first time adoption of AIFRS. Refer to note 38 for further details.

(b) Analysis of expenses by function				
General insurance business expenses	–	–	6,570	6,791
Corporate and administration expenses	57	–	423	367
Total expenses	57	–	6,993	7,158

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 4. ANALYSIS OF EXPENSES (CONTINUED)

	PARENT		CONSOLIDATED	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m
(c) Other items				
Disclosure of the following items is considered relevant in explaining the results for the year:				
Insurance protection tax levied by the NSW State Government	–	–	21	20
Depreciation and amortisation				
– Property, plant and equipment (refer note 18)	–	–	47	43
– Capitalised software development expenditure	–	–	6	–
– Acquired intangibles	–	–	8	13
	–	–	61	56
Impairment charges (note (i))				
– Trade and other receivables	–	–	1	1
	–	–	1	1
Employee benefits				
– Defined contribution superannuation	–	–	78	78
– Defined benefit superannuation	–	–	7	2
– Share based remuneration	–	–	19	7
– Salaries and other employee benefits expense	–	–	926	831
	–	–	1,030	918
Transfers to provisions charged to profit or loss				
– Restructuring provision	–	–	11	12
	–	–	11	12
Finance costs				
– Reset preference share distributions paid / payable	29	–	29	–
– Subordinated term notes interest paid / payable	–	–	53	54
– Reset exchangeable securities	–	–	–	12
– Amortisation of capitalised transaction costs	2	–	4	3
– Loans from controlled entity / related bodies corporate	26	–	–	–
	57	–	86	69
Other				
– Net loss on disposal of property, plant and equipment	–	–	4	–
– Operating lease payments	–	–	182	191
– Software research and development costs expensed	–	–	26	38
– Net foreign exchange losses / (gains)	–	–	34	27
– Liability adequacy test deficiency	–	–	11	–

The IAG Group operates a shared services model with the use of dedicated units and entities to provide services throughout the IAG Group. The costs incurred by business units and entities directly, together with internal charges between them, are allocated to the various operating functions and so feed through to relevant lines in the income statement. For example, the Consolidated entity incurs expenses in meeting the superannuation contribution obligations for employees involved in a wide range of functions including sales and marketing, underwriting, and claims management. Hence the superannuation expense is allocated across the lines in the income statement based on the areas for which these employees provide services.

Note:

(i) There were no impairment charges for goodwill, intangible assets and property, plant and equipment for the year ended 30 June 2006 (2005 – none).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 5. REMUNERATION OF AUDITORS

	CONSOLIDATED	
	2006 \$000	2005 \$000
(a) KPMG Australia		
<i>(i) Assurance services</i>		
Audit of the financial statements prepared for the parent and subsidiaries	4,598	3,113
Audit of statutory returns in accordance with regulatory requirements	667	792
Other assurance services	1,702	2,447
	6,967	6,352
<i>(ii) Advisory services</i>		
Taxation services	287	563
Due diligence in relation to potential acquisitions outside Australia	1,627	2,016
Due diligence in relation to capital raising (RES transaction)	–	332
Due diligence and other services on other acquisitions, divestment and capital transactions	–	442
Other	126	39
	2,040	3,392
(b) Overseas related practices of KPMG Australia		
<i>(i) Assurance services</i>		
Audit of the financial statements prepared for subsidiaries	574	498
Audit of statutory returns in accordance with regulatory requirements	4	–
Other assurance services	79	25
	657	523
<i>(ii) Advisory services</i>	83	39
Total remuneration of auditors	9,747	10,306

It is IAG Group policy that KPMG may provide assurance and other audit-related services that, while outside the scope of the statutory audit, are consistent with the role of auditor. These include regulatory and prudential reviews requested by a regulator such as the Australian Prudential Regulation Authority. KPMG may not provide services that are perceived to be materially in conflict with the role of auditor. It is IAG Group policy to contract KPMG on assignments additional to their statutory audit and assurance duties where KPMG's expertise and experience with the IAG Group are important. The total fees for such services cannot exceed the audit fees without the approval of the IAG Audit Committee and KPMG can be contracted only in relation to reviewing financial information and not in its preparation. The Board is of the opinion that audit independence was not impaired during the current financial year as a result of the provision of these services.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 6. INCOME TAX

	PARENT		CONSOLIDATED	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m
(a) Income tax expense				
Current tax	(9)	(2)	375	310
Deferred tax	(1)	–	(10)	51
(Over) / under provided in prior years	–	–	8	(4)
Income tax (credit) / expense	(10)	(2)	373	357
Deferred income tax expense / (credit) included in income tax comprises:				
(Increase) / decrease in deferred tax asset	(1)	–	(5)	(29)
Increase / (decrease) in deferred tax liability	–	–	(5)	80
	(1)	–	(10)	51
(b) Income tax reconciliation				
The income tax for the financial year differs from the amount calculated on the profit before income tax. The differences are reconciled as follows:				
Profit for the year before income tax	692	585	1,235	1,285
Income tax calculated at 30% (2005 – 30%)	208	176	371	386
Tax effect of permanent differences:				
Rebateable dividends	(223)	(176)	(19)	(22)
Capital profits / (losses) not subject to income tax	–	–	3	(4)
Other non-deductible items	9	–	13	3
Other	(4)	(2)	(3)	(2)
Income tax (credit) / expense applicable to current year	(10)	(2)	365	361
Adjustment relating to prior year	–	–	8	–
Income tax (credit) / expense attributable to profit for the year before impact of tax consolidation	(10)	(2)	373	361
Effect of resetting tax values on entering tax consolidation	–	–	–	(4)
Income tax (credit) / expense attributable to profit for the year after impact of tax consolidation	(10)	(2)	373	357

(c) Tax consolidation

Effective 1 July 2002, the Company became the head entity in a tax-consolidated group comprising the Company and all of its Australian wholly-owned subsidiaries and the requirements of the relevant accounting standards have been applied.

NOTE 7. SEGMENT REPORTING

(a) Primary reporting – business segments

The Parent is a non-operating holding company operating only in Australia.

The Consolidated entity operated in the general insurance industry throughout the year. Revenue from the general insurance industry is derived from the underwriting of Australian personal, Australian commercial and international insurance businesses and these form separate reportable segments. The reportable segments comprise the following businesses (each insurance product is predominantly short-tail in duration except where noted):

- Australian personal insurance – The Australian personal insurance business develops and underwrites personal insurance products (through direct and indirect distribution channels), and manages claims and assessing services. Insurance products include motor vehicle, home and contents, compulsory third party (long-tail), consumer credit, and niche insurance products such as pleasure craft, veteran and classic car, boat, caravan, and travel insurance;
- Australian commercial insurance – The Australian commercial insurance business develops and underwrites insurance for businesses. Insurance products include commercial property, commercial motor and fleet motor, construction and engineering, farm, crop and livestock, home warranty, marine, public and product liability (long-tail), professional indemnity (long-tail), directors and officers (long-tail), and workers' compensation (long-tail);
- International insurance – comprises all direct insurance business underwritten outside Australia through foreign subsidiaries in New Zealand and Thailand and an associate in Malaysia, and the operations of the captive reinsurer;
- Corporate and investments – comprises other activities, including corporate services, investment management and investment of the Consolidated entity's equity holders' funds.

The net outstanding claims liability for each segment includes an allocation of the diversification benefit incorporated into the risk margin relating to the combination of the segments at the Consolidated entity level. Depreciation expense is allocated to different business segments as management fees from the Corporate segment and so all depreciation relating to property, plant and equipment is treated as part of the Corporate segment.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	Australian personal insurance \$m	Australian commercial insurance \$m	International insurance \$m	Corporate and investment \$m	Inter- segment elimination \$m	Total \$m
2006						
External revenue	4,340	2,071	1,167	650	–	8,228
Intersegment revenue	–	–	240	–	(240)	–
Total revenue	4,340	2,071	1,407	650	(240)	8,228
Underwriting profit	287	235	11	–	–	533
Investment income net of investment fees – technical reserves	193	81	36	–	–	310
Insurance profit	480	316	47	–	–	843
Investment income net of investment fees – equity holders' funds	–	–	–	537	–	537
Share of net profit of associates	–	–	2	–	–	2
Other net operating result	–	8	(7)	(148)	–	(147)
Profit before income tax	480	324	42	389	–	1,235
Income tax expense						(373)
Profit for the year						862
Segment assets	5,951	3,702	777	6,542	–	16,972
Unallocated assets						–
Total assets						16,972
Segment liabilities	5,951	3,702	777	2,871	–	13,301
Unallocated liabilities						–
Total liabilities						13,301
Acquisitions of property, plant and equipment, intangibles and other non-current segment assets	–	–	–	158	–	158
Depreciation expense	20	13	5	9	–	47
Amortisation of acquired intangibles	–	–	–	8	–	8
Total depreciation and amortisation expense	20	13	5	17	–	55
Other non-cash expenses	45	25	9	9	–	88
2005						
External revenue	4,552	2,102	1,193	596	–	8,443
Intersegment revenue	–	–	267	–	(267)	–
Total revenue	4,552	2,102	1,460	596	(267)	8,443
Underwriting profit	271	33	126	–	–	430
Investment income net of investment fees – technical reserves	303	179	34	–	–	516
Insurance profit	574	212	160	–	–	946
Investment income net of investment fees – equity holders' funds	–	–	–	500	–	500
Other net operating result	–	(14)	(5)	(142)	–	(161)
Profit before income tax	574	198	155	358	–	1,285
Income tax expense						(357)
Profit for the year						928
Segment assets	5,992	3,755	679	6,676	–	17,102
Unallocated assets						–
Total assets						17,102
Segment liabilities	5,992	3,755	679	2,173	–	12,599
Unallocated liabilities						–
Total liabilities						12,599
Acquisitions of property, plant and equipment, intangibles and other non-current segment assets	–	–	–	109	–	109
Depreciation expense	17	11	8	7	–	43
Amortisation of acquired intangibles	–	–	–	13	–	13
Total depreciation and amortisation expense	17	11	8	20	–	56
Other non-cash expenses	73	73	9	5	–	160

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 7. SEGMENT REPORTING (CONTINUED)

(b) Secondary reporting – geographical segments

The Consolidated entity operates mainly in the Australian and New Zealand general insurance industry. In the Australian market the operations cover all states and territories. Australia and International (primarily New Zealand) markets are separate reportable geographical segments. There have been changes in the composition of the international geographic segment during the financial year (refer note 26).

	AUSTRALIA		INTERNATIONAL		INTER-SEGMENT ELIMINATION		TOTAL	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m	2006 \$m	2005 \$m	2006 \$m	2005 \$m
External revenue	6,928	7,196	1,300	1,247	–	–	8,228	8,443
Segment assets	15,649	15,791	2,929	2,187	(1,606)	(876)	16,972	17,102
Acquisitions of property, plant and equipment, intangibles and other non-current segment assets	71	93	87	16	–	–	158	109

NOTE 8. EARNINGS PER SHARE

	CONSOLIDATED	
	2006 cents	2005 cents
(a) Ordinary shares		
Basic earnings per ordinary share ⁽ⁱ⁾	47.87	49.31
Diluted earnings per ordinary share	47.59	49.00

(i) The basic earnings per ordinary share excludes the treasury shares held in trust from the denominator of the calculation, but includes earnings attributable to those shares in the numerator, to comply with AASB 133 *Earnings per Share*. If the amounts relating to those shares are excluded from both the numerator and denominator, the basic earnings per ordinary share for the year ended 30 June 2006 would be reduced to 47.60 cents (2005 – 49.07 cents).

	2006 \$m	2005 \$m
<i>(i) Reconciliation of earnings used in calculating earnings per share</i>		
Profit for the year	862	928
Profit attributable to minority interests	(103)	(117)
Profit attributable to equity holders of the Parent	759	811
Profit attributable to reset preference shares (refer note 9(d))	n/a	(29)
Earnings used in calculating basic and diluted earnings per share	759	782

	2006 Number of shares million	2005 Number of shares million
<i>(ii) Reconciliation of weighted average number of ordinary shares used in calculating earnings per share</i>		
Ordinary shares on issue	1,595	1,594
Treasury shares held in trust	(9)	(9)
Weighted average number of ordinary shares used in the calculation of basic earnings per share	1,586	1,585
Weighted average number of dilutive potential ordinary shares relating to:		
– Rights issued under the Performance Share Rights Plan (refer note 30)	–	2
– Unvested share based remuneration rights supported by treasury shares held in trust	9	8
Weighted average number of ordinary shares used in the calculation of diluted earnings per share	1,595	1,595

The following matters are relevant to the determination of the weighted average number of ordinary shares:

- The reset preference shares are not considered to be dilutive potential ordinary shares even though they may convert into ordinary shares because the contingent conversion conditions were not met at the reporting date.
- The reset exchangeable securities (refer note 33(b)) are not considered to be dilutive potential ordinary shares because the contingent conversion conditions were not met at the reporting date.

(b) Reset preference shares

While for accounting purposes the reset preference shares are presented as debt from 1 July 2005 onwards, they were previously presented as equity under Australian GAAP (refer to note 38 for further details). When presented as equity, a separate earnings per share calculation was conducted for the reset preference shares and the distributions on the shares were deducted from the profit attributable to equity holders of the Parent prior to calculation of the earnings per share for ordinary shares. From 1 July 2005 onwards the distributions are treated as finance costs and so are included in profit for the year. When presented as equity, the reset preference shares had a basic earnings per share for the year ended 30 June 2005 of 533.09 cents based on distributions paid or payable for the year of \$29 million and a weighted average number of reset preference shares outstanding during the period of 5.5 million shares.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 9. DIVIDENDS

	Cents per share	Total amount \$m	Payment date	Tax rate for franking credit	Percentage franked
(a) Ordinary shares					
Recognised in year ended 30 June 2006					
Special dividend	12.5	201	26 June 2006	30%	100%
2006 interim dividend	13.5	215	10 April 2006	30%	100%
2005 final dividend	14.5	231	17 October 2005	30%	100%
		647			
Recognised in year ended 30 June 2005					
2005 interim dividend	12.0	191	18 April 2005	30%	100%
2004 final dividend	14.0	222	18 October 2004	30%	100%
		413			

It is standard practice to declare the dividend for a period after the relevant reporting date. In accordance with the relevant accounting policy (refer note 1(aa)) a dividend is not accrued for until it is declared and so the dividends for a period are generally recognised and measured in the financial reporting period following the period to which the dividend relates.

A special dividend was paid to shareholders during the year as a return of excess capital in line with the commitment to ensure capital is managed efficiently. The total special dividend is presented inclusive of transaction costs of \$1.3 million.

(b) Dividend reinvestment

A Dividend Reinvestment Plan ("DRP") is operated which allows equity holders to elect to receive their dividend entitlement in the form of IAG shares. The price of DRP shares is the average share market price, less a discount if any (determined by the Directors) calculated over the pricing period (which is at least five trading days) as determined by the Directors for each dividend payment date. The price of DRP shares in 2006 includes no discount (2005 – no discount). The 29.5 million shares allocated to equity holders participating in the DRP for the year ended 30 June 2006 were purchased on-market (2005 – 20.0 million shares). This included 8.7 million shares relating to the special dividend.

(c) Dividend not recognised at reporting date

In addition to the above dividends, the following dividend was declared after the reporting date but before finalisation of this financial report and has not been recognised in this financial report.

	Cents per share	Total amount \$m	Expected payment date	Tax rate for franking credit	Percentage franked
2006 final dividend – ordinary shares	16.0	255	9 October 2006	30%	100%

The dividend was declared on 25 August 2006. The last date for the receipt of an election notice for participation in the dividend reinvestment plan in relation to this final dividend is 6 September 2006. The DRP will operate using shares acquired on-market with no discount applied.

	Distribution percentage per annum	Total amount \$m	Payment date	Percentage franked
(d) Reset preference shares				
Recognised in year ended 30 June 2006	*n/a	*n/a	*n/a	*n/a
Recognised in year ended 30 June 2005				
First issue June 2002 – IAGPA	5.80%	20	15 June 2005 and 15 December 2004	100%
Second issue June 2003 – IAGPB	4.51%	9	15 June 2005 and 15 December 2004	100%
		29		

* This item has been treated differently in the current reporting period following the election to not restate comparatives for certain accounting standards as allowed upon first time adoption of AIFRS. Refer to note 38 for further details.

All of the distributions paid in relation to the reset preference shares for the current annual reporting period and the previous annual reporting period were fully franked at 30%.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 9. DIVIDENDS (CONTINUED)

(e) Restrictions that may limit the payment of dividends

There are presently no restrictions on the payment of dividends by the Parent other than:

- The payment of dividends generally being limited to profits subject to ongoing solvency obligations; and
- No dividends can be paid and no returns of capital can be made on ordinary shares, if distributions are not paid on the reset preference shares, unless certain actions are taken by IAG. For further details refer to note 23.

There are presently no restrictions on the payment of dividends from subsidiaries to the Parent other than:

- The payment of dividends generally being limited to profits subject to ongoing solvency obligations of the subsidiary; and
- For certain subsidiaries, statutory reserve and regulatory minimum capital requirements, in particular, the Australian Prudential Regulation Authority has advised Australian general insurers that a general insurer under its supervision must obtain approval from it before declaring a dividend if the general insurer has incurred a loss, or proposes to pay dividends which exceed the level of profits earned in the current period.

The impact to these requirements caused by the payment of dividends is monitored. Payments of dividends from overseas subsidiaries may attract withholding taxes which have not been provided for in this financial report.

(f) Dividend franking account

The amount of franking credits available for the subsequent annual reporting period are:

	PARENT		CONSOLIDATED	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m
Franking account balance at reporting date at 30%	452	343	483	354
Franking credits to arise from payment of income tax payable	83	165	103	205
Franking debits to arise from receipt of income tax refundable	(19)	(20)	(20)	(20)
Franking credits to arise from receipt of dividends receivable	3	3	4	4
Franking credits available for future reporting periods	519	491	570	543
Franking account impact of dividends declared before issuance of financial report but not recognised at reporting date	(109)	(99)	(109)	(99)
Franking credits available for subsequent financial years based on a tax rate of 30%	410	392	461	444

The balance of the franking account arises from:

- franked income received or recognised as a receivable at the reporting date;
- income tax paid, after adjusting for any franking credits which will arise from the payment of income tax provided for in the financial statements; and
- franking debits from the payment of dividends recognised as a liability at the reporting date.

The consolidated amounts include franking credits that would be available to the Parent if distributable profits of non-wholly owned subsidiaries were paid as dividends.

NOTE 10. INSURANCE CONTRACTS RISK MANAGEMENT

A key risk from operating in the general insurance industry is the exposure to insurance risk arising from underwriting general insurance contracts. The insurance contracts transfer risk to the insurer by indemnifying the policyholders against adverse affects arising from the occurrence of specified uncertain future events. The risk is that the actual amount of claims to be paid in relation to contracts will be different to the amount estimated at the time a product was designed and priced. The Consolidated entity is exposed to this risk because the price for a contract must be set before the losses relating to the product are known. Hence the insurance business involves inherent uncertainty. The Consolidated entity also faces other risks relating to the conduct of the general insurance business including financial risks (refer principally to note 35) and capital risks (refer principally to note 36).

A fundamental part of the overall risk management strategy is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows arising from insurance contracts.

(a) Risk management objectives and policies for mitigating insurance risk

The insurance activities primarily involve the underwriting of risks and the management of claims. A disciplined approach to risk management is adopted in accordance with IAG Group protocols rather than a premium volume or market share orientated approach. It is believed this approach provides the greatest long term likelihood of being able to meet the objectives of all stakeholders; including policyholders, lenders and equity holders.

The risk management activities can be broadly separated into underwriting (acceptance and pricing of risk), claims management, reserving (including investment in data capabilities), and investment management. The objective of these risk management functions is to enhance the longer term financial performance of the overall insurance operations. The policies for the management of risk are applied consistently across the IAG Group with certain allowances made for non-Australian jurisdictions.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

The key policies in place to mitigate risks arising from underwriting insurance contracts include the following:

- **Acceptance of risk** – The IAG Group Underwriting and Pricing Policy Committee establishes, reviews and monitors the underwriting and pricing standards and strategies. The underwriting of large numbers of uncorrelated individual risks, across a range of classes of insurance businesses, in different geographical segments reduces the variability in overall claims experience. Limiting exposure to long-tail classes of business (where the settlement of claims typically takes longer than one year) to a target of 20% of the business as measured by gross written premiums, limits risk. Maximum limits are set for the acceptance of risk both on an individual contract basis and for classes of business and specific risk groupings. Management information systems are maintained that provide up-to-date, reliable data on the risks to which the business is exposed at any point in time. Efforts are made, including plain language policy terms, to ensure there is no misalignment between what policyholders perceive will be paid when a policy is initially entered and what is actually paid when a claim is made;
- **Pricing** – Statistical models are used which combine historical and projected data to calculate premiums and monitor claims patterns for each class of business. The data used includes historical pricing and claims analysis for each class of business as well as current developments in the respective markets and classes of business. All data used is subject to rigorous verification and reconciliation processes. The models incorporate consideration of market conditions;
- **Reinsurance** – The use of reinsurance to limit exposure to large single claims and accumulation of claims that arise from the same event or the accumulation of similar events. This includes the monitoring of reinsurers' credit risk to control exposure to reinsurance counterparty default (refer note 12);
- **Claims management** – initial claim determination is managed by claims officers with the requisite degree of experience and competence with the assistance, where appropriate, of a loss adjustor or other party with specialist knowledge. It is IAG Group policy to respond and settle claims quickly whenever possible and to pay claims fairly, based on policyholders full entitlement in line with community and regulator expectations;
- **Investment management** – assets and liabilities are managed so as to effectively match the expected pattern of claims payments with the assets that are held to back insurance liabilities;
- **Risk reduction** – Reducing the frequency and severity of a claim in the first place by investing in community risk reduction programmes such as fire prevention strategies, crime prevention programmes and motor vehicle safety initiatives.

(b) Terms and conditions of insurance contracts

The terms and conditions attaching to insurance contracts affect the level of insurance risk accepted. The majority of direct insurance contracts written are entered into on a standard form basis. Insurance contracts are generally entered into on an annual basis and at the time of entering into a contract all terms and conditions are negotiable or, in the case of renewals, renegotiable. Non-standard and long term policies may only be written if expressly approved by a relevant delegated authority. There are no special terms and conditions in any non standard contracts that would have a material impact on the financial report. Insurance contracts written in all jurisdictions are subject to substantially the same terms and conditions. There are no embedded derivatives that are separately recognised from a host insurance contract.

(c) Concentrations of insurance risk

The exposure to concentrations of insurance risk is mitigated by a portfolio diversified into many classes of business across different countries. A high level indication of the spread of insurance risk may be obtained from the segment reporting note.

Concentration risk is particularly relevant in the case of natural disasters and other catastrophes which generally result in a concentration of affected policyholders over and above the norm and which constitutes the largest individual potential financial loss. Each year, the Consolidated entity sets its tolerance for concentration risk. Various models are used to estimate the impact of different potential natural disasters and other catastrophes. The tolerance for concentration risk is used to determine the maximum event retention which is the maximum net exposure to insurance risk determined appropriate for any single event with a given probability. While it is desirable to limit the net exposure, it is reduced to only the maximum event retention limit because the cost of purchasing reinsurance cover to reduce the net exposure further is not capital efficient.

Specific processes for monitoring identified key concentrations are set out below:

Risk	Source of concentration	Risk management measures
An accumulation of risks arising from a natural peril	Insured property concentrations	Accumulation risk modelling, reinsurance protection
A large property loss	Fire or collapse affecting one building or a group of adjacent buildings	Maximum acceptance limits, property risk grading, reinsurance protection
Multiple liability retentions being involved in the same event	Response by a multitude of policies to the one event	Purchase of reinsurance clash protection

As an example of the impact of a potential catastrophe on the Consolidated entity, the exposure to an earthquake in Sydney with associated claims costs of \$3.5 billion would be limited to an estimated \$200 million.

For concentrations of risk relating to the reinsurance contracts refer to note 12(e).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 10. INSURANCE CONTRACTS RISK MANAGEMENT (CONTINUED)

(d) Credit risk

Financial assets or liabilities arising from insurance contracts are presented on the balance sheet at the amount that best represents the maximum credit risk exposure at reporting date.

The credit risk relating to insurance contracts relates primarily to:

- Premium receivable which is due from individual policyholders and intermediaries (brokers, agents and business partners). The brokers and agents collect premium from policyholders and remit the monies to the insurer in accordance with contractual arrangements being generally within 90 days for brokers and 30 – 60 days for agents. The recoverability of premium receivable is assessed and provision is made for impairment based on objective evidence and having regard to past default experience. Concentrations of credit risk are considered low due to the large number of customers / corporate partners comprising the customer base and their dispersion across different industries and geographies. The premium receivable is presented on the balance sheet net of a provision for impairment of \$41 million (2005 – \$37 million).
- Reinsurance recoveries receivable which are discussed further in note 12.

Additional information about credit risk is disclosed in note 35.

(e) Interest rate risk

The underwriting of general insurance contracts creates exposure to the risk that interest rate movements may materially impact the value of the outstanding claims liability. Movements in interest rates impact the determination of the liability through the selection of discount rates. Discounting the liability is in effect allowing for future investment earnings on the assets held to back the insurance liabilities. The funds held to pay outstanding claims are invested principally in fixed interest securities matched to the settlement durations of the outstanding claims. Movements in market interest rates affect the value of the fixed interest securities. Hence movements in interest rates should have minimal impact on the insurance profit for a year due to movements in investment income on assets backing insurance liabilities offsetting the impact of movements in discount rates on the claims liabilities.

(f) Reinsurance risk

Refer to note 11(f) and note 12(d) and (e).

(g) Operational risk

Operational risk is the risk of financial loss (including lost opportunities) resulting from external events and / or inadequate or failed internal processes, people and systems to perform as required. The IAG Group Risk Management Strategy includes consideration of operational risk. Operational risk is identified and assessed on an ongoing basis and the capital management strategy includes consideration of operational risk. Management and staff are responsible for identifying, assessing and managing operational risks in accordance with their roles and responsibilities. The IAG Group has an internal audit function which monitors processes and procedures surrounding operational risk.

NOTE 11. CLAIMS

	CONSOLIDATED	
	2006 \$m	2005 \$m
(a) Claims expense, net		
Direct business	3,899	4,088
Inwards reinsurance business	1	2
Net claims expense	3,900	4,090

(b) Claims development

(i) Net claims expense recognised in the income statement

Given the uncertainty in establishing the outstanding claims liability, it is likely that the final outcome will be different from the original liability established. Claims development refers to the financial adjustment in the current period relating to claims incurred in previous periods because of new and more up to date information that has become available and to reflect changes in inflation and discount assumptions. The information is presented on an accident year basis (claims are related to the period in which the insured event occurred and not the period in which the policy was underwritten).

	CONSOLIDATED					
	2006			2005		
	Current year \$m	Prior years \$m	Total \$m	Current year \$m	Prior years \$m	Total \$m
Direct business						
Gross claims – undiscounted	5,261	(763)	4,498	5,114	(236)	4,878
Discount	(277)	243	(34)	(247)	118	(129)
Gross claims – discounted	4,984	(520)	4,464	4,867	(118)	4,749
Reinsurance and other recoveries – undiscounted	(645)	127	(518)	(609)	(168)	(777)
Discount	24	(71)	(47)	19	97	116
Reinsurance and other recoveries – discounted	(621)	56	(565)	(590)	(71)	(661)
Net claims expense	4,363	(464)	3,899	4,277	(189)	4,088

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

Current year claims relate to claim events that occurred in the current financial year. Prior year claims relate to a reassessment of the claim events that occurred in all previous financial periods. A major component of the prior year movement is the release of risk margins in respect of claims payments during the year (largely offset by inclusion of risk margins in respect of current year claims). Other factors contributing to the prior year claims development in the current financial year are releases in commercial liability portfolios and a reduction in the probability of adequacy used in determining the outstanding claims liability at reporting date (refer note 11(f)).

The table above disclosing the net claims expense recognised in the income statement (Table A) and the table on the next page in note 11(b)(ii) disclosing the net outstanding claims liability recognised on the balance sheet (Table B) both relate to claims development but present information in different formats and so are not directly reconcilable. Key differences between the tables relate to the inclusion in the prior year columns in Table A of items that in Table B are included in the reconciliation section of the table and not the development section. The key items are:

- Claims handling expenses;
- Development on claims for accident years 2001 and prior; and
- Development on claims from acquisitions which relates to accident years prior to the year of acquisition.

(ii) Net outstanding claims liability recognised on the balance sheet

The following table shows the development of the estimated net undiscounted outstanding claims liability relative to the current estimate of ultimate claims costs for the five most recent accident years as estimated at each reporting date. The table also shows a reconciliation of the net discounted liability for the five most recent accident years to the gross outstanding claims liability on the balance sheet. The development section of the table includes only direct business because the financial impact of the inwards reinsurance business, which is in run-off, is not significant.

Net ultimate claims cost estimate	ACCIDENT YEAR					Total \$m
	2002 \$m	2003 \$m	2004 \$m	2005 \$m	2006 \$m	
Development						
At end of accident year	2,313	3,677	3,881	4,024	4,105	
One year later	2,215	3,360	3,521	3,743		
Two years later	2,137	3,249	3,493			
Three years later	2,087	3,163				
Four years later	2,051					
Current estimate of net ultimate claims cost	2,051	3,163	3,493	3,743	4,105	
Cumulative payments	(1,744)	(2,614)	(2,720)	(2,683)	(2,011)	
Net undiscounted outstanding claims liability for the five most recent accident years	307	549	773	1,060	2,094	4,783
Discount to present value	(41)	(82)	(122)	(176)	(246)	(667)
Net discounted outstanding claims liability for the five most recent accident years	266	467	651	884	1,848	4,116
Reconciliation						
Claims handling expense (inclusive of risk margin)						461
Net discounted outstanding claims for accident years 2001 and prior						379
Net outstanding claims liability for acquired subsidiaries for accident years prior to acquisition						667
Net outstanding claims liability for Thailand based insurance entities						31
Net outstanding claims liability for inwards reinsurance						76
Net outstanding claims liability						5,730
Gross outstanding claims liability on the balance sheet						6,916
Reinsurance and other recoveries on outstanding claims liabilities						(908)
GST recoverable on net outstanding claims liability						(278)
Net outstanding claims liability						5,730

Favourable development of claims provisions has given rise to the release of risk margins, and in some cases central estimates, as the ultimate claims costs were settled or became more certain.

Conditions and trends that have affected the development of the liabilities in the past may, or may not, occur in the future, and accordingly, conclusion about future results may not necessarily be derived from the information presented in the tables above.

Short-tail claims are normally reported soon after the incident and are generally settled within months following the reported incident. Hence any development on short-tail claims is normally limited to the year the incident occurred and the following year. For long-tail classes of business it can be several years before a claim is reported and settled, hence the original estimation involves greater uncertainty and so inherently there is more likely to be greater disparity between the original and current estimates. It is for these long-tail classes of business that the development of the outstanding claims liability generally occurs over a number of years.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 11. CLAIMS (CONTINUED)

(b) Claims development (continued)

(ii) Net outstanding claims liability recognised on the balance sheet (continued)

Where an entity or business has been acquired that includes outstanding claims liabilities, the claims costs for the acquired businesses are included in the claims development table from and including the year of acquisition. Development on the liabilities of such acquired businesses relating to accident years prior to the year of acquisition is included in the reconciliation section of the table.

The Consolidated entity conducts general insurance business in local currencies in foreign countries. The gross outstanding claims liability for international operations includes contracts written in New Zealand dollars and Thai Baht. The translation of the outstanding claims liabilities denominated in foreign currencies into Australian dollars over a number of reporting dates, includes exchange rate movements that have no reflection on the development of the measurement of the underlying claims. The amounts included in the development section of the tables have been determined using constant exchange rates being the rates as at 30 June 2006.

	CONSOLIDATED	
	2006 \$m	2005 \$m
(c) Composition of outstanding claims liability – gross, discounted		
Expected future payments for claims incurred		
– Central estimate	5,228	5,045
– Claims handling costs	380	380
– Risk margin	1,308	1,415
Outstanding claims liability	6,916	6,840

The outstanding claims liability includes \$4,547 million (2005 – \$4,465 million) which is expected to be settled after more than twelve months from reporting date. The net outstanding claims liability at the financial reporting date relating to the inwards reinsurance business which is in run-off and for which commutation opportunities are being pursued was \$76 million (2005 – \$86 million).

(d) Reconciliation of movements in outstanding claims liability

Outstanding claims liability at the beginning of the financial year – gross, discounted	6,840	6,327
Reinsurance and other recoveries receivable on outstanding claims at the beginning of the financial year (refer note 12(a))	(883)	(745)
GST recoverable on net outstanding claims liability at beginning of the financial year	(298)	(267)
Net outstanding claims liability at the beginning of the year	5,659	5,315
Risk margin at the beginning of the year	(1,149)	(1,052)
Net central estimate at the beginning of the year	4,510	4,263
Claims incurred in the current year	4,660	4,487
Reinsurance and other recoveries in the current year	(581)	(544)
Claims cost paid	(4,423)	(4,179)
Reinsurance and other recoveries received	589	452
Unwind of the discount	189	176
Development on prior year net central estimate	(184)	(211)
Movement in discounting	(87)	66
Movement in foreign currency exchange rates	(17)	–
Net movement for acquired Thailand businesses	32	–
Net central estimate at the end of the year	4,688	4,510
Risk margin at the end of the year	1,042	1,149
Net outstanding claims liability at the end of the year	5,730	5,659
Reinsurance and other recoveries receivable on outstanding claims at the end of the financial year (refer note 12(a))	908	883
GST recoverable on net outstanding claims liability at end of the financial year	278	298
Outstanding claims liability at the end of the financial year – gross, discounted	6,916	6,840

(e) Discounting of net outstanding claims liability

Net outstanding claims liability – undiscounted	7,020	6,770
Discount to present value	(1,290)	(1,111)
Net outstanding claims liability – discounted	5,730	5,659

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

(f) Central estimate and risk margin

(i) Reporting date values

As at 30 June 2006, the percentage risk margin applied to the present value of expected future payments for claims incurred net of expected recoveries on outstanding claims liability and expected input tax credit is 22.2% (2005 – 25.5%), representing a probability of adequacy of 90.0% (2005 – 92.5%).

The high level of professional judgement applied by actuaries in calculating the outstanding claims liability, and hence the probability of adequacy of the liability, means that for a certain probability of adequacy, different risk margins may be applied for similar risks, which is important in considering the overall reserving strength of an insurer.

(ii) Process

The estimation of the outstanding claims liability is based on a variety of actuarial techniques that analyse experience, trends and other relevant factors. The claims estimation process commences with the actuarial projection of the future payments relating to claims incurred at the reporting date. The expected future payments include those in relation to claims reported but not yet paid or not yet paid in full, claims incurred but not enough reported ("IBNER"), claims incurred but not reported ("IBNR") and the anticipated direct and indirect claims handling costs.

The estimation process involves using the Consolidated entity's specific data, relevant industry data and more general economic data. Each class of business is usually examined separately and the process involves consideration of a large number of factors including the risks to which the business is exposed at a point in time, claim frequencies and average claim sizes, historical trends in the incidence and development of claims reported and finalised, legal, social and economic factors that may impact upon each class of business as well as the key actuarial assumptions set out in note 11(g), and the impact of reinsurance and other recoveries (refer note 12).

Different actuarial valuation models are used for different claims types with the results then being aggregated. This aggregation of results enhances the valuation process by allowing the use of the model best suited to particular claims types. The selection of the appropriate model takes into account the characteristics of a class of business and the extent of development of each past accident period.

The different components of the outstanding claims liability are subject to different levels of uncertainty. The estimation of the cost of claims reported but not yet paid or not yet paid in full is made on a case-by-case basis by claims personnel having regard to the facts and circumstances of the claim as reported, any information available from assessors and information on the cost of settling claims with similar characteristics in previous periods. A further amount, which may be a reduction, is included for IBNER on the basis of past experience with the accuracy of initial claims estimates. With IBNR, the estimation is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified, as no information is currently available about the claim. IBNR claims may often not be apparent to the insured until many years after the events giving rise to the claim have occurred. In calculating the estimated cost of unpaid claims a variety of estimating techniques are used, generally based on statistical analysis of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience. Allowance is made, however, for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims.

Large claims impacting each relevant business class are generally assessed separately, being measured on a case by case basis or projected separately in order to allow for the possible distortive effect of the development and incidence of these large claims. For new products the growing experience with the development of claims is closely monitored.

Reserves are not established for catastrophes in advance of such events and so these events may cause volatility in the results for a period and in the levels of the outstanding claims liability, subject to the effects of reinsurance recoveries.

A projection of future claims payments, both gross and net of reinsurance and other recoveries, is undertaken. Projected future claims payments and associated claims handling costs are discounted to a present value as required using appropriate risk free discount rates.

Over 99.9% of the outstanding claims liability is reviewed at least annually by external actuaries from organisations which are independent of both the IAG Group and the external auditor.

The central estimate of the outstanding claims liability is an estimate which is intended to contain no deliberate or conscious over or under estimation and is commonly described as providing the mean of the distribution. It is considered appropriate for the measurement of the claims liability to represent a higher degree of certainty regarding the sufficiency of the liability over time, and so a risk margin is added to the central estimate. The risk margin refers to the amount by which the liability recognised in the financial statements is greater than the actuarial central estimate of the liability. The risk margin added to the central estimate increases the probability that the net outstanding claims liability will ultimately prove to be adequate.

Risk margins are held to allow for uncertainty surrounding the outstanding claims liability estimation process. Potential uncertainties include those relating to the actuarial models and assumptions, the quality of the underlying data used in the models, general statistical uncertainty, the general insurance environment, scope for and experience of political intervention (particularly for long-tail classes) and the impact of legislative reform. Uncertainty from the above sources is examined for each class of business and expressed as a volatility of the net central estimate. The volatility for each class is derived after consideration of stochastic modelling and benchmarking to industry analysis.

The long-tail classes of business generally have the highest volatilities of the insurance classes as the longer average time for claims to be reported and settled allows more time for sources of uncertainty to emerge. Short-tail classes generally have lower levels of volatility.

The risk margin required to provide a given probability of adequacy for two or more classes of business or for two or more geographic locations combined is likely to be less than the sum of the risk margins for the individual classes. This reflects the benefit of diversification in general insurance. Two key components of the valuation methodology are the selection of coefficients of variation (CoV) for each class of business and the correlation factors between each pair of classes of business. The CoV is a measure of the volatility of a class of business and is generally greater for long tail classes when compared to short tail classes because of the increased uncertainty relating to the longer time until settlement of claims. The correlation factors are a measure of the correlation between pairs of business classes and measure the strength of the relationship of movements in that pair of class liabilities. The higher the correlation between two classes of business, the more likely it is that a negative outcome in one class will correspond to a negative outcome in the other class. The correlations adopted are normally derived from industry analysis, historical experience and the judgement of experienced and qualified actuaries.

The risk margin is set taking into account the correlations assessed between the outstanding claims liabilities arising from the various forms of business underwritten by the different entities within the Consolidated entity. The Approved Actuary estimates the overall risk margin on a diversified basis, taking into account the diversification benefit arising from combining all classes of business within the Consolidated entity. The assumptions regarding uncertainty for each class are applied to the net central estimates, and the results are aggregated. The aggregated central estimate plus the risk margin calculated on a diversified basis forms the outstanding claims liability. The policy is for the risk margin to be set so as to provide an overall probability of adequacy for the outstanding claims liability of 90% or greater which has been determined having regard to the inherent uncertainty in the central estimate and the prevailing market environment.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 11. CLAIMS (CONTINUED)

(g) Actuarial assumptions

The following key actuarial assumptions were used in the measurement of outstanding claims and recoveries, where appropriate, at reporting date:

	CONSOLIDATED FOR 2006			
	Australian personal insurance	Australian commercial insurance	New Zealand insurance	Reinsurance captive
Weighted average terms to settlement	2.8 years	5.9 years	0.4 years	1.8 years
Inflation rate	3.3 – 4.3%	3.5 – 4.3%	3.1%	4.3%
Superimposed inflation rate	2.0 – 5.0%	2.5 – 8.0%	4.0%	–
Discount rate	5.5 – 5.9%	5.8 – 5.9%	*5.5 – 6.8%	5.7 – 5.8%
Claims handling expense ratio	7.6%	6.3%	5.7%	1.9%

* In accordance with New Zealand Government bond yields ranging from 6.8% in the next year to 5.5% from year seven onwards.

(h) Processes used to determine the assumptions

The process for establishing the outstanding claims liability involves extensive consultation with internal and external actuaries, claims managers, underwriters and other senior management. One of the key elements of the valuation processes is rigorous data verification and reconciliation.

A description of the key assumptions and the processes used to determine those assumptions is provided below:

- *Weighted average term to settlement* – The weighted average term to settlement relates to the expected payment pattern for claims. The payment pattern is important in considering the timing of future cash outflows and hence discounting and in managing the assets backing insurance liabilities to support the outflows. The future cashflow pattern is estimated separately for each class of business based on historic settlement patterns and estimated future settlement patterns. The weighted average term to settlement, while not itself an assumption, provides a summary indication of the future cashflow pattern.
- *Inflation rate* – Insurance costs are subject to inflationary pressures. Economic inflation assumptions are set by reference to current economic indicators. For example, for the motor and property classes, claims costs are related to the inflationary pressures of the materials and goods insured as well as labour costs to effect repairs.
- *Superimposed inflation rate* – Superimposed inflation occurs due to non-economic effects such as court settlements increasing at a faster rate than wages or CPI inflation and from social and environmental pressures. Where appropriate, the effect of superimposed inflation is made either in the underlying model for the class of business, for example where the past pattern of development in claims cost are used to estimate future claim cost development factors, or by including a specific superimposed inflation rate assumption designed to allow for all other claims inflation not modelled. The level of superimposed inflation is estimated after considering both the superimposed inflation present in the portfolio and industry superimposed inflation trends.
- *Discount rate* – Because the outstanding claims liability represents payments that will be made in the future, they are discounted to reflect the time value of money effectively recognising that the assets held to back insurance liabilities will earn a return during that period. Discount rates represent a risk-free rate derived from market yields on government securities.
- *Claims handling expense ratio* – It is known that costs will be incurred in the future in the management of claims to finalisation that have been incurred up to the reporting date. An estimate of these costs is incorporated into the outstanding claims liability using the claims handling expense ratio. The ratio incorporates assumptions about the future costs to be incurred based on past experience with such costs for each class of business.

(i) The effect of changes in assumptions

(i) General impact of changes

Sensitivity analyses are conducted to quantify the exposure to changes in the key underlying variables. The valuations included in the reported results are calculated using certain assumptions about these variables as disclosed above. The movement in any key variable will impact the financial position and performance for a period. The information below describes how a change in each assumption will affect claims liabilities and provides an analysis of the sensitivity of the net outstanding claims liability to changes in these assumptions.

- *Weighted average term to settlement* – A decrease in the average term to settlement would reflect claims being paid sooner than anticipated and so increase the claims expense.
- *Inflation and superimposed inflation rates* – Expected future payments are inflated to take account of inflationary increases. An increase or decrease in the assumed levels of inflation would have a corresponding impact on claims expense, with particular reference to long-tail business. The inflation rate sensitivity is provided as an indicator of the impact of inflation on the portfolio, whether it be from economic inflation, inflation implied from the use of the past pattern of development in claims cost in the valuation method or inflation related to a specific superimposed inflation rate specified.
- *Discount rate* – The outstanding claims liability is calculated by reference to expected future payments. These payments are discounted to adjust for the time value of money. An increase or decrease in the assumed discount rate will have an opposing impact on total claims expense.
- *Claims handling expense ratio* – An increase in the ratio reflects an increase in the estimate for the internal costs of administering claims which will increase the outstanding claims liability.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

(ii) Sensitivity analysis of changes

The impact of changes in key outstanding claims variables are summarised below. Each change has been calculated in isolation of the other changes and each change shows the relevant impact assuming that there is no change to:

- *Any of the other variables* – This is considered unlikely as, for example, an increase in interest rates is normally accompanied by an increase in the rate of inflation.
- *The probability of adequacy* – The directors and management have set an internal target for the probability of adequacy for the outstanding claims liability. It is likely that if, for example, the central estimate was to increase by 5%, at least part of the increase would result in a decrease in the probability of adequacy rather than being reflected wholly in the net outstanding claims liability as inferred below.

An economic assumption may be relevant to only a part of a business segment and so a large change in the assumption may have only a small financial impact on the business segment.

The impact on the net outstanding claims liability for each of the key assumptions:

CONSOLIDATED FOR 2006					
Variable	Movement in variable	Australian personal insurance \$m	Australian commercial insurance \$m	New Zealand insurance \$m	Reinsurance captive \$m
Weighted average term to settlement	+10%	(47)	(60)	–	(2)
	–10%	46	61	–	2
Inflation rate	+1.0%	77	76	1	4
	–1.0%	(75)	(66)	(1)	(4)
Discount rate	+1.0%	(73)	(75)	(1)	(4)
	–1.0%	77	85	1	4
Claims handling expense ratio	+1.0%	31	21	2	2
	–1.0%	(31)	(21)	(2)	(2)

The movements in the net outstanding claims liability would have an opposing net impact on the profit or loss before tax for a year.

NOTE 12. REINSURANCE AND OTHER RECOVERIES ON OUTSTANDING CLAIMS

CONSOLIDATED		
	2006 \$m	2005 \$m
(a) Reinsurance and other recoveries receivable on outstanding claims		
Reinsurance recoveries receivable on outstanding claims	598	599
Other recoveries receivable on outstanding claims	310	284
Reinsurance and other recoveries receivable on outstanding claims	908	883

The carrying value of reinsurance and other recoveries receivable on outstanding claims includes \$597 million (2005 – \$576 million) which is expected to be settled after more than twelve months from reporting date. Because of the nature of the amount being an estimate, the credit risk is incorporated into the estimate rather than being presented separately as a provision for impairment.

(b) Actuarial assumptions

Reinsurance and other recoveries on outstanding claims are computed using actuarial assumptions and methods similar to that used for outstanding claims (refer note 11(f)). The outstanding claims liability is calculated gross of any reinsurance recoveries and a separate estimate is then made of the amounts that are expected to be recoverable from reinsurers based upon the gross provisions. Estimates of potential reinsurance recoveries are made on an individual claim basis for reported claims. The recoverability of these assets is assessed on a periodic basis to ensure that the balance is reflective of the amounts that will ultimately be received.

(c) The effect of changes in assumptions

The effect of changes in assumptions on the net outstanding claims liability, which incorporates the reinsurance and other recoveries receivable on outstanding claims, is disclosed in note 11(i).

(d) Risk management

The Board and senior management of the IAG Group have developed, implemented and maintain a Reinsurance Management Strategy (“REMS”) which is in accordance with the prudential standards issued by the Australian Prudential Regulation Authority (“APRA”). The REMS is updated annually and approved by the Board.

The REMS identifies the IAG Group’s policies and procedures, processes and controls that comprise its risk management and control systems relating to reinsurance. Annually, the Board certifies to APRA that adequate strategies have been put in place to monitor those risks, that systems are in place to ensure compliance with legislative and prudential requirements, and that the Board has satisfied itself as to compliance with the REMS.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 12. REINSURANCE AND OTHER RECOVERIES ON OUTSTANDING CLAIMS (CONTINUED)

(e) Reinsurance programme

Risks underwritten are reinsured in order to limit exposure to losses, stabilise earnings, protect capital resources and ensure efficient control and spread of the risks underwritten. Each subsidiary that is an insurer has its own reinsurance programme and determines its own risk limits. To facilitate the reinsurance process and to create economies of scale, the IAG Group has established a captive reinsurance company, IAG Re Limited ("IAG Re"), incorporated in the Republic of Ireland, which acts as the reinsurer for the IAG Group by being the main buyer of the IAG Group's outwards reinsurance programme. The operations of IAG Re are intended to manage reinsurance and earnings volatility and the IAG Group's exposure to catastrophe risk. IAG Re retains a portion of the intercompany business it assumes and retrocedes (passes on) the remainder to external reinsurers.

While a large portion of the business ceded by the Consolidated entity's subsidiaries is reinsured with IAG Re, individual business units do purchase additional reinsurance protection outside the IAG Group. This generally relates to facultative reinsurance covers and selected treaty reinsurance arrangements for the Australian commercial insurance operations. IAG Re helps to facilitate these arrangements.

IAG Re purchases reinsurance on behalf of IAG Group entities to cover a maximum return period of at least APRA's minimum of 1:250 year event on a single site basis but is authorised to elect to purchase covers up to 1:250 year event on a whole of portfolio basis. Dynamic Financial Analysis modeling is used to determine the optimal level to which reinsurance should be purchased for capital efficiency, compared with the cost and benefits of covers available in the market.

The external reinsurance programmes consist of a combination of the following reinsurance protection:

- A Group Catastrophe cover which is placed in line with the strategy of buying to the level of a 1:250 year event on a modified whole of portfolio basis. The catastrophe programme is negotiated on an annual basis. Covers purchased are dynamic; the maximum event retention (MER) changes as total requirements change and as the reinsurance purchase strategy evolves.
- An Aggregate cover is also purchased alongside the catastrophe cover. This is designed to protect the IAG Group from certain attritional losses as well as providing subsequent event covers.
- A Surplus cover, which provides "per risk" protection for IAG Commercial Property and Engineering business in Australia and New Zealand.
- Excess of loss reinsurance for all casualty portfolios including CTP, Public Liability and Workers' Compensation.

Reinsurance arrangements mitigate insurance risk but potentially expose the IAG Group to credit risk. Reinsurance is placed with companies based on an evaluation of the financial strength of the reinsurers, terms of coverage, and price. The IAG Group has clearly defined credit policies for the approval and management of credit risk in relation to reinsurers. The Consolidated entity monitors the financial condition of its reinsurers on an ongoing basis and periodically reviews the reinsurers' ability to fulfill its obligations to the Consolidated entity under respective existing and future reinsurance contracts.

It is IAG Group policy to deal with reinsurers with credit ratings of at least Standard & Poor's "A-" (or other rating agency equivalent) without collateralisation. For some newly acquired businesses a transition period is used for implementation of this policy. Where the credit rating of a reinsurer falls below the threshold level during the period of risk, there exists a contractual right to replace the counterparty. Some of the reinsurance protection is purchased on a 'collateralised' basis, where reinsurers have deposited funds equivalent to their participation in a trust fund. The level and quality of reinsurance protection is an important element in understanding the financial strength of an insurer. There is limited value in purchasing reinsurance protection from a reinsurer when that reinsurer may be unable to meet its payment obligations upon submission of a claim. The counterparty credit profile of the reinsurance catastrophe programme currently stands with 75% of the limit for the 2006 programme with parties rated by Standard & Poor's as "AA" or better.

Having reinsurance protection with strong reinsurers also benefits the Consolidated entity in its regulatory capital calculations. The risk charges vary with the grade of the reinsurers such that higher credit quality reinsurance counterparties incur lower APRA regulatory capital charges.

There are no significant concentrations of credit risk for reinsurance recoveries receivable. Reinsurance contracts are entered into with a number of reinsurers from different countries each of which has a high independent credit rating. The use of reinsurance as part of the overall risk management strategy, and the level of reinsurance cover entered into with particular reinsurers are sufficiently diversified so as to avoid a concentration charge in the regulatory capital calculation (refer note 36).

Changes during the year

The catastrophe event limit cover purchased was maintained at \$3.5 billion. However, with effect from 1 January 2006, the maximum event retention (MER) for a first event was increased from \$100 million to \$200 million, dropping to \$175 million for a second event. The decision to increase the retained single event loss was made as the cost of the coverage available in the reinsurance market was such that the transaction proved to be capital inefficient compared with retaining the risk against the Consolidated entity's capital.

NOTE 13. DEFERRED ACQUISITION COSTS

	CONSOLIDATED	
	2006 \$m	2005 \$m
Reconciliation of movements for the financial year		
Deferred acquisition costs at the beginning of the financial year	621	558
Acquisition costs deferred during the year	1,051	1,133
Amortisation charged to profit for the year	(1,081)	(1,070)
Deferred acquisition costs at the end of the financial year	591	621

The carrying value of deferred acquisition costs includes \$46 million (2005 – \$33 million) which is expected to be amortised after more than twelve months from reporting date.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 14. UNEARNED PREMIUM LIABILITY

	CONSOLIDATED	
	2006 \$m	2005 \$m
(a) Reconciliation of movements for the financial year		
Unearned premium liability at the beginning of the financial year	3,586	3,472
Deferral of premiums on contracts written in the financial year	3,402	3,500
Earning of premiums written in previous years	(3,485)	(3,386)
Unearned premium liability at the end of the financial year	3,503	3,586

The carrying value of unearned premium liability includes \$146 million (2005 – \$101 million) which is expected to be earned after more than twelve months from reporting date.

(b) Liability adequacy test

The liability adequacy test has been conducted using the premium liabilities methodology for reporting to APRA (refer note 36), adjusted as appropriate, for each portfolio of contracts, being Australian personal insurance operations, Australian commercial insurance operations, the IAG New Zealand operations, the reinsurance captive, and other geographical locations separately.

The conduct of the liability adequacy test as at 30 June 2006 identified a surplus for each portfolio of contracts except for the reinsurance captive portfolio of contracts for which a deficiency was recognised (1 July 2005 – a surplus for all portfolios). The deficiency has been recognised through the recognition of an unexpired risk liability.

The deficiency for the reinsurance captive portfolio of contracts of \$11 million represents the amount by which the present value of the expected future cash flows relating to future claims of \$202 million (which is inclusive of risk margin and is net of related reinsurance recoveries of \$201 million) exceeds the unearned premium liability of \$313 million less the related deferred reinsurance expense of \$122 million. The test is based on prospective information and so is heavily dependent on assumptions and judgements.

For the purposes of the liability adequacy test, the present value of expected future cash flows for future claims including the risk margin for the Consolidated entity of \$2,513 million (1 July 2005 – \$2,567 million) comprises the discounted central estimate of \$2,280 million (1 July 2005 – \$2,323 million), and a risk margin of \$233 million (1 July 2005 – \$244 million).

The risk margin included in the Consolidated entity's expected future cash flows for future claims as a percentage of the central estimate is 10.2% (1 July 2005 – 10.5%) which was determined via a process similar to that described in note 11(f) allowing also for diversification between the outstanding claims liability and the premium liabilities to give a probability of adequacy of 75%. The probability of adequacy applied in the test is different to the probability of adequacy adopted in determining the outstanding claims liability. No specific guidance exists for the risk margin to be used in determining the adequacy of premium liabilities. The 75% basis is considered appropriate having regard to the purpose and nature of the test, the use of the 75% basis as a regulatory benchmark in Australia, and consistency with developing market practice.

NOTE 15. INVESTMENTS

Listed

Money market securities

- Australian government and semi-government
- Foreign government and institutions
- Financial institutions and corporate

Equity and trust securities

- Australian
- International

Unlisted

Money market securities

- Financial institutions and corporate

Equity and trust securities

- Australian
- International

	1,893	2,698
	867	181
	151	159
	1,961	2,381
	597	527
	5,469	5,946
	4,152	4,215
	160	129
	148	80
	4,460	4,424
	9,929	10,370

The carrying value of investments includes \$7,037 million (2005 – \$7,501 million) which is expected to be settled after more than twelve months from reporting date. None of the investments have been pledged as collateral (2005 – none).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 16. TRADE AND OTHER RECEIVABLES

	PARENT		CONSOLIDATED	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m
Reinsurance and other recoveries on paid claims	–	–	140	178
Provision for impairment	–	–	(8)	(8)
	–	–	132	170
Other trade debtors	–	–	31	35
Provision for impairment	–	–	(11)	(10)
	–	–	20	25
Premium funding loans secured on policies (net of unearned interest)	–	–	127	130
Provision for impairment	–	–	(2)	(2)
	–	–	125	128
GST recoverable on gross outstanding claims liability	–	–	284	300
Investment income receivable	–	–	94	99
Investment transactions not yet settled at reporting date	–	–	12	11
Corporate treasury derivatives receivable	–	–	–	3
Other debtors	1	–	97	91
	1	–	764	827

Trade and other receivables are non-interest bearing and are normally settled between 30 days and 12 months. The balance has not been discounted because the effect of the time value of money is not material. The net carrying amount of receivables is a reasonable approximation of the fair value of the assets because of the short term nature of the assets. A portion of the trade and other receivables balance is owed by related parties, which are considered to be fully recoverable.

NOTE 17. DEFERRED TAX ASSETS AND LIABILITIES

(a) Deferred tax assets

(i) The balance comprises temporary differences attributable to:

Amounts recognised in profit for the financial year

Property, plant and equipment	–	–	48	63
Employee benefits	–	–	65	54
Defined benefit superannuation plans	–	–	7	8
Insurance provisions	–	–	146	138
Investments	–	–	15	11
Provisions	–	–	2	2
Other	1	–	2	1
	1	–	285	277
Amounts recognised directly in equity				
Hedges	–	–	5	–
Defined benefit superannuation plans	–	–	(9)	–
	1	–	281	277
Set-off of deferred tax liabilities	–	–	(122)	(146)
	1	–	159	131
(ii) Movements				
Balance at the beginning of the financial year	–	–	277	263
Adjustment at 1 July 2005 (refer note 38)	–	–	2	–
	–	–	279	263
Credited / (charged) to profit or loss	1	–	5	29
Credited / (charged) to equity	–	–	(5)	–
Acquisitions	–	–	8	–
Transfers	–	–	(5)	(3)
Adjustments relating to prior year	–	–	(1)	(12)
Balance at the end of the financial year	1	–	281	277

(iii) Tax losses

The Consolidated entity has not brought to account any tax losses (2005 – \$Nil). Included in deferred tax assets is \$Nil relating to tax losses which the directors believe will probably be realised.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	PARENT		CONSOLIDATED	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m
(b) Deferred tax liabilities				
<i>(i) The balance comprises temporary differences attributable to:</i>				
<i>Amounts recognised in profit for the financial year</i>				
Investments	–	–	116	137
Other provisions	–	–	42	33
	–	–	158	170
<i>Amounts recognised directly in equity</i>				
Hedges	–	–	4	–
	–	–	162	170
Set-off against deferred tax assets	–	–	(122)	(146)
	–	–	40	24
<i>(ii) Movements</i>				
Balance at the beginning of the financial year	–	–	170	98
Charged / (credited) to profit or loss	–	–	(5)	80
Credited to equity	–	–	4	–
Foreign exchange differences	–	–	(2)	–
Transfers	–	–	(5)	(3)
Adjustments relating to prior year	–	–	–	(5)
Balance at the end of the financial year	–	–	162	170

NOTE 18. PROPERTY, PLANT AND EQUIPMENT

	CONSOLIDATED			
	Land and buildings \$m	Motor vehicles \$m	Other plant and equipment \$m	Total \$m
2006				
(a) Composition				
Cost*	70	71	336	477
Accumulated depreciation*	(5)	(23)	(192)	(220)
Accumulated impairment charges	–	–	–	–
Balance at the end of the financial year	65	48	144	257
* Additions through business combinations are presented on a gross basis.				
(b) Reconciliation of movements for the financial year				
Balance at the beginning of the financial year	60	51	148	259
Additions	–	20	35	55
Additions through business combinations	6	1	3	10
Disposals	–	(11)	(8)	(19)
Net foreign exchange differences	–	–	(1)	(1)
Depreciation	(1)	(13)	(33)	(47)
Balance at the end of the financial year	65	48	144	257
2005				
(c) Composition of comparatives				
Cost	61	70	319	450
Accumulated depreciation	(1)	(19)	(171)	(191)
Accumulated impairment charges	–	–	–	–
Balance at the end of the financial year	60	51	148	259

The net carrying amount of all classes of property, plant and equipment is considered a reasonable approximation of the fair value of the assets in the context of the financial statements. For property, this assessment included consideration of valuations prepared as at the reporting date by Mr Scott Fullarton FAPI of Scott Fullarton Valuations Pty Limited.

There were no impairment indicators present for each class of property, plant and equipment at the reporting date or noted during the year (2005 – none). There are no items of property, plant and equipment pledged as security for liabilities. The depreciation expense amounts are allocated across various lines in the income statement.

The net carrying amount of the lease provision capitalised in other plant and equipment was \$7 million as at 30 June 2006 (2005 – \$10 million).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 19. INTANGIBLE ASSETS

CONSOLIDATED				
	Software development expenditure \$m	Contractual arrangements \$m	Other \$m	Total \$m
2006				
(a) Composition				
Cost	58	109	2	169
Accumulated depreciation	(6)	(105)	(1)	(112)
Accumulated impairment charges	–	–	–	–
Balance at the end of the financial year	52	4	1	57
(b) Reconciliation of movements for the financial year				
Balance at the beginning of the financial year	24	6	1	31
Additions acquired and developed	34	–	1	35
Additions through business combinations	–	5	–	5
Amortisation	(6)	(7)	(1)	(14)
Balance at the end of the financial year	52	4	1	57
2005				
(c) Composition of comparatives				
Cost	24	104	1	129
Accumulated depreciation	–	(98)	–	(98)
Accumulated impairment charges	–	–	–	–
Balance at the end of the financial year	24	6	1	31

All of the intangible assets have been acquired other than the capitalised software development expenditure intangible asset. All of the intangible assets have finite useful lives. The amortisation of the capitalised software development expenditure is included in the claims expense, acquisition costs, other underwriting expenses, and corporate, administration and other expenses lines in the income statement. The amortisation of other intangible assets forms part of corporate, administration and other expenses in the income statement.

There were no impairment indicators present for each class of intangible asset at the reporting date or noted during the year (2005 – none). The capitalisation of the software development expenditure involves the exercise of judgement in determining whether the costs incurred will be recovered through the probable generation of future economic benefits from the internal use of the asset. This process is supported by the preparation of detailed business cases and subsequent review processes that are required to approve a greater than \$2 million project including a detailed business case. Reasonable variations in the exercise of this judgement would not have a material impact on the amounts recognised.

There are a number of other intangible assets that are controlled but which are not presented on the balance sheet because they do not meet the recognition criteria. These are both acquired and internally generated intangible assets. These include brands, information technology systems, and distribution channels.

NOTE 20. GOODWILL

CONSOLIDATED		
	2006 \$m	2005 \$m
(a) Composition		
Goodwill	1,505	1,452
Net cumulative foreign exchange movements	(19)	11
Accumulated impairment charges	–	–
	1,486	1,463
(b) Reconciliation of movements for the financial year		
Goodwill at the beginning of the financial year	1,463	1,455
Additional goodwill amounts arising from business combinations	53	8
Net foreign exchange movements during the financial year	(30)	–
Goodwill at the end of the financial year	1,486	1,463
(c) Allocation to cash generating units		
Australian personal insurance operations	418	418
Australian commercial insurance operations	724	724
New Zealand insurance operations	294	321
Other cash generating units	50	–
	1,486	1,463

The goodwill relating to certain acquisitions outside Australia is denominated in currencies other than Australian dollars and so is subject to foreign exchange rate movements.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

There was no impairment recognised during the year (2005 – \$Nil). The impairment testing of the goodwill involves the use of accounting estimates and assumptions. The recoverable amount of each cash generating unit is determined on the basis of value in use calculations. The value in use is calculated using a discounted cash flow methodology covering a five year period with an appropriate terminal value at the end of year five, less net assets, for each of the key business units within a cash generating unit.

The following describes the key assumptions on which management has based its cash flow projections to undertake impairment testing of goodwill:

- **Cash flow forecasts** – Cash flow forecasts are based on five year business plans presented to and approved by the Board.
- **Terminal value** – Terminal value is calculated using a perpetuity growth formula based on the cash flow forecast for year five, discount rate (after tax), and terminal growth rate.
- **Terminal growth rates** – Terminal growth rates are based on past performance and management's expectations for future performance in each segment and country.
- **Discount rate** – Discount rates used reflect the risk free rate, an appropriate beta and equity risk premium (after tax) in each segment and country, risk adjusted where applicable. Discount rates used are pre-tax.

The cash flow projections derived values for the cash generating units that were in excess of the carrying value of goodwill. Reasonably possible changes in the key assumptions on which the recoverable amounts are based would not cause the respective recoverable amounts for each cash generating unit to fall short of the carrying amounts at 30 June 2006.

NOTE 21. TRADE AND OTHER PAYABLES

	PARENT		CONSOLIDATED	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m
Trade creditors				
– Commissions payable	–	–	116	111
– Stamp duty payable	–	–	69	67
– GST payable on premium receivable	–	–	62	58
– Other	–	–	179	186
	–	–	426	422
Other payables				
– Investment creditors	–	–	40	14
– Interest payable on interest-bearing liabilities	1	–	8	8
– Other	1	1	186	194
– Loan from former related party ⁽ⁱ⁾	–	–	83	83
	2	1	743	721

(i) The loan from former related party relates to an entity that was previously a subsidiary and is now in liquidation. The loan is expected to be settled in conjunction with the final distribution from that entity by the liquidator.

Trade and other payables are unsecured, non interest-bearing and are normally settled within 30 days. The balance has not been discounted because the effect of the time value of money is not material. The carrying amount of payables is a reasonable approximation of the fair value of the liabilities because of the short-term nature of the liabilities.

NOTE 22. RESTRUCTURING PROVISION

	CONSOLIDATED	
	2006 \$m	2005 \$m
(a) Composition		
Restructuring of customer-facing outlets	6	1
Other restructuring projects	4	10
Balance at the end of the financial year	10	11
(b) Reconciliation of movements for the financial year		
Balance at the beginning of the financial year	11	29
Additions during the financial year	11	12
Settled during the financial year	(12)	(30)
Balance at the end of the financial year	10	11

All of the provision outstanding at the reporting date is expected to be settled within twelve months (2005 – \$11 million).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 23. INTEREST-BEARING LIABILITIES

		PARENT		CONSOLIDATED	
	Notes	2006 \$m	2005 \$m	2006 \$m	2005 \$m
(a) Composition					
Unsecured					
NZ senior term notes	(c)(i)	–	–	41	91
Subordinated term notes	(c)(ii)	–	–	299	299
US subordinated term notes	(c)(iii)	–	–	323	315
Derivatives related to US subordinated term notes	(c)(iii)	–	–	95	88
Reset preference shares	(c)(iv)	550	–	550	–
Perpetual subordinated loan	(c)(v)	–	–	2	2
Less: capitalised transaction costs		(3)	–	(14)	(16)
		547	–	1,296	779

The carrying value of interest-bearing liabilities (gross, without deducting transaction costs) includes \$1,310 million (2005 – \$749 million) for the Consolidated entity and \$550 million (2005 – \$Nil) for the Parent, which is expected to be settled after more than twelve months from reporting date. Other than the reset preference shares, the liabilities are unable to be traded in markets in a standardised form.

(b) Reconciliation of movements for the financial year

Balance at the end of the previous financial year	–	–	779	786
AIFRS transition adjustments				
– Reclassification of reset preference shares*	550	–	550	–
– Reclassification of capitalised transaction costs*	(11)	–	(11)	–
– Cumulative amortisation of capitalised transaction costs*	6	–	6	–
– Fair value transition adjustment for cash flow hedge*	–	–	7	–
Balance at the beginning of the financial year	545	–	1,331	786
Foreign exchange movement on US subordinated term notes	–	–	8	(30)
Foreign exchange movement on cash flow hedge	–	–	(8)	32
Other fair value movement on cash flow hedge	–	–	7	–
Repayment of tranche of NZ senior term notes	–	–	(46)	–
Foreign exchange movement on NZ senior term notes	–	–	(4)	–
Transaction costs capitalised during the financial year	–	–	–	(12)
Amortisation of capitalised transaction costs	2	–	7	3
Other foreign exchange movements	–	–	1	–
Balance at the end of the financial year	547	–	1,296	779

* These reconciliation adjustments arose from the election to not restate comparatives for certain accounting standards as allowed upon first time adoption of AIFRS. Refer to note 38 for further details.

The transaction costs capitalised during the year to 30 June 2005 of \$12 million relate to the issuance of the reset exchangeable securities which are held off balance sheet and so not included in interest-bearing liabilities (refer note 1(ff) for further details).

(c) Significant terms and conditions

- The NZ senior term notes were issued through IAG (NZ) Holdings Limited's medium-term note programme. NZ\$100 million of notes were issued at a discount, with NZ\$50 million that matured and was fully repaid in August 2005 and NZ\$50 million to mature in August 2008. They are fixed rate notes (7.25% payable semi-annually) with the principal and interest flows denominated in New Zealand dollars. Amounts are translated into the equivalent Australian dollars using the reporting date exchange rate. The primary difference between the Australian dollar equivalent of the face value of the notes at inception and the carrying value is due to foreign exchange rate movements.
- The subordinated term notes have a face value of \$300 million and were issued at a discount through Insurance Australia Limited's debt issuance programme with \$250 million at a fixed rate and \$50 million at a floating rate. The notes mature in November 2012, however, they may be redeemed at par at the issuer's option from November 2007 onwards, subject to the approval of APRA. If the notes are not redeemed in November 2007, all notes become floating rate notes with an interest rate of the three month Bank Bill Swap Rate plus a margin of 1.58% per annum. The notes qualify as Lower Tier 2 capital for the purposes of Insurance Australia Limited's APRA regulatory capital position.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

(iii) The US subordinated term notes have a face value of US\$240 million and were issued at par by NRMA Insurance Funding 2003 Limited (a wholly-owned subsidiary of Insurance Australia Limited). They are fixed rate notes (5.19% payable semi-annually) with the principal and interest flows denominated in US dollars, which are hedged with cross currency swaps and interest rate swaps. Cash flow hedge accounting is applied for this hedge arrangement (refer note 35 for further information). The notes mature in April 2015, however, they may be redeemed at par at the issuer's option from April 2010 onwards, subject to the approval of APRA. If the notes are not redeemed in April 2010, all notes become floating rate notes with an interest rate of the three month London Inter-Bank Offer Rate plus a margin of 2.04% per annum. The notes qualify as Lower Tier 2 capital for the purposes of Insurance Australia Limited's APRA regulatory capital position.

(iv) The reset preference shares ("RPS") are a hybrid security with characteristics of both debt and equity. The securities were issued in two tranches referred to as IAGPA (issued June 2002) and IAGPB (issued June 2003) with the first reset date for each tranche being 15 June 2007 and 15 June 2008 respectively. IAG may, prior to any reset date, make changes to certain terms (such as the next reset date, the market rate, the margin and the frequency and timing of the dividend payment dates) which will apply from the day after the relevant reset date. The RPS rank in priority to ordinary shares for the payment of dividends and in the event of a winding up. In a winding up, all RPS will rank equally for return of capital behind all other creditors of IAG, and ahead of ordinary shares. The RPS do not carry voting rights at general meetings, except in limited circumstances.

The RPS entitle the holder to a preferred, but not cumulative, distribution (currently 5.8% per annum for IAGPA and 4.51% per annum for IAGPB). The distributions are payable semi-annually in arrears on 15 December and 15 June and are able to be franked. The distributions are expected to be fully franked and if a distribution is unfranked or partially franked, the distribution will be increased to compensate for the unfranked component. Because of the hybrid nature of the securities, distributions on the RPS are not the same as interest payments and may not always be paid, as there are a number of conditions that must be met before a distribution can be paid. If distributions are not paid on the RPS, no dividends can be paid and no returns of capital can be made on ordinary shares unless IAG takes certain actions.

The RPS may be exchanged by IAG or the holder on a reset date, by the holder upon a specified trigger event (such as change in control of IAG by a takeover bid), or by IAG on a tax event (such as a more than insignificant increase in taxation costs), regulatory event (such as not all of the RPS being entitled to be treated as Tier 1 capital for regulatory reporting purposes) or following certain takeovers or schemes of arrangements. While the holder may initiate an exchange, IAG is able to select the method of exchange being either conversion into ordinary shares, arranging for a third party to acquire the shares for their face value, or to redeem, buy-back or cancel the shares (subject to APRA approval). The RPS convert into ordinary shares that would rank equally in all respects with all other ordinary shares. All conversions into ordinary shares, other than a holder requesting conversion on a reset date, will receive a discount of 2.5% of the ordinary share price used in calculating the number of ordinary shares to be issued on conversion.

(v) The perpetual subordinated loan is between Mutual Community General Insurance Proprietary Limited, a non-wholly owned subsidiary, and the minority interest equity holder in that company. The loan bears a fixed rate of interest.

CONSOLIDATED					
		FACILITIES DRAWN AT REPORTING DATE		FACILITIES AVAILABLE	
	Notes	2006 \$m	2005 \$m	2006 \$m	2005 \$m
(d) Financing arrangements					
Standby letter of credit facilities	(i)	67	2	74	7
Standby facility	(ii)	–	–	30	30
Debt issuance programme	(iii)	299	299	750	750
NZ medium-term note programme	(iv)	41	91	41	91

Various entities within the Consolidated entity have facilities outstanding with external service providers, mostly banks, providing short term financing arrangements for specific situations including standby letters of credit, and guarantees for lease guarantees and performance bonds.

Notes:

- (i) The standby letter of credit facilities are denominated in US dollars and are translated into equivalent Australian dollars using the reporting date exchange rate.
- (ii) The standby facility is for liquidity support in the event that Insurance Australia Limited is unable to refinance maturing obligations under the debt issuance programme due to a market disturbance. Interest on this standby facility when drawn down is charged at a margin over the bank bill rate.
- (iii) Insurance Australia Limited has a \$750 million debt issuance programme. Standard & Poor's has assigned its "AA" long-term and "A-1+" short-term ratings to the programme's senior obligations and "AA-" to its subordinated notes. Insurance Australia Limited is rated "AA" for its insurer financial strength and counterparty credit ratings.
- (iv) IAG (NZ) Holdings Limited has a NZ\$50 million medium-term note programme (2005 – NZ\$100 million). Standard & Poor's has assigned a "AA" long-term rating to the guaranteed and unsubordinated series of wholesale notes issued under the programme. The programme is guaranteed by Insurance Australia Limited. This programme is denominated in New Zealand dollars and is translated into equivalent Australian dollars using the reporting date exchange rate. Exchange rate movements are recognised in the foreign currency translation reserve.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 24. RECONCILIATION OF TOTAL EQUITY

	PARENT		CONSOLIDATED	
	2006 Number of shares million	2005 Number of shares million	2006 \$m	2005 \$m
(a) Share capital				
<i>Ordinary shares</i>				
Balance at the beginning of the financial year	1,594	1,591	3,263	3,263
Shares issued under Performance Share Rights Plan	1	3	–	–
Balance at the end of the financial year	1,595	1,594	3,263	3,263
<i>Reset preference shares</i>				
Balance at the end of the previous financial year	6	6	539	539
AIFRS transition adjustments at 1 July 2005				
– Reclassification of reset preference shares ^{(e)(i)}	(6)	–	(550)	–
– Reclassification of capitalised transaction costs ^{(e)(i)}	–	–	11	–
Balance at the beginning and end of the financial year	–	6	–	539
Total share capital at the end of the financial year	1,595	1,600	3,263	3,802

	PARENT		CONSOLIDATED	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m
(a) Share capital (refer above)	3,263	3,802	3,263	3,802
(b) Treasury shares held in trust				
Balance at the beginning of the financial year	–	–	(34)	(21)
Acquisition of shares	–	–	(19)	(13)
Shares vested and / or released to participants	–	–	13	–*
Balance at the end of the financial year	–	–	(40)	(34)
(c) Reserves				
<i>Foreign currency translation reserve</i>				
Balance at the beginning of the financial year	–	–	(6)	(5)
Net exchange difference on translation of foreign operations	–	–	(18)	(1)
Hedge of net investment in a subsidiary	–	–	9	–
Balance at the end of the financial year	–	–	(15)	(6)
<i>Share based remuneration reserve</i>				
Balance at the beginning of the financial year	–	–	13	5
Charged to profit for the year	–	–	19	8
Transfers from the reserve upon vesting of rights / shares	–	–	(13)	–
Balance at the end of the financial year	–	–	19	13
<i>Hedging reserve</i>				
Balance at the end of the previous financial year	–	–	–	–
AIFRS transition adjustments at 1 July 2005	–	–	(5)	–
– Recognition of cash flow hedges, net of tax ^{(e)(i)}	–	–	(5)	–
Balance at the beginning of the financial year	–	–	(5)	–
Net movements in fair value of derivatives forming hedge	–	–	1	–
Net movements in fair value recycled to profit	–	–	(8)	–
Net tax impact on movements	–	–	2	–
Balance at the end of the financial year	–	–	(10)	–
<i>Other reserve</i>				
Balance at the beginning of the financial year	–	–	–	–
Additions during the year	–	–	–*	–
Balance at the end of the financial year	–	–	–*	–
Total reserves	–	–	(6)	7

* Rounds to zero.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

	PARENT		CONSOLIDATED	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m
(d) Retained earnings				
Balance at the end of previous financial year	638	493	142	(227)
Net total AIFRS transition adjustments (refer to note 38)	(7)	–	(5)	–
Adjustment for Safety Insurance at 1 July 2005	–	–	5	–
Balance at the beginning of the financial year	631	493	142	(227)
Profit attributable to equity holders of the Parent	702	587	759	811
Actuarial gains / (losses) on defined benefit plans, net of tax	–	–	21	–*
Vesting of share based remuneration	–	–	(1)	–
Dividends declared and paid ^{(e)(ii)}	(647)	(442)	(647)	(442)
Balance at the end of the financial year	686	638	274	142
Parent interest	3,949	4,440	3,491	3,917
(e) Minority interests				
Balance at the end of previous financial year	–	–	586	689
AIFRS transition adjustments				
– Reclassification of minority interests in unitholders' funds ^{(e)(ii)}	–	–	(421)	–
– Net impact of other AIFRS transition adjustments	–	–	(1)	–
Balance at the beginning of the financial year	–	–	164	689
Profit attributable to minority interests	–	–	103	117
Distributions to minority interests	–	–	(89)	(120)
Other movements in unitholders' funds	–	–	–	(100)
Business combination	–	–	2	–
Balance at the end of the financial year	–	–	180	586
Minority interests comprising:				
– Share capital	–	–	126	124
– Retained earnings	–	–	54	41
– Foreign currency translation reserve	–	–	–*	–
– Unitholders' funds	–	–	–	421
Minority interests	–	–	180	586
Total equity	3,949	4,440	3,671	4,503

* Rounds to zero.

(i) These reconciliation adjustments arose from the election to not restate comparatives for certain accounting standards as allowed upon first time adoption of AIFRS. Refer to note 38 for further details.

(ii) Prior to 1 July 2005 the distributions on reset preference shares were included as dividends. From 1 July 2005 onwards the distributions are treated as finance costs and in this reconciliation are included in profit attributable to equity holders of the Parent. Refer to note 38 for further details. Refer to note 23 for further details regarding the instruments.

(f) Notes to sections (a) to (e) above

(i) Share capital

All ordinary shares on issue are fully paid and have no par value (the concepts of authorised capital and par value have been abolished under Australian law). Ordinary shares entitle the holder to a vote at a general meeting of the Company and to participate in the dividends and the proceeds on winding up the Company in proportion to the number of, and amounts paid on, the shares held. Dividends, if declared, are subject to there being distributable profits available and not breaching APRA capital adequacy requirements. Reset preference shares rank before ordinary shares in the event of the Parent being wound up and distributions on reset preference shares are paid in priority to any dividends on ordinary shares.

(ii) Treasury shares held in trust

Share based remuneration is provided in different forms to eligible employees and directors. To satisfy obligations under the various share based remuneration plans, shares are generally bought on-market at or near grant date of the relevant arrangement and held in trust. Upon consolidation of the trusts, the shares held are recognised as treasury shares held in trust, as described in note 1(ee). The balance of treasury shares held in trust at a reporting date represents the cumulative cost of acquiring IAG shares that have not yet been distributed to employees as share based remuneration.

(iii) Nature and purpose of reserves

Foreign currency translation reserve

The foreign currency translation reserve records the foreign currency differences arising from the translation of the financial position and performance of subsidiaries that have a functional currency other than Australian dollars.

Hedging reserve

The hedging reserve is used to record gains or losses on derivatives that form part of hedging relationships which have been designated as cash flows hedges or net investment hedges, as described in note 1(q).

Share based remuneration reserve

The share based remuneration reserve is used to recognise the fair value at grant date of equity-settled share based remuneration provided to employees and directors over the vesting period, as described in note 1(z).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 24. RECONCILIATION OF TOTAL EQUITY (CONTINUED)

(f) Notes to sections (a) to (e) above (continued)

(iii) Nature and purpose of reserves (continued)

Other reserve

Some of the overseas subsidiaries are required for various regulatory and legal purposes to set aside reserves from their retained earnings. These reserves are not able to be used in the normal course of business.

(iv) Minority interests

Minority interests represent the proportion of equity holders' equity that is attributable to minority shareholders. Minority interests relates to Insurance Manufacturers of Australia Pty Limited (Australia), World Class Accident Repairs (Cheltenham North) Pty Limited (Australia), Mutual Community General Insurance Proprietary Limited (Australia), Mike Henry Travel Insurance Limited (New Zealand), NHCT Limited (Thailand), and Safety Insurance Public Company Limited (Thailand). Prior to 1 July 2005, minority interests also related to IAG Asset Management Cash Management Trust, IAG Asset Management Private Equity Trust, and IAG Asset Management Fund of Hedge Fund, however the third party interest in those trusts is now presented as a liability on the balance sheet. The change in treatment arose from the election to not restate comparatives for certain accounting standards as allowed upon first time adoption of AIFRS. Refer to note 38 for further details.

NOTE 25. NOTES TO THE CASH FLOW STATEMENTS

	PARENT		CONSOLIDATED	
	2006 \$m	2005 \$m	2006 \$m	2005 \$m
(a) Composition				
Cash and cash equivalents	1	1	718	456
Cash and cash equivalents comprises cash at bank and on hand and short term deposits. The net carrying amount of cash and cash equivalents is equivalent to the fair value of the assets because of the negligible credit risk and frequent repricing. There are no cash balances held that are not available for use in normal operations.				
The carrying amount of the cash and cash equivalents presented on the balance sheet is the same as that used for the purposes of the cash flow statements as there are no bank overdrafts used which are repayable upon demand.				
(b) Reconciliation of profit for the year to net cash flows from operating activities				
Profit for the year	702	587	862	928
Depreciation of property, plant and equipment	–	–	47	35
Amortisation of intangibles	–	–	8	13
Realised gains on disposal of investments	–	–	(148)	(221)
Unrealised gains on revaluation of investments	–	–	(295)	(344)
Loss on disposal of property, plant and equipment	–	–	4	–
Foreign exchange (gains) and losses	–	–	34	27
Provision for impairment	–	–	1	1
Other	2	–	31	(21)
Decrease / (increase) in operating assets:				
Premium and other receivables	58	(73)	155	(252)
Prepayments and deferred levies and expenses	–	–	(4)	(67)
Deferred tax assets	(1)	7	(18)	(86)
Increase / (decrease) in operating liabilities:				
Trade and other payables	12	(140)	(77)	74
Provisions	–	–	(9)	78
Current tax liabilities	(77)	(3)	(117)	(29)
Deferred tax liabilities	–	53	16	160
Outstanding claims liability	–	–	43	511
Unearned premium liability	–	–	(146)	114
Net cash flows from operating activities	696	431	387	921

(c) Significant non-cash transactions relating to financing and investing transactions

There were no financing or investing transactions during the year which have had a material effect on the assets and liabilities that did not involve cash flows.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 26. ACQUISITIONS AND DISPOSALS OF BUSINESSES

There were no acquisitions or disposals of businesses by the Parent during the year (2005 – none). The following acquisitions and disposals of businesses relate to the Consolidated entity.

2006

(a) Acquisition of subsidiaries

(i) Acquisition of a Thailand based general insurance business

The Consolidated entity acquired all of the ordinary shares in IAG Insurance (Thailand) Ltd (“IAG Thailand”) (formerly Royal and Sun Insurance Alliance (Thailand) Ltd) effective 4 July 2005. This subsidiary is involved in general insurance underwriting in Thailand.

The key changes made to bring the financial report of IAG Thailand prepared in accordance with Thai GAAP in line with the significant accounting policies of the Consolidated entity related to an analysis of all insurance products on offer to confirm the status as insurance contracts, the measurement of all investments at fair value through profit or loss, and the alignment of reserving policies. After those adjustments were made, there were no significant fair value adjustments required.

(ii) Acquisition of a further interest in a Thailand based listed general insurance business

On 10 February 2006, an additional 16.7% interest was acquired in Safety Insurance Public Company Limited (“Safety Insurance”) taking the then 21.6% shareholding to 38.3%. A general tender offer to all Safety Insurance shareholders was subsequently lodged at the end of February 2006. The tender closed on 27 March 2006 with the Consolidated entity holding 96.09% of the voting share capital. The entity has been deemed to be a subsidiary from 31 March 2006.

Safety Insurance, which has been listed on the Stock Exchange of Thailand since 1977, is Thailand’s 7th largest general insurer and 6th largest motor insurer and currently generates approximately A\$100 million in gross written premium per annum. Providing predominantly motor insurance, as well as fire, marine and other general insurance, Safety Insurance distributes its products through insurance agents and brokers, as well as selling direct to customers.

The key changes made to bring the financial report of Safety Insurance prepared in accordance with Thai GAAP to comply with the significant accounting policies of the Consolidated entity related to an analysis of all insurance products on offer to confirm the status as insurance contracts, the measurement of all investments at fair value through profit or loss, and the alignment of reserving policies. After those adjustments were made, there were no significant fair value adjustments required.

(iii) Acquisition of a specialist New Zealand underwriter

On 3 May 2006 IAG New Zealand Limited acquired a 51% share of Driveright Limited, a specialist underwriter of mechanical breakdown insurance in New Zealand, with a contractual obligation, subject to certain criteria being satisfied, to acquire the remaining 49% on or before 31 August 2008.

Details of the 2006 acquisitions of subsidiaries are as follows:

	CONSOLIDATED		
	Driveright \$m	Safety Insurance \$m	IAG Insurance (Thailand) \$m
Purchase price:			
Cash paid	4	68	34
Costs directly associated with acquisition	–	2	2
Total purchase consideration	4	70	36
Fair value of net identifiable assets acquired:			
Cash and cash equivalents	2	10	6
Investments	–	107	18
Receivables	–	30	22
Deferred acquisition costs	–	–	1
Property, plant and equipment	–	9	1
Deferred tax assets	–	8	–
Payables	(1)	(19)	(18)
Current tax liabilities	–	(3)	(1)
Unearned premium liability	–	(58)	(5)
Outstanding claims liability	–	(30)	(14)
Less: minority interests	–	(2)	–
Less: transfer of associate to subsidiary	–	(11)	–
Net identifiable assets acquired during the financial year	1	41	10
Goodwill*	3	29	21
Intangible	–	–	5
	3	29	26

* The goodwill on Safety Insurance includes the goodwill amount on the first acquisition in 1998 (which rounded to zero).

The goodwill is attributable to the synergies expected to arise after the acquisition. The fair value of assets and liabilities are based on discounted cash flow models. No restructuring provisions were created. In addition to the intangible assets recognised and disclosed in the table above, there are other intangible benefits that have been acquired as part of the transactions. These benefits have not been recognised separately from goodwill because they were not separately recognisable and / or were not able to be reliably measured.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 26. ACQUISITIONS AND DISPOSALS OF BUSINESSES (CONTINUED)

(a) Acquisition of subsidiaries (continued)

(iii) Acquisition of a specialist New Zealand underwriter (continued)

The net cash flow in relation to the acquisitions is as follows:

	CONSOLIDATED		
	Driveright \$m	Safety Insurance \$m	IAG Insurance (Thailand) \$m
Cash consideration paid	4	70	36
Cash balance acquired	(2)	(10)	(6)
Net outflow of cash	2	60	30
Contribution from the acquired businesses (from date of acquisition):			
Income	–	28	37
Profit before income tax	–	1	1

The gross written premium and profit of the Consolidated entity for the year ended 30 June 2006 would have been higher by \$63 million and \$3 million respectively, had the subsidiaries acquired during the year been consolidated from the beginning of the financial year.

2005

During the year ended 30 June 2005 the consolidated entity made the following acquisitions:

- Mike Henry Travel Insurance Limited: 50.1% acquired on 6 July 2004 for \$4 million with a contractual obligation to purchase remaining equity on or before 1 July 2006;
- Clipper Club Underwriters Limited: 100% acquired on 1 January 2005 for \$1 million; and
- National Auto Club Underwriters Agency (NZ) Limited: 100% acquired on 1 January 2005 for \$6 million.

The total outlay for these acquisitions in 2005 (net of cash acquired) was \$7 million. As these acquisitions are not significant to the Consolidated entity no further disclosure is provided.

(b) Other acquisitions

(i) Acquisition of an interest in a Malaysian based composite insurance business

On 31 March 2006, the Consolidated entity acquired a 30% strategic stake in AmAssurance Berhad, a Malaysian based general and life insurer. Based on the annual report for the year ended 31 March 2006 prepared under Malaysian generally accepted accounting principles, AmAssurance Berhad had gross assets of RM1,783 million (approximately A\$653 million). The general insurance operations generate an annual gross written premium of RM438 million (approximately A\$161 million).

(ii) Lloyd's managing agency and specialist Asian syndicate

In June 2006, the Consolidated entity agreed to acquire a newly-formed Lloyd's managing agency and specialist Asian syndicate to support the development and management of its expanding Asian business. The businesses operate as Alba Group Pte Limited and have been newly established. The syndicate has access to all markets in which Lloyd's is licensed. The terms of the acquisition are confidential but neither the purchase price nor the capital required in the first two years from completion is material to the Consolidated entity. A letter of credit was issued in support of the Consolidated entity's participation. The terms of the acquisition are subject to final regulatory approval from the relevant regulatory authorities in Singapore and the United Kingdom.

(c) Disposals of subsidiaries

During the year the Consolidated entity disposed of New Zealand Car Parts Limited. As this disposal was not significant to the consolidated entity no further disclosure is provided.

There were no disposals of businesses by the Consolidated entity during the year ended 30 June 2005.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 27. DETAILS OF SUBSIDIARIES

The following entities constitute the Consolidated entity:

			EXTENT OF BENEFICIAL INTEREST IF NOT 100%	
	Notes	Country of incorporation / formation	2006 %	2005 %
Ultimate parent				
Insurance Australia Group Limited		Australia	n/a	n/a
Subsidiaries				
<i>Australian general insurance operations</i>				
Insurance Australia Limited		Australia		
NRMA Personal Lines Holdings Pty Limited		Australia		
Insurance Manufacturers of Australia Pty Limited		Australia	70.00	70.00
World Class Accident Repairs (Cheltenham North) Pty Limited		Australia	70.00	70.00
CGU Insurance Australia Limited		Australia		
CGU Insurance Limited		Australia		
Swann Insurance (Aust) Pty Ltd		Australia		
Mutual Community General Insurance Proprietary Limited		Australia	51.00	51.00
NZI Insurance Australia Limited		Australia		
Sitrof Australia Limited		Australia		
CGU-VACC Insurance Limited		Australia		
CGU Workers Compensation (NSW) Limited		Australia		
CGU Workers Compensation (VIC) Limited		Australia		
CGU Workers Compensation (SA) Limited		Australia		
CGU Premium Funding Pty Ltd		Australia		
<i>International operations</i>				
IAG International Pty Limited		Australia		
IAG (NZ) Holdings Limited	C	New Zealand		
IAG New Zealand Limited	C,F	New Zealand		
Mike Henry Travel Insurance Limited	C	New Zealand	50.10	50.10
National Auto Club Underwriters Agency (NZ) Limited	C	New Zealand		
Clipper Club Underwriters Limited	C	New Zealand		
Driveright Limited	B	New Zealand	51.00	–
New Zealand Insurance Limited	C	New Zealand		
State Insurance Limited	C	New Zealand		
Direct Insurance Services Limited	C	New Zealand		
Swann Insurance (NZ) Limited	C	New Zealand		
IAG (NZ) Share Plan Nominee Limited	C	New Zealand		
The IAG New Zealand Limited Employee Share Plan	C,E	New Zealand		
The IAG Performance Awards Rights Plan for Executives in New Zealand	C,E	New Zealand		
NZI Staff Superannuation Fund Nominees Limited	C	New Zealand		
Belves Investments Limited	C	New Zealand		
IAG Re Limited	C	Ireland		
IAG (Asia) General Pte Ltd	C	Singapore		–
IAG (Asia) Services Pte Ltd	C	Singapore		–
IAG (Asia) Holdings Pte Ltd	C	Singapore		–
NHCT Limited	(ii), C	Thailand	49.00	49.00
IAG Insurance (Thailand) Ltd	(iii), C,D	Thailand		
Safety Insurance Public Company Limited	(iv), B,D	Thailand	96.09	21.60
IAG Re Labuan (L) Berhad	C	Malaysia		
Beijing Continental Automobile Association Limited	C,D	China		
IAG China (Mauritius)	C	Mauritius		–
China Investments (Mauritius)	C	Mauritius		–

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 27. DETAILS OF SUBSIDIARIES (CONTINUED)

		EXTENT OF BENEFICIAL INTEREST IF NOT 100%	
	Notes	Country of incorporation / formation	
		2006 %	2005 %
Subsidiaries (continued)			
<i>Investment operations</i>			
IAG Asset Management Limited		Australia	
IAG Nominees Pty Limited		Australia	
IAG Portfolio Limited		Australia	
IAG Asset Management Cash Management Trust	(i)	Australia	62.30
IAG Asset Management Private Equity Trust	(i)	Australia	83.18
IAG Asset Management Fund of Hedge Funds	(i)	Australia	72.54
<i>Corporate operations</i>			
NRMA Information Services Pty Limited		Australia	82.85
NRMA Insurance Funding 2003 Limited		Australia	
IAG Finance (New Zealand) Limited		Australia	
Insurance Australia Group Services Pty Limited		Australia	
IAG & NRMA Superannuation Pty Limited	A	Australia	
IAG Share Plan Nominee Pty Limited	A	Australia	
The IAG Share and Performance Award Rights Plan Trust	E	Australia	
ACN 007 078 140 Pty Limited	A	Australia	
<i>Subsidiaries that commenced deregistration after the year ended 30 June 2006</i>			
Sitrof Life Holdings Limited		Australia	
Sitrof Superannuation Pty Ltd		Australia	
<i>Subsidiaries that commenced deregistration during the year ended 30 June 2006</i>			
SWAPL Pty Limited	A	Australia	
<i>Entities de-registered during the year ended 30 June 2006</i>			
ACN 069 065 158 Pty Limited	A	Australia	—
<i>Entities disposed of during the year ended 30 June 2006</i>			
New Zealand Car Parts Limited	C	New Zealand	—

General notes relating to a number of subsidiaries

- A Small proprietary companies that are not required to prepare, and have not prepared, audited financial statements.
- B Audited by accounting firms not affiliated with KPMG.
- C Audited by overseas KPMG firms.
- D All subsidiaries have a 30 June financial year end, except these companies which have a 31 December year end. These entities have been consolidated using financial information as at 30 June.
- E These entities have been deemed to be controlled for the first time under AIFRS. Refer note 38.
- F All subsidiaries have only ordinary shares on issue except this entity also has perpetual preference shares on issue.

The following special conditions exist with respect to certain subsidiaries

- (i) As at the reporting date, the Consolidated entity has a majority holding, is the Responsible Entity for, and has the capacity to control, IAG Asset Management Cash Management Trust, IAG Asset Management Private Equity Trust and IAG Asset Management Fund of Hedge Funds.
- (ii) IAG International Pty Limited owns 49% of the share capital of NHCT Limited and has a majority voting right and the right to appoint the board of directors of NHCT Limited. Therefore, NHCT Limited is considered a subsidiary of IAG International Pty Limited. The remaining 51% is held by Allessi Capital Co., Ltd, a company registered in Thailand.
- (iii) IAG International Pty Limited owns 25% directly in IAG Insurance (Thailand) Ltd and is able to govern the financial and operating policies of the company through a further 75% interest held indirectly through its holding in NHCT Limited.
- (iv) During the year, a controlling interest was acquired in Safety Insurance Public Company Limited. For the comparative period, a strategic investment was held in the company of 21.6% of the issued capital carrying voting rights.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 28. DETAILS OF JOINT VENTURES AND ASSOCIATES

		REPORTING DATE	COUNTRY OF FORMATION	CARRYING VALUE	PRINCIPAL ACTIVITY	OWNERSHIP INTEREST	
Notes				2006 \$m		2006 %	2005 %
(a) Interests in the joint ventures and associates							
Joint venture							
NTI Limited	(i), A,C	31 December	Australia	2	Managing co-insurance arrangement	50.00	50.00
Associates							
AmAssurance Berhad	C	31 March	Malaysia	71	Insurance underwriting	30.00	–
First Rescue and Emergency (NZ) Limited	A,C	31 March	New Zealand	1	Roadside assistance	50.00	50.00
Loyalty New Zealand Limited	A,C	31 March	New Zealand	–*	Loyalty programme	25.00	25.00
Sureplan NZ Limited	A,C	31 March	New Zealand	–*	Fleet risk management	30.00	30.00
AR Hub Pty Ltd	A,B	30 June	Australia	–*	Software development	33.33	33.33
				74			

* Amounts round to zero.

General notes relating to a number of joint ventures and associates

- A Investment is measured at cost in the Consolidated entity due to materiality.
- B Small proprietary companies that are not required to prepare, and have not prepared, audited financial statements.
- C Audited by accounting firms not affiliated with KPMG.

None of the associates are listed on a stock exchange. Those entities that are equity accounted and that do not have a 30 June financial year end are equity accounted for using financial information for the year to 30 June which includes, at least in part, unaudited management results.

The following special conditions exist with respect to the joint venture

- (i) CGU Insurance Limited, a subsidiary of the Consolidated entity, has a 50% interest in NTI Limited, the principal activity of which is to facilitate a co-insurance arrangement of commercial motor vehicle business. The Consolidated entity's portion of the results of the co-insurance arrangement is recorded directly in its accounting records

	CONSOLIDATED	
	2006 \$m	2005 \$m
(b) Reconciliation of movements in investment in joint ventures and associates for the financial year		
Balance at the beginning of the financial year	8	8
Adjustment for Safety Insurance at 1 July 2005	5	–
Balance at the beginning of the financial year	13	8
Investment in associate acquired during the financial year	73	–
Share of associate's net profit	2	–
Associate transferred to subsidiary	(11)	–
Foreign currency exchange movements	(3)	–
Balance at the end of the financial year	74	8
(c) Share of associate's profit for the financial year		
Profit before and after income tax	2	–

The following disclosures relate only to the investment in AmAssurance, as all other investments in joint ventures and associates are not significant.

(d) Summarised financial information of associate

These disclosures relate only to the investment in AmAssurance, as all other investments in joint ventures and associates are not significant.

Assets	653	–
Liabilities	590	–
Revenue*	317	–
Profit*	14	–

* These amounts are for the year ended 31 March 2006, being the financial year of AmAssurance, and not the period during which the entity was an associate. These amounts have been extracted from the audited financial report of AmAssurance.

(e) Commitments and contingent liabilities

There are no capital or other commitments or contingent liabilities arising from the investment in AmAssurance that are significant to the Consolidated entity.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 29. EMPLOYEE BENEFITS

	Note	CONSOLIDATED	
		2006 \$m	2005 \$m
(a) Employee benefits provision			
Annual leave		75	70
Long service leave		56	49
Cash based incentive arrangements		72	74
Defined benefit pensions ⁽ⁱ⁾		11	13
Defined benefit superannuation plans ⁽ⁱⁱ⁾	31	(7)	23
		207	229

(i) There is one defined benefit pension arrangement in Australia with a discounted liability as at 30 June 2006 of \$8 million (2005 – \$9 million) involving 86 participants (2005 – 93), and one defined benefit pension arrangement in New Zealand with a discounted liability as at 30 June 2006 of \$3 million (2005 – \$4 million) involving 52 participants (2005 – 55). These liabilities are met from the general assets of the relevant entities rather than assets being set aside in trust. Further details are not disclosed, as the financial impact of these arrangements is not significant to the Consolidated entity.

(ii) The 30 June 2006 amount for defined benefit superannuation plans represents an asset that should be presented separately on the balance sheet but is included here to align with the presentation of the comparative as the amount is not significant.

The carrying value of employee benefits includes \$38 million (2005 – \$67 million) which is expected to be settled after more than twelve months from reporting date.

(b) Employee numbers

The Consolidated entity had 12,093 employees on full time equivalent basis as at 30 June 2006 (2005 – 11,502).

(c) Cash based incentive arrangements

(i) Short-term incentive plan

The short-term incentive plan continued in operation during the year ended 30 June 2006. Eligible employees have the capacity to earn a proportion of their base pay (generally up to 10%, 15%, 20%, 30% or 45%) depending on an employee's role and responsibilities, as a cash incentive annually. The incentive payments are determined based on a range of corporate, divisional and individual measures and goals.

Employees, with maximum incentives of 20% and over, may elect to receive up to a maximum of 50% of their short-term incentive plan benefit in the form of IAG shares rather than cash through the related bonus equity share plan. The plan facilitates the voluntary election to receive part of a bonus in the form of IAG shares and does not represent an additional remuneration benefit to the employee. The acquisition of the shares is funded by the participating employee's remuneration. There are no vesting conditions attached to the shares provided, there are limited forfeiture conditions, and they carry full dividend entitlements and voting rights from the time of allocation. The shares are purchased on market and held in trust subject to a restriction period for tax purposes of between one and ten years (nominated by the participating employee) or until such time as the participating employee ceases relevant employment, whichever is earlier, after which they are released to the employee.

(ii) IMA long-term incentive scheme

A long-term incentive is provided to relevant Insurance Manufacturers of Australia Pty Limited ("IMA") personnel split evenly between two components. One component comprises an equity settled share based payment through the performance award rights plan (refer note 30(a)). The other component is a cash based incentive arrangement involving a hurdle relating to compound growth in the IMA underwriting result. Each participant may elect to receive the cash based incentive payment, if any, in the form of cash, superannuation contributions, or a combination of these.

NOTE 30. SHARE BASED REMUNERATION

The provision of share based remuneration creates a link between shareholder value creation, financial performance and rewarding employees. Share based remuneration encourages employee share ownership, links employee reward to the performance of the IAG Group and assists with retention of key personnel. This type of remuneration aims to focus performance so that over the longer term shareholder value will increase.

The obligations under share based payment arrangements are covered by the on-market purchase of IAG ordinary shares which are held in trust. The shares are purchased on or near grant date at the prevailing market price. The arrangements are managed using in-house trusts, one for Australia and two for New Zealand, which are controlled for accounting purposes and so are subsidiaries of the Consolidated entity. The trustee for each trust is a subsidiary of the Consolidated entity. The trusts are administered by an external company.

The number of shares purchased to cover each tranche is determined by the trustee based on independent actuarial advice. The trusts allow for excess shares purchased in relation to one plan to be used to meet obligations of the other plans at the trustee's discretion. The trusts held 9,399,771 shares as at 30 June 2006 (2005 – 9,090,114 shares) representing 0.59% (2005 – 0.57%) of the share capital. This includes shares that are not controlled for accounting purposes and so not recognised as treasury shares.

Trading in IAG shares that are awarded under the share based remuneration arrangements is covered by the same restrictions that apply to all forms of share ownership by employees. These restrictions limit an employee trading in IAG shares where they are in a position to be aware, or are aware, of price sensitive information.

Share based remuneration is provided through three different plans each of which have different purposes and different rules. A further plan, the Performance Share Rights Plan (refer below), closed for further new rights issues during the year ended 30 June 2003 and had an insignificant impact on the current financial year. The share based remuneration expense amounts are included in the claims expense, other underwriting expenses, and corporate, administration and other expenses lines in the income statement.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

(a) Performance award rights ("PARs") plan

The PARs Plan continued in operation during the year ended 30 June 2006. There are effectively two plans in operation, one for Australia and one for New Zealand, however the structure of the plans is the same. The rights are granted for nil consideration, are non-transferable, and can be settled only with existing IAG shares. Where the rights vest (the holder becomes entitled to exercise the right), the plan entitles participating employees to acquire one IAG ordinary share for each right. The exercise price for all rights is a nominal value of \$1 per tranche of rights exercised. Holders do not receive dividends and do not have voting rights until the rights are exercised. IAG shares are bought on-market and held in trust to satisfy future exercise of the rights.

The rights may vest between three and five years (the performance period) from base date (calculation date selected for each tranche) subject to the satisfaction of two vesting conditions. The first vesting condition is not market related and requires the participant to continue in relevant employment. The second vesting condition is a market related performance hurdle based on a comparison of IAG's total shareholder return ("TSR", the measure of return on an investment in IAG ordinary shares) with the TSR of a peer group of companies in the S&P / ASX 100 index. The peer group includes insurers and non-insurers because the IAG Group competes for investment funds with a range of large listed companies across many industries. For the performance hurdle, a tiered vesting scale is applied, such that the percentage of allocated rights that vest increases proportionately as IAG's TSR performance increases from the 50th percentile to the 75th percentile of the peer group. Below the 50th percentile no rights vest while at or above the 75th percentile all of the rights vest. Testing for the satisfaction of the performance hurdle generally occurs quarterly during the performance period.

There are additional circumstances in which the rights may vest such as a takeover of IAG. If either of the vesting conditions is not met then the rights lapse. The rights also lapse where the holder chooses to forego the rights, and all rights expire ten years from grant date where they have not previously lapsed or been exercised.

The following information relates to rights issued under the PARs Plan:

Grant Date	Fair value at grant date	Rights on issue at beginning of year	Rights granted during year	Rights exercised during year	Rights lapsed during year	NUMBER OF RIGHTS AT END OF YEAR	
						On issue	Exercisable
24/12/2002	\$1.870	3,820,592	–	1,602,050	29,928	2,188,614	523,047
22/09/2003	\$2.840	4,008,978	–	–	95,509	3,913,469	–
10/12/2003	\$2.764	400,000	–	–	–	400,000	–
26/03/2004	\$3.287	948,758	–	–	6,972	941,786	–
17/09/2004	\$2.715	4,238,000	–	–	112,000	4,126,000	–
30/11/2004	\$2.718	905,500	–	–	–	905,500	–
30/03/2005	\$3.269	41,000	–	–	–	41,000	–
19/09/2005	\$3.187	–	4,561,500	–	61,500	4,500,000	–
30/11/2005	\$2.596	–	705,500	–	12,500	693,000	–
22/03/2006	\$3.145	–	189,000	–	–	189,000	–
		14,362,828	5,456,000	1,602,050	318,409	17,898,369	523,047

The fair value of the rights is calculated as at the grant date using the Monte Carlo valuation methodology. The valuations take into account the probability of achieving the market related performance hurdle. For those rights granted during the year to 30 June 2006, the following significant factors and assumptions were used:

Grant date	19/09/2005	30/11/2005	22/03/2006
Share price on grant date (\$)	\$5.42	\$5.25	\$5.43
Exercise price (\$)	\$1 per tranche exercised	\$1 per tranche exercised	\$1 per tranche exercised
Risk free interest rate (%)	5.63%	5.84%	5.74%
Expected share price volatility (%)	25%	25%	25%
Expected dividend yield (%)	4.98%	5.14%	5.16%
Expected life of rights (years)	3.962 years	3.884 years	3.518 years

Some of the assumptions, including expected share price volatility, are based on historical data which is not necessarily indicative of future trends. Reasonable changes in these assumptions would not have a material impact on the amounts recognised in the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 30. SHARE BASED REMUNERATION (CONTINUED)

(b) Performance share rights ("PSRs") plan

The PSRs plan was in operation from December 2000 and closed for further new rights issues during the year ended 30 June 2003. The following information relates to rights issued under the PSRs Plan:

Grant Date	Fair value at grant date	Rights on issue at beginning of year	Rights exercised during year	Rights lapsed during year	NUMBER OF RIGHTS AT END OF YEAR	
					On issue	Exercisable
21/12/2000	\$1.70	–	–	–	–	–
30/04/2001	\$1.67	336,600	211,600	20,000	105,000	105,000
02/08/2001	\$2.14	113,200	65,700	–	47,500	47,500
22/10/2001	\$1.84	–	–	–	–	–
13/12/2001	\$2.30	60,000	60,000	–	–	–
05/03/2002	\$2.68	306,017	306,017	–	–	–
15/07/2002	\$2.28	102,222	102,222	–	–	–
		918,039	745,539	20,000	152,500	152,500

Further details are not disclosed because the PSRs plan is a closed plan and the financial impact of this plan is not significant.

(c) Non-executive directors' share plan

The non-executive director's share plan continued in operation during the year ended 30 June 2006. Non-executive Directors are required to receive at least 20%, but not in excess of 90%, of their annual base fee (at the time shares are allocated) in IAG shares, rather than in cash. Annual share allocations are generally made effective from 1 December each year. The shares vest on a pro-rata daily basis with limited forfeiture conditions and the participant is entitled to dividends and other shareholder rights during the vesting period. The on-market share price at grant date is used as the fair value of the equity instruments granted which for those granted during the current reporting period was \$5.17. The shares are purchased on market and held in trust subject to a restriction period, for tax purposes, of between one and ten years. The number of shares purchased is determined by the amount of the base fee each Director is to receive in IAG shares, the weighted average market price of the shares at the date of allocation, and the trustee's discretion to use excess shares from another plan.

Further details are not disclosed as the financial impact of this plan is not significant.

(d) Employee share plans

There are employee share plan arrangements in place for both Australian and New Zealand employees. The employee share plans involve the granting of shares (sometimes restricted shares which are subject to a holding lock) to a substantial percentage of employees in both Australia and New Zealand, arranged through different trusts with different terms and conditions. New tranches were awarded for Australia and New Zealand in November 2005, with the previous arrangements having grant dates of 19 March 2001 for Australia and 11 October 2002 for New Zealand.

(i) Australia

During the year to 30 June 2006, a grant of 1,472,064 shares was made to 7,872 employees in Australia (187 shares to each participant). The grant date was 18 November 2005. Participation in the plan was open to employees that were not directors, that were not participants in the PARs Plan, that had completed at least twelve months service on a date set prior to the allocation date, and that remained in relevant employment on the allocation date being 18 November 2005.

The offer was predicated on exceeding a performance target based on IAG's total shareholder return for the 12 months to 30 June 2005. Eligible employees who accepted the offer received an allocation of IAG shares to the equivalent value of \$1,000 based on the volume weighted average price at which IAG shares traded on the Australian stock exchange for the week up to and including the allocation date. The tranche was designed to comply with the conditions set out in the Australian tax legislation which gives permanent employees the opportunity to acquire up to \$1,000 worth of shares at their tax market value in any one financial year as tax-exempt remuneration. Although the number of shares paid to each employee is determined by a cash amount, the payment is made in shares and is therefore treated as an equity settled share based payment.

The shares were granted for nil consideration. Shares granted under the plan vested immediately but remain held in trust on behalf of the participants subject to a restriction period of the earlier of three years from the allocation date or cessation of employment. The participants are entitled to dividends, which are paid directly to the participants, and other shareholder rights during the restriction period. The cost of acquiring the shares on-market in the days leading up to the grant was used as a proxy for the grant date fair value of the equity instruments.

Shares subscribed under this plan were purchased on-market. The full cost of purchasing the shares on-market of \$8 million (including brokerage) was recognised as an expense in the year to 30 June 2006.

Previous tranche

Under the previous tranche of the employee share plan for Australian employees, eligible employees received an allocation of IAG shares to the value of 5% of their total salary for no consideration. The grant date for the tranche was 19 March 2001. The restricted shares were subject to a two year vesting period which ended on 19 March 2003 and a further three year restriction period which ended on 19 March 2006. Shares were purchased in 2001 to support the tranche. All of the remaining shares were transferred from the plan during the current financial year upon expiry of the restriction period. There is no expense for this tranche relevant to the year ended 30 June 2006 (2005 – \$Nil) with previous expense allocations being based on an allocation of the cost to acquire the shares. The tranche will have no financial impact on future financial reporting periods.

(ii) New Zealand

During the year to 30 June 2006, a grant of 287,232 shares was made to 1,536 employees in New Zealand (187 shares to each participant). The grant date was 18 November 2005. The general terms of the offer are the same as the Australian tranche however because of the different taxation laws, the New Zealand tranche is subject to a 3 year vesting period. There remained in the plan 177,307 shares from the previous tranche which were able to be used for the current tranche and so only an additional 109,925 shares were purchased for the current tranche.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

Employees that cease relevant employment before completion of the vesting period forfeit any rights to the shares. Under certain circumstances such as retirement, death or permanent disability, the vesting period may be waived. Forfeited shares may be reallocated as part of a future approved offer or disposed of at the discretion of the trustee. Dividends received on forfeited shares may, at the trustee's discretion, be used to defray costs of administering the plan. Participants are entitled to dividends and full voting rights during the vesting period.

Previous tranche

Under the previous tranche of the employee share plan for New Zealand employees, eligible employees received an allocation of IAG shares to the value of NZ\$1,500, for nominal consideration of NZ\$1. The grant date for the tranche was 11 October 2002. The shares were subject to a three year vesting period which ended on 11 October 2005 and no subsequent restriction period. Shares were purchased in 2002 to support the tranche. The final shares for the tranche that vested were transferred from the plan during the current financial year with the remaining shares being used for the new tranche. The expense incurred for this tranche relevant to the year ended 30 June 2006 was \$Nil (2005 – \$0.5 million) based on an allocation of the cost to acquire the shares. The tranche will have no financial impact on future financial reporting periods.

NOTE 31. SUPERANNUATION

Contributions are made to a number of superannuation plans both in Australia and New Zealand. The majority of employees are defined contribution members with fewer than 8% (2005 – 9%) of employees participating on a defined benefit basis. Entry to defined benefit plans is closed and so all new employees are provided with defined contribution arrangements. The plans provide benefits for members or their dependants in the form of lump sum or pension payments generally upon ceasing relevant employment.

The superannuation expense for the year is included in the claims expense, other underwriting expenses, and corporate, administration and other expenses lines in the income statement.

(a) Defined contribution superannuation arrangements

Contributions to the plans are made in accordance with the governing rules of each plan together with the Australian Superannuation Guarantee legislation and, for some plans, obligations under industry awards. The contributions are generally based on a percentage of employees' salaries.

The Consolidated entity contributed \$78 million to the IAG & NRMA Superannuation Plan ("the Plan") for defined contribution members during the year (2005 – \$10 million, the Plan was on contribution holiday for 11 months of the year as the governing rules of the Plan allow any surplus to be used to meet the contributions that would otherwise have been payable for both the defined benefit and defined contribution members of the Plan) and there were no employer contributions payable at the end of the year for those members (2005 – \$Nil).

The Consolidated entity is not exposed to risks or rewards of the defined contribution arrangements and has no obligations beyond the payment of contributions.

(b) Defined benefit superannuation arrangements

Employees who are entitled to defined benefit superannuation arrangements are members of one of three superannuation plans each of which are funded plans. The defined benefit sections of those plans are closed to new members and so membership is reducing over time. Contributions to the plans are made in accordance with the governing rules of each plan and the contribution recommendations of an independent actuary. In contrast to defined contribution superannuation arrangements, the future cost of the defined benefit plans is not known with certainty in advance. The benefits received for defined benefit members are generally based on length of service and final average salary together with the member's own contributions (if any). The net positions of the plans are recognised on the balance sheet of the Consolidated entity.

Two of the plans are in New Zealand (the NZI Superannuation Fund and the IAG New Zealand Limited Staff Pension Scheme) with 23 defined benefit members as at 30 June 2006 (2005 – 32) with a combined surplus of \$2.6 million (2005 – \$2.4 million). These New Zealand defined benefit superannuation arrangements are not disclosed in more detail as the financial impact of these arrangements is not significant to the Consolidated entity.

All Australian employees with defined benefit superannuation arrangements are members of the Plan. The Plan had 881 defined benefit members as at 30 June 2006 (2005 – 980). The Consolidated entity has contributed to the Plan during the year in accordance with the recommendations of the actuary and has contributed \$7 million for defined benefit members (2005 – \$1 million, contribution holiday for 11 months of the year). There were no employer contributions payable at the end of the year (2005 – \$Nil).

There are two subsidiaries in the Consolidated entity, being Insurance Australia Group Services Pty Ltd and Insurance Manufacturers of Australia Pty Limited, with employees that are defined benefit members of the Plan. While separate records are maintained for the liabilities relating to each member, there is effectively a sharing of the risks associated with the assets of the Plan. For the measurement of the net financial position of the Plan for recognition on the balance sheets of the employers sponsors, the assets of the Plan are allocated between the employers in proportion to the actuarial reserves for each entity.

The following information relates only to the part of the Plan for employees of the Consolidated entity that are entitled to defined benefit superannuation arrangements. Actuarial valuations are performed at each reporting date by Guy Holley, BEc FIAA of Mercer Human Resource Consulting. The financial information disclosed below has been prepared in accordance with AASB 119 *Employee Benefits*, except where otherwise stated:

	2006		2005	
	Number	\$m	Number	\$m
Number of defined benefit members	881		980	
Fair value of net assets		191		178
Present value of defined benefit obligation*		(186)		(203)
Defined benefit surplus / (deficit)		5		(25)

* Inclusive of contribution tax liability or asset

The calculation of the net financial position of the Plan under AASB 119 is different to the calculation used for determination of the funding position of the Plan (refer (ix)). While the majority of the underlying assumptions are the same, the contributions made to the Plan in accordance with the recommendations of the actuary, and in compliance with the terms of the Trust Deed, are not based on the AASB 119 net financial position. The key difference is the discount rate used. An employer can meet all of its superannuation contribution obligations and still have to recognise a liability for a net financial deficit under AASB 119.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 31. SUPERANNUATION (CONTINUED)

	2006 \$m	2005 \$m
(b) Defined benefit superannuation arrangements (continued)		
<i>(i) Reconciliation of the movement in the present value of the defined benefit obligation</i>		
Defined benefit obligation at the beginning of the financial year	200	189
Current service cost	9	9
Interest cost	8	10
Contributions by plan participants	2	1
Actuarial (gains) and losses	(14)	7
Benefits paid	(18)	(16)
Defined benefit obligation at the end of the financial year	187	200
<i>(ii) Reconciliation of the movement in the fair value of assets</i>		
Fair value of assets at the beginning of the financial year	178	235
Expected return on plan assets	12	16
Actuarial gains and (losses)	10	19
Contributions by employers	7	1
Contributions by plan participants	2	1
Benefits paid	(18)	(16)
Use of surplus to fund defined contribution members	–	(78)
Fair value of assets at the end of the financial year	191	178
<i>(iii) Reconciliation of the present value of the defined benefit obligation and the fair value of the net assets to the assets and liabilities recognised on the balance sheet</i>		
Fair value of net assets	191	178
Present value of funded defined benefit obligation (net discount rate)	(187)	(200)
Net defined benefit asset / (liability)	4	(22)
Contribution tax asset / (liability)	1	(3)
Net asset / (liability) recognised on the balance sheet	5	(25)
<i>(iv) Items recognised from reporting date valuation</i>		
Current service cost	8	9
Interest cost (net of tax)	9	10
Expected return on plan assets	(12)	(16)
Actuarial (gains) and losses	(29)	–
Defined benefit expense	(24)	3
Accumulation contributions – employer*	–	59
Accumulation contributions – salary sacrifice*	–	12
Insurance costs and expenses (Accumulation Plan)*	–	7
Total net amount recognised from reporting date valuation	(24)	81

* The governing rules of the Plan allow any surplus to be used to meet the contributions that would otherwise have been payable for both the defined benefit and defined contribution members of the Plan.

	ALLOCATION PERCENTAGE	
	2006 %	2005 %
<i>(v) Plan assets</i>		
The percentage invested in each asset class at reporting date:		
Australian shares	37.1	34.8
Overseas shares	25.4	25.1
Listed property trusts	10.2	10.0
Fixed interest	24.6	24.6
Cash	2.7	5.5

The assets of the Plan are managed by the IAG Group. The assets of the Plan do not include any shares issued by the Consolidated entity nor any property or other assets used by the Consolidated entity.

To determine the expected rate of return on assets, the actuary has considered the expected future investment returns for each major asset class net of investment tax and investment fees. These estimated returns for each asset class have been used to calculate the expected rate of return on the assets supporting the defined benefits based on the Plan's target asset allocation and allowing for correlations of the investment returns between asset classes. The actual return on Plan assets for the year ended 30 June 2006 was 15.6% (2005 – 11.9%).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

(vi) Actuarial assumptions

Assumptions used in the determination of the financial position of the Plan are reviewed annually and determined in conjunction with the independent actuaries to the Plan. The principal actuarial assumptions used in determining the financial position of the Plan include:

	2006 %	2005 %
Discount rate (gross) / (net)*	5.1 / 4.3	5.9 / 5.0
Expected rate of return on plan assets supporting pension liabilities	7.4	7.4
Expected rate of return on other plan assets	6.9	6.9
Expected future salary increases	4.0	4.0
Future pension increases – adult / child	2.5 / 0.0	2.5 / 0.0

* The discount rate has been determined by reference to the market yields on government bonds.

(vii) Sensitivity of measurement to actuarial assumptions

The superannuation arrangements are by nature long term. The majority of the assumptions reflect this and are not changed to reflect short term variations in factors. The discount rate required to be applied must reflect the market yields on government bonds and so is subject to change if those yields change. A one percent reduction in the discount rate would result in a \$17 million increase in the present value of the defined benefit obligation of the Plan and result in the net financial surplus becoming a \$20 million deficit.

(viii) Historical information

The experience adjustments are as follows:

	2006		2005	
	\$m	%	\$m	%
Plan liabilities	6	3.3	6	3.2
Plan assets	10	5.4	19	10.7

The experience adjustments are based on the actuarial gain or loss after removing the impact of any change in assumptions.

(ix) Funding obligations

The financial information disclosed below has been determined in accordance with AAS 25 *Financial Reporting by Superannuation Plans*, using the Attained Age Actuarial Funding method.

	2006 \$m	2005 \$m
Net market value of plan assets	190	177
Present value of accrued benefits	(161)	(161)
Defined benefit surplus / (deficit)	29	16
Vested benefits	151	150

	2006 %	2005 %
Contribution recommendation current at the end of the financial year	15.3	15.3

It is estimated that the employer contributions to the Plan for defined benefit members for the year to 30 June 2007 will be \$7 million.

The principal actuarial assumptions used in determining the financial position of the Plan in accordance with AAS 25 and the funding recommendation include:

Expected investment returns – pension assets / other assets	7.5 / 7.0	7.5 / 7.0
Expected future salary increases	4.0	4.0
Future pension increases – adult / child	2.5 / 0.0	2.5 / 0.0

The accrued benefits are determined on the basis of the present value of expected future payments that arise from membership up to the measurement date. The accrued benefits are determined by reference to expected future salary levels and are discounted by using a market-based, risk-adjusted discount rate. Vested benefits are the benefits which would be payable to members if they all voluntarily resigned as at the reporting date.

Assumptions used in the determination of the financial position of the Plan are reviewed annually and determined in conjunction with the independent actuary to the Plan. Changes in financial and / or demographic assumptions, or changes in the relevant regulatory environment, could significantly impact the financial position of the Plan. The financial position of the Plan is calculated at a specific point in time, however the superannuation arrangements are by nature long term. Short term variations between long term actuarial assumptions and actual experience will cause the net funding status of the Plan to change without impacting on the long term viability of the Plan.

The contribution recommendation uses a different actuarial methodology and a different discount rate assumption to that used in determining the financial position for measurement on the balance sheet of the employer sponsor. In determining the contribution recommendation, the actuarial valuation method focuses on the funding of benefits for current members, irrespective of whether they stem from past or future membership, whereas, for financial reporting purposes, the present value of expected future benefit payments does not include benefits that have not yet accrued. The difference in methodologies used for determining the employer contributions and the measurement of the asset / liability recognised on the balance sheet mean that a liability may be recognised even where the employer has met all of the superannuation contribution obligations.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 32. COMMITMENTS

Commitments are not recorded on the balance sheet but are disclosed here at their face value.

	CONSOLIDATED	
	2006 \$m	2005 \$m
(a) Capital commitments		
– due within 1 year	3	5
(b) Operating lease commitments		
Property		
– due within 1 year	81	89
– due within 1 to 2 years	65	85
– due within 2 to 5 years	56	112
– due after 5 years	24	21
Plant and equipment		
– due within 1 year	12	34
– due within 1 to 2 years	7	24
– due within 2 to 5 years	5	7
	250	372
(c) Software licence and rental commitments		
– due within 1 year	39	41
– due within 1 to 2 years	3	26
– due within 2 to 5 years	1	3
	43	70
(d) Other commitments		
– due within 1 year	9	4
– due within 1 to 2 years	9	2
– due within 2 to 5 years	6	2
	24	8

Certain property, motor vehicles and computer equipment are leased under non-cancellable operating leases. Most leases are subject to annual reviews with increases subject to a set percentage or based on either movements in consumer price indices or operating criteria. Where appropriate, a right of renewal has been incorporated into the lease agreements at which time all terms and conditions may be renegotiated. There are no options to purchase the relevant assets on expiry of the lease. The operating lease commitments for property are to an extent offset by the receipt of sub-lease income of approximately \$6 million per year from non-cancellable subleases.

NOTE 33. CONTINGENCIES

Contingent liabilities are not recognised on the balance sheet but are disclosed here, unless the possibility of settlement is remote, in which case no disclosure is made. If settlement becomes probable, a provision is recognised. The best estimate of the settlement amount is used in measuring a contingent liability for disclosure.

(a) Contingent liabilities

In the normal course of business, transactions are entered into that may generate a range of contingent liabilities. These include:

- (i) litigation arising out of insurance policies;
- (ii) various types of investment contracts including forward foreign exchange contracts, financial futures, interest rate swaps, exchange traded options, forward rate agreements and other underwriting subscription contracts, usually as part of the management of the Consolidated entity's investment portfolios (refer note 35 for details regarding the exposures);
- (iii) undertakings for maintenance of net worth and liquidity support to subsidiaries in the Consolidated entity. It is normal practice to provide wholly-owned subsidiaries with support and assistance as may be appropriate with a view to enabling them to meet their obligations and to maintain their good standing. Such undertakings constitute a statement of present intent only and are not intended to give rise to any binding legal obligation; and
- (iv) guarantees for performance obligations, including a letter of credit issued in support of the Consolidated entity's participation in Lloyd's of London (refer 26(b)).

The Directors do not believe there are any other potential material exposures to the Consolidated entity and know of no event that would require it to satisfy the guarantees or take action under a support agreement.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

(b) Reset exchangeable securities

In respect of the issue of reset exchangeable securities ("RES") by a wholly-owned subsidiary, IAG Finance (New Zealand) Limited ("IAGF NZ"):

- (i) IAGF NZ has granted to Permanent Trustee Company Limited ("Trustee"), the trustee of the RES, a fixed charge over its right, title and interest in the payments to it under the Portfolio Management Agreement and certain intragroup receivables. IAG Portfolio Limited, a wholly-owned subsidiary of IAG, has granted to the Trustee a mortgage over IAG Portfolio Limited's portfolio of investments ("Portfolio") and a floating charge over its rights, property and undertaking as security to the RES holders.
- (ii) Insurance Australia Limited has put in place an interest rate floor with IAG Portfolio Limited in the event the bank bill rate applicable to the calculation of the interest rate payable on the RES falls below a specified rate. This will enable IAG Portfolio Limited to generate sufficient income to allow IAGF NZ to make part or full interest payments on the RES.
- (iii) In the event of an interest payment on the RES being unfranked, IAG must pay an amount into IAG Portfolio Limited to fund a gross-up of the interest payment on the RES.
- (iv) IAG may exchange some or all of the RES for preference shares issued by IAG at any time. This exchange right is considered an embedded derivative within the RES and is recognised at fair value on the balance sheet. The exchange right has been assessed as having a fair value of nil at 30 June 2006.
- (v) IAGF NZ may, in relation to the RES, change their terms, redeem them for cash or convert them into ordinary shares issued by IAG on any reset date. The next reset date is 15 March 2010.
- (vi) IAGF NZ may, in relation to the RES, redeem them for cash or convert them into ordinary shares issued by IAG, if a tax event, regulatory event or acquisition event, as defined in the RES terms, occurs.
- (vii) RES holders may redeem the RES on any reset date or if a trigger event, as defined in the RES terms, occurs.
- (viii) IAG has an obligation to pay all costs, charges and expenses in managing the Portfolio including costs of the trustee and custodian.
- (ix) IAG and other members of the IAG Group may be entitled to any surplus in the Portfolio from excess income from the Portfolio after the payment of aggregate interest payments on the RES or from excess net assets of the Portfolio after the payment of aggregate redemption amounts on the RES.

(c) Fiduciary activities

The Consolidated entity's fiduciary activities consist of investment management and other fiduciary activities conducted as manager, custodian or trustee for a number of investments and trusts. The funds managed on behalf of third parties which are not included in the Consolidated entity's balance sheet had a fair value as at 30 June 2006 of \$1,969 million (2005 – \$2,920 million). This does not include the investment by third parties in the IAG Asset Management Wholesale Trusts presented as minority interests in unitholders' funds on the balance sheet. The Consolidated entity is exposed to operational risk relating to managing these funds on behalf of third parties.

NOTE 34. RELATED PARTY DISCLOSURES

(a) Controlling entities

The ultimate parent entity in the Consolidated entity is Insurance Australia Group Limited which is incorporated in Australia.

(b) Subsidiaries

The Consolidated entity consists of Insurance Australia Group Limited and its subsidiaries (information in relation to ownership interests is provided in note 27). The IAG Group operates a shared services model with the use of dedicated units (such as head office finance providing accounting and processing services to operational entities) and entities (such as an entity that provides employee services, a technology company that provides software development services, and a reinsurance captive providing reinsurance services). All such intragroup transactions are charged to the relevant entities on either normal commercial terms and conditions, a direct and actual cost recovery basis or time allocation basis. Certain entities are economically dependent on other entities in the IAG Group. There are also loans between entities in the Consolidated entity. Only the transactions between the Parent and the wholly-owned subsidiaries are disclosed here because all other transactions that have occurred among entities within the Consolidated entity have been eliminated for consolidation purposes.

Aggregate amounts included in the determination for the Parent of profit before income tax for the year that resulted from transactions with related parties within the wholly-owned group were as follows:

	PARENT	
	2006 \$m	2005 \$m
Dividend revenue	746	585
Interest expense	26	–

Aggregate amounts receivable from, and payable to, related parties in the wholly-owned group were as follows:

Amounts receivable	160	215
Amounts payable	84	73
Loans receivable	–	5
Loans payable	313	184

The loans receivable and payable are either interest bearing or non-interest bearing and are repayable on demand.

While the Parent does not transact directly with all subsidiaries, the Parent does however generally receive dividends from all subsidiaries even if indirectly through other subsidiaries. Details of the tax sharing and tax funding agreements are disclosed in note 1(m)(ii).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 34. RELATED PARTY DISCLOSURES (CONTINUED)

(b) Subsidiaries (continued)

Other notes:

(i) Insurance Manufacturers of Australia Pty Limited ("IMA")

Both IMA and a subsidiary in the wholly-owned group have employees that are defined benefit members of the IAG & NRMA Superannuation Plan (refer note 31). While separate records are maintained for the liabilities relating to each member, there is effectively a sharing of the risks associated with the assets of the plan.

(ii) Transactions with IAG Asset Management Wholesale Trusts

IAG Asset Management Wholesale Trusts (some of which are disclosed as non-wholly owned subsidiaries in note 27), were established to enable higher investment yields for smaller investment portfolios. All entities within the IAG Group can invest in the trusts in accordance with their investment mandates. All investments in these trusts are on normal commercial terms and conditions.

The IAG & NRMA Superannuation Plan, the net financial position of which is recognised on the balance sheet, has a significant holding in some of the IAG Asset Management Wholesale Trusts. All transactions between the Plan and the trusts are on normal commercial terms and conditions.

(iii) Other

Both the amount of the transactions and the outstanding balances at reporting date relating to transactions between the Parent and other subsidiaries are not significant and no further information is disclosed.

(c) Joint ventures and associates

Details of interests in joint ventures and associates are disclosed in note 28.

During the course of the financial year, transactions with associates were conducted on normal terms and conditions. Both the amount of the transactions and the outstanding balances at reporting date are not significant and no further information is provided.

(d) Key management personnel

(i) Details of compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. It is important to note that the Company's Non-executive Directors are specifically required to be included as key management personnel in accordance with Accounting Standard AASB 124 *Related Party Disclosures*. However, the Non-executive Directors do not consider that they are part of "management".

The names and details of the Company's Non-executive Directors in office at any time during the financial year are as follows (Directors were in office for this entire period unless otherwise stated):

Mr James Strong, Ms Yasmin Allen, Mr John Astbury, Mr Geoffrey Cousins, Mr Neil Hamilton, Mr Rowan Ross, Mr Brian Schwartz.

During the year the following persons were the executives identified as key management personnel, with the greatest authority and responsibility for planning, directing and controlling the activities of the IAG Group:

Name	Current title
Mr MJ Hawker	Chief Executive Officer and Managing Director
Mr JP Breheny ⁽ⁱ⁾	Chief Executive Officer – Asia
Mr AM Coleman	Chief Risk Officer and Group Actuary
Mr NB Hawkins ⁽ⁱⁱ⁾	Chief Executive Officer – IAG New Zealand
Mr DA Issa ⁽ⁱⁱ⁾	Chief Executive Officer – Personal Insurance
Ms JS Johnson ⁽ⁱⁱ⁾	Chief Executive Officer – Business Partnerships
Ms CF McLoughlin ⁽ⁱⁱⁱ⁾	Group Executive – Strategy
Ms SJ Mostyn	Group Executive – Culture & Reputation
Mr MJ Pirone	Chief Executive Officer – CGU
Mr J van der Schalk ^(iv)	Chief Executive Officer – Asset Management & Reinsurance
Mr G Venardos	Chief Financial Officer

(i) Mr JP Breheny, joined the IAG Group as Chief Executive Officer – Asia, on 20 March 2006.

(ii) On 8 February 2006, IAG announced a new structure for its operations. This led to a change in the executive team structure. Mr DA Issa has held his current position since this time and previously held the position of Chief Information Officer. Mr NB Hawkins and Ms JS Johnson were appointed to their roles on 1 March 2006 and 13 February 2006 respectively.

(iii) Ms CF McLoughlin, joined the IAG Group on 2 August 2005 and her current position is Group Executive – Strategy.

(iv) On 26 May 2006 Mr Jan van der Schalk was appointed to the role of Chief Executive Officer – Asset Management & Reinsurance following Mr RJ Jackson leaving the IAG Group.

Mr IF Brown retired on 31 December 2005. Mr DRA Pearce left on 31 August 2005, Mr DJP Smith left on 8 February 2006 and Mr RJ Jackson left on 26 May 2006.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

The aggregate compensation of the key management personnel is set out below:

	CONSOLIDATED	
	2006 \$000	2005 \$000
Short-term employee benefits	12,242	12,590
Post-employment benefits	1,012	1,479
Other long-term benefits	187	435
Termination benefits	2,440	1,062
Share-based payments	3,242	2,435
	19,123	18,001

The key management personnel receive no compensation specifically in relation to the management of the Company. The compensation disclosed in the table above represents the key management personnel's estimated compensation received from the IAG Group in relation to their involvement in the activities with the Consolidated entity.

The Consolidated entity has applied the exemption under Corporations Amendment Regulations 2006 which exempt listed companies from providing remuneration disclosures in relation to the key management personnel in the financial statements as recognised by Accounting Standard AASB 124. These remuneration disclosures are provided in the Remuneration Report of the Directors' report.

(ii) Interest in securities

Holdings of PARs

Movements in total number of PARs on issue by each of the key management personnel are as follows:

	PARs on issue 1 July 2005 Number	PARs granted during the year Number	PARs exercised during the year Number	PARs lapsed during the year Number	PARs on issue 30 June 2006 Number	PARs vested and exercisable 30 June 2006 Number
Mr MJ Hawker	1,200,000	600,000	(168,000)	–	1,632,000	–
Mr JP Breheny	–	100,000	–	–	100,000	–
Mr AM Coleman	258,195	90,000	(54,176)	–	294,019	–
Mr NB Hawkins	168,456 ⁽¹⁾	–	–	–	168,456	–
Mr DA Issa	223,177	83,500	(47,675)	–	259,002	–
Ms JS Johnson	87,300 ⁽¹⁾	–	(5,972)	–	81,328	–
Ms CF McLoughlin	–	80,000	–	–	80,000	–
Ms SJ Mostyn	214,307	80,000	(45,508)	–	248,799	–
Mr MJ Pirone	239,881	90,000	(47,675)	–	282,206	–
Mr J van der Schalk	149,004 ⁽¹⁾	–	–	–	149,004	22,753
Mr G Venardos	305,048	100,000	(66,745)	–	338,303	–
Total	2,845,368	1,223,500	(435,751)	–	3,633,117	22,753
<i>Executives who ceased as key management personnel during the year:</i>						
Mr IF Brown	221,716	–	–	–	221,716	45,508
Mr RJ Jackson	161,451	90,000	–	–	251,451	–
Mr DRA Pearce	196,232	–	–	–	196,232	49,029
Mr DJP Smith	238,167	80,000	(48,560)	–	269,607	–
Total	817,566	170,000	(48,560)	–	939,006	94,537

(1) This balance represents the PARs held by Mr Hawkins, Ms Johnson and Mr van der Schalk at the date of appointment as executive.

The Non-executive Directors, who are key management personnel, did not participate in the PARs Plan.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 34. RELATED PARTY DISCLOSURES (CONTINUED)

(d) Key management personnel (continued)

(ii) Interest in securities (continued)

Holdings of PSRs

The PSRs Plan was closed for issuing further PSRs from the financial year ended 30 June 2003. Following is a summary of the movements in total number of PSRs on issue by each key management personnel:

	PSRs on issue 1 July 2005 Number	PSRs exercised during the year Number	PSRs lapsed during the year Number	PSRs on issue 30 June 2006 Number	PSRs vested and exercisable 30 June 2006 Number
Mr MJ Hawker	60,000	(60,000)	–	–	–
Ms SJ Mostyn	68,670	(68,670)	–	–	–
Mr J van der Schalk	40,000 ⁽¹⁾	–	–	40,000	40,000

(1) This balance represents the PSRs held by Mr van der Schalk at the date of appointment as executive.

The Non-executive Directors, who are key management personnel, did not participate in the PSRs Plan.

Holding of ordinary shares

The relevant interest of each key management personnel and their related parties in ordinary shares of IAG:

	Shares held at the beginning of the year	Shares granted as remuneration during the year	Shares received on exercise of PSRs	Shares received on exercise of PARs	Net movement of shares due to other changes ⁽²⁾	Total shares held at the end of the year	Shares held nominally at the end of the year ⁽¹⁾
Mr JA Strong	225,547	33,918	–	–	–	259,465	247,382
Ms YA Allen	3,437	4,522	–	–	–	7,959	7,959
Mr JF Astbury	51,772	4,522	–	–	9,400	65,694	55,611
Mr GA Cousins	171,689	4,522	–	–	–	176,211	26,211
Mr ND Hamilton	80,744	20,351	–	–	173	101,268	96,278
Mr RA Ross	154,100	11,306	–	–	–	165,406	62,849
Mr B Schwartz	3,906	6,783	–	–	–	10,689	10,689
Mr MJ Hawker	1,150,059	–	60,000	168,000	–	1,378,059	–
Mr JP Breheny	–	–	–	–	–	–	–
Mr AM Coleman	65,896	–	–	54,176	(58,020)	62,052	54,176
Mr NB Hawkins	–	–	–	–	24,332 ⁽³⁾	24,332	–
Mr DA Issa	–	–	–	47,675	(47,675)	–	–
Ms JS Johnson	–	–	–	5,972	–	5,972	–
Ms CF McLoughlin	–	–	–	–	–	–	–
Ms SJ Mostyn	16,083	–	68,670	45,508	–	130,261	–
Mr MJ Pirone	31,388	–	–	47,675	–	79,063	11,432
Mr J van der Schalk	–	–	–	–	–	–	–
Mr G Venardos	38,289	–	–	66,745	5,746	110,780	27,632
<i>Executives who ceased employment during the year:</i>							
Mr IF Brown	253,691	36,920	–	–	(2,530)	*	*
Mr RJ Jackson	7,351	–	–	–	–	*	*
Mr DRA Pearce	7,806	–	–	–	(6,738)	*	*
Mr DJP Smith	129,591	–	–	48,560	(54,511)	*	*

(1) Nominally held shares are included in the column headed total shares held at the end of the year. These shares are held by the key management personnel's related parties, inclusive of domestic partner, dependents and entities controlled, jointly controlled or significantly influenced by the key management personnel.

(2) Net movement of shares relate to acquisition and disposal transactions by the key management personnel and their related parties during the year. It includes any opening balances of shares held by key management personnel who were appointed during the year.

(3) This balance represents the shares held by Mr Hawkins at the date of appointment as executive.

* These key management personnel ceased employment during the financial year. Information on shares held only disclosed up to the date of their cessation.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

Holdings of reset preference shares

No key management personnel had any interest in reset preference shares at any time during the financial year.

Holdings of reset exchangeable securities

In respect of the relevant interest of each key management personnel in reset exchangeable securities ("RES") of IAG Finance (New Zealand) Limited, other than Mr Hawker who held 1,000 RES nominally at the beginning and the end of the financial year. There were no other movements in holdings of RES by any key management personnel during the financial year ended 30 June 2006.

(e) Other related parties

Contributions are made to various superannuation plans, both defined contribution and defined benefit plans. Information regarding transactions with the plans is provided in note 31.

NOTE 35. FINANCIAL RISK MANAGEMENT

THE PARENT

The Parent is a non-operating holding company and so has limited direct exposure to financial risks. The Board of the Parent sets the risk management policies for the IAG Group.

The financial assets and liabilities of the Parent are limited to amounts receivable from / payable to related bodies corporate, loans to / from related bodies corporate, and an interest-bearing liability. The Parent does not use derivatives but is party to an embedded derivative in relation to reset exchangeable securities outlined in note 33(b)(iv). The intragroup balances are considered highly liquid and of negligible credit risk and so the carrying amount is a reasonable approximation of the fair value of the balances. The intragroup balances bear a variable interest rate or bear no interest but are repayable on demand. The interest-bearing liability represents the issue of reset preference shares (refer note 23). The impact from interest rate risk is as discussed in the notes below for the Consolidated entity.

(a) Interest rate risk exposures

The exposure to interest rate risk and the weighted average effective interest rates on the interest-bearing financial assets and liabilities of the Parent are summarised in the table below. Where assets and liabilities on the balance sheet include both interest-bearing and non interest-bearing amounts, they are included as interest-bearing assets and liabilities for the purposes of this note. All other assets and liabilities presented on the balance sheet are non-interest bearing and therefore not subject to interest rate risk.

PARENT						
	Floating interest rate \$m	FIXED INTEREST RATE MATURING IN			Non-interest bearing \$m	Weighted average interest rate %
		1 year or less \$m	Over 1 to 5 years \$m	More than 5 years \$m		
2006						
Financial assets						
Cash and cash equivalents	1	-	-	-	-	5.50
Amounts receivable from related bodies corporate	-	-	-	-	-	-
Loans to related bodies corporate	-	-	-	-	-	-
Financial liabilities						
Loans from related bodies corporate	(138)	-	-	-	(175)	6.20
Reset preference shares*	-	(350)	(200)	-	-	5.33
Net financial assets / (liabilities)	(137)	(350)	(200)	-	(175)	(862)

* The reset preference shares were previously presented as equity under Australian GAAP but are presented as debt from 1 July 2005 onwards (refer to note 38 for further details). These shares have no maturity date but they do have a reset date upon which certain terms, including the dividend rate, can be changed.

2005

The only interest-bearing financial asset or liability during the year ended 30 June 2005 was cash and cash equivalents of \$1 million bearing a floating interest rate. The weighted average interest rate on cash and cash equivalents of \$1 million for the year ended 30 June 2005 was 5.25%. Loans from related bodies corporate of \$184 million were not interest bearing.

PARENT		
	2006 \$m	2005 \$m
Reconciliation of net financial assets to net assets		
Net financial assets		
– Interest-bearing	(862)	1
– Other	4,873	4,579
Net non financial assets	(62)	(140)
Net assets	3,949	4,440

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 35. FINANCIAL RISK MANAGEMENT (CONTINUED)

THE CONSOLIDATED ENTITY

The Consolidated entity is exposed to a variety of financial risks in the normal course of business; market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk. The Board and senior management of the IAG Group have developed, implemented and maintain a Risk Management Strategy ("RMS") which is in accordance with the prudential standards issued by APRA. The RMS is updated annually and approved by the Board. The RMS:

- Describes Board and management approved parameters (ie risk appetite) within which key decisions must be made;
- Is a key input into how regulators and the external auditor understand and assess the approach to risk management; and
- Forms the basis of twice yearly declarations provided by executives and senior management to the Board.

The RMS (together with the Derivative Risk Management Statement ("DRMS") and the Reinsurance Management Strategy ("REMS")) identifies the IAG Group's policies and procedures, processes and controls that comprise its risk management and control systems. These systems address all material risks, financial and non-financial, likely to be faced by the IAG Group. Annually, the Board certifies to APRA that adequate strategies have been put in place to monitor those risks, that the IAG Group has systems in place to ensure compliance with legislative and prudential requirements and that the Board has satisfied itself as to the compliance with the RMS and REMS.

That part of the RMS concerning financial risk focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance. Key aspects of the processes established in the RMS to mitigate financial risks include:

- Having an Asset and Liability Committee ("ALCO") comprised of key executives with relevant oversight responsibilities that meets on a regular basis;
- Monthly stress testing is undertaken to determine the impact of adverse market movements and the impact of any derivative positions;
- Maintenance of an approved counterparty credit risk policy which is reviewed at least annually; and
- The external auditors of IAG conduct a complete review of IAG Asset Management's operations on a yearly basis, including compliance with risk management strategies and other operational documents, as well as conducting reviews of internal controls.

The IAG Group's risk management policies include the use of derivatives for both investment operations and corporate treasury operations. The DRMS sets out the permissible use of derivatives in relation to investment strategies, the parameters within which the derivatives may be used, and the control environment within which they are used.

Derivatives used in investment operations include share price index futures, equity swap agreements, exchange traded options and bank bill and bond futures. Derivatives used in corporate treasury operations include cross currency swaps, interest rate swaps, and forward foreign exchange contracts. Derivatives used include exchange traded derivatives which are standardised and over-the-counter derivatives which are individually negotiated between the contracting parties.

(a) Market risk

(i) Currency risk

Currency risk is the risk of loss arising from an unfavourable move in market exchange rates. The Consolidated entity is exposed to currency risk on its investments in international equities, receivables, payables and borrowings denominated in a currency other than Australian dollars, and the net investment in controlled foreign operations. The currencies giving rise to this risk are primarily New Zealand dollars and Thai Baht for insurance contracts and United States dollars, Japanese Yen and Euros for investment activities. Derivatives are used to manage selected currency exposures.

Forward foreign exchange contracts

The most common form of derivative used to manage currency risk is forward foreign exchange contracts. At reporting date, the contractual amount and maturity profile of these derivatives was as follows:

	CONSOLIDATED	
	2006 \$m	2005 \$m
Forward foreign exchange contracts		
– matures within 1 year	1,094	325
– matures within 4 to 5 years	31	–
	1,125	325

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

Cross currency swaps on US dollar subordinated term notes

Insurance Australia Limited ("IAL") has entered into cross currency swaps to fully hedge the Australian dollar value of principal and interest flows on the Consolidated entity's US subordinated term notes. The swaps mature in 2010. Over the term of the swaps, IAL will receive US dollar payments equal to the interest payable on the notes and will pay interest at either a fixed rate or variable rate of the three month bank bill swap rate plus a margin on a principal amount of A\$401 million. On maturity of the swap, the IAG Group will repay the principal amount of A\$401 million and receive US\$240 million based on the original spot exchange rate at inception. Hedge accounting is applied in relation to these swap agreements (refer note 23).

Net investment hedges

Forward foreign exchange contracts are used to manage the currency risk relating to the net investment in controlled foreign operations. At the reporting date, hedge accounting was used for the net investment in the New Zealand operations of the Consolidated entity.

(ii) Interest rate risk

The exposure to interest rate risk results from the holding of financial assets and liabilities in the normal course of business. Fixed interest rate assets and liabilities create exposure to fair value interest rate risk which is a market risk. Financial assets and liabilities with floating interest rates create exposure to cash flow interest rate risk. The two types of interest rate risk are disclosed here together for convenience. The most commonly used derivatives to manage interest rate risk exposures are interest rate swap agreements and futures.

Interest rate risk exposures

The exposure to interest rate risk and the weighted average effective interest rates on the interest-bearing financial assets and liabilities of the Consolidated entity are summarised in the table below. Where assets and liabilities on the balance sheet include both interest-bearing and non interest-bearing amounts, they are included as interest-bearing assets and liabilities for the purposes of this note. All other assets and liabilities presented on the balance sheet are non-interest bearing and therefore not subject to interest rate risk.

CONSOLIDATED							
	Floating interest rate \$m	FIXED INTEREST RATE MATURING IN			Non-interest- bearing \$m	Total \$m	Weighted average interest rate %
		1 year or less \$m	Over 1 to 5 years \$m	More than 5 years \$m			
2006							
Financial assets							
Cash and cash equivalents	678	26	-	-	14	718	5.32
Premium funding loans	-	125	-	-	-	125	14.40
Money market securities	92	2,026	3,470	1,475	-	7,063	5.91
Financial liabilities							
NZ senior term notes	-	-	(41)	-	-	(41)	7.25
Subordinated term notes	(50)	-	(249)	(2)	-	(301)	6.46
US subordinated term notes	-	-	(323)	-	-	(323)	5.19
Reset preference shares*	-	(350)	(200)	-	-	(550)	5.33
Net interest-bearing financial assets	720	1,827	2,657	1,473	14	6,691	
2005							
Financial assets							
Cash and cash equivalents	451	-	-	-	5	456	5.28
Premium funding loans	-	128	-	-	-	128	14.65
Money market securities	26	2,760	3,111	1,356	-	7,253	5.59
Financial liabilities							
NZ senior term notes	-	(46)	(45)	-	-	(91)	7.12
Subordinated term notes	(50)	-	(249)	(2)	-	(301)	6.35
US subordinated term notes	-	-	-	(315)	-	(315)	5.19
Net interest-bearing financial assets	427	2,842	2,817	1,039	5	7,130	

* The reset preference shares were previously presented as equity under Australian GAAP, but are presented as debt from 1 July 2005 onwards (refer to note 38 for further details). These shares have no maturity date but they do have a reset date upon which certain terms, including the dividend rate, can be changed.

The spread of maturity of the money market securities for the financial year ended 30 June 2006, is approximately 29% for 1 year or less, 18% for 1 to 2 years, 14% for 2 to 3 years, 6% for 3 to 4 years, 15% for 4 to 5 years and 18% for more than 5 years (2005 – 39%, 13%, 14%, 10%, 6% and 18%).

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 35. FINANCIAL RISK MANAGEMENT (CONTINUED)

(a) Market risk (continued)

(ii) Interest rate risk (continued)

Interest rate risk exposures (continued)

The significant terms and conditions of the interest-bearing liabilities are disclosed in note 23.

	CONSOLIDATED	
	2006 \$m	2005 \$m
Reconciliation of net financial assets to net assets		
Net financial assets		
– Interest-bearing	6,691	7,130
– Other	2,447	2,652
– Net insurance liabilities	(7,738)	(7,663)
Net non financial assets	2,271	2,384
Net assets	3,671	4,503

Interest rate swap agreements

IAL has entered into interest rate swap agreements to manage the interest rate exposure on the Consolidated entity's borrowings. IAL pays a fixed rate of interest under the swap agreements and receives a variable rate of interest equal to the amount payable on the underlying hedged borrowings. The interest income and expense associated with the swap agreements are recognised in profit or loss on a daily basis over the term for which the swap is effective as a hedge of the underlying borrowing. As at 30 June 2006, the weighted average fixed interest rate payable under the swap agreements was 6.77% per annum (2005 – 6.77% per annum) and the weighted average floating rate receivable was 7.32% per annum (2005 – 7.20% per annum).

As at reporting date, the notional principal amounts and period of expiry of these swap agreements were as follows:

Interest rate swap agreements		
– within 1 to 2 years	50	–
– within 2 to 5 years	350	400
	400	400

Hedge accounting is applied in relation to these swap agreements (refer note 23).

As at reporting date, the notional principal amounts and periods of expiry of the swap agreements included in investments were as follows:

Interest rate swap agreements		
– within 2 to 5 years	203	–
– within 5 to 7 years	39	–
– over 7 years	721	–
	963	–

Futures

At reporting date, the notional principal amounts and period of expiry of the interest rate related futures contracts were as follows:

Futures		
– matures within 1 year	3,252	2,306
– matures within 1 to 2 years	1,029	449
	4,281	2,755

(iii) Price risk

The Consolidated entity is exposed to equity markets price risk through its investment in equities and the use of equity related derivative contracts. At reporting date, the notional principal amounts and period of expiry of the equity related derivative contracts were as follows:

SPI futures		
– matures within 1 year	1,032	865
Options		
– purchased – within 1 year	4	28
– written – within 1 year	59	35
	1,095	928

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

(b) Fair value of financial instruments

The net carrying amount on the balance sheet of all financial instruments is either the fair value of the assets and liabilities or a reasonable approximation of the fair value of the assets and liabilities. The measurement of the fair value of certain financial instruments is determined using valuation techniques and the use of different pricing models and assumptions could affect the reported fair value of these instruments. Provided below is information regarding the fair value of derivatives.

The net fair value of derivatives presented as investments at 30 June 2006 was \$1 million (2005 – \$6 million).

The total fair value of all derivatives for which cash flow hedge accounting was applied at 30 June 2006 was \$95 million (1 July 2005 – \$95 million). At reporting date, cash flow hedge accounting was applied in relation to two economic hedges relating to the US subordinated term notes (refer note 23(c)(iii)) and the hedge of the deferred consideration payable in relation to the acquisition of Alba Group Pte Limited. This was an anticipated transaction at reporting date.

The total fair value of all derivatives for which net investment hedge accounting was applied at 30 June 2006 was \$12 million (1 July 2005 – \$Nil). At the reporting date, hedge accounting was applied in relation to only the net investment in the IAG New Zealand operations of the Consolidated entity.

(c) Credit risk

Credit risk is the risk of loss from a counterparty failing to meet their financial obligations. The Consolidated entity's credit risk arises predominantly from investment activities, reinsurance activities (refer note 12), and dealings with intermediaries (refer note 10(d)). The Consolidated entity's credit quality management roles, principles and processes are detailed in the IAG Group Credit Risk Management Policy document which is approved by the IAG Board and complies with APRA's requirements for credit risk management by a general insurer. The policy outlines the framework and procedures in place to ensure an adequate and appropriate level of monitoring and management of credit quality throughout the IAG Group. The IAG Group Treasury function is responsible for ensuring that the policies governing the management of credit quality risk are properly implemented. The IAG Group's credit risk appetite relies heavily on credit rating agency research and is heavily weighted towards obligors of high quality investment grade. All new, changed and continuing credit risk exposures must be approved in accordance with the IAG Group's approval authority framework.

The IAG Group is exposed to credit risk from investments in third parties where the IAG Group holds debt and other securities issued by those companies. The credit risk relating to investments is monitored and assessed, and maximum exposures are limited. The investments comprising assets held to back insurance liabilities are restricted to investment grade securities.

Some of the more significant credit exposures relate to reinsurance receivables. For further information refer to note 12(e).

Only derivatives in liquid markets are used. As the primary purpose for using derivatives is hedging, any over-the-counter derivatives used have been transacted with investment grade quality financial institutions only. The IAG Group's credit policy and procedures ensure that exposures to counterparty risks are monitored constantly to operate within the risk limits approved by the IAG Board. As the exchange traded derivatives are being settled on a daily basis with the clearing house of the respective exchange, credit risk associated with these contracts is minimal.

Concentrations of credit risk exist if a number of counterparties have similar economic characteristics. At the reporting date, there were no material concentrations of credit risk as the Consolidated entity transacts with a large number of counterparties in various countries without any individual debtor having a material outstanding balance. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivatives, on the balance sheet.

(d) Liquidity risk

Liquidity risk is concerned with the risk of there being insufficient cash resources to meet payment obligations without affecting the daily operations or the financial condition of the Consolidated entity. Liquidity facilitates the ability to meet expected and unexpected requirements for cash. The liquidity position is derived from operating cashflows, investment portfolios and access to outside sources of liquidity such as bank lines of credit, established debt funding programmes, reinsurance arrangements and other sources. The balance sheet is prepared using the liquidity format in which the assets and liabilities are presented broadly in order of liquidity. The liquidity management roles, principles and processes are detailed in the IAG Group Liquidity Risk Management Policy document which is approved by the IAG Board and complies with APRA's requirements for liquidity risk management by a general insurer. The policy outlines the framework and procedures in place to ensure an adequate and appropriate level of monitoring and management of liquidity.

Sound liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities and the ability to close-out market positions. The nature of insurance activities means that the timing and amount of cash flows are uncertain. The liquidity risk management policy is concerned with ensuring the ongoing ability to meet the payment obligations to policyholders and other creditors across a wide range of operating conditions without suffering any significant additional cost. These processes are principally in the control of the IAG Group Treasury function.

Management of liquidity risk includes asset and liability management strategies. The assets held to back insurance liabilities consist predominantly of Government securities (the most liquid of securities) and other very high quality securities which can generally be readily sold or exchanged for cash. The assets are managed so as to effectively match the maturity profile of the assets with the expected pattern of claims payments. The money market securities are restricted to investment grade securities with concentrations of investments managed by various criteria including issuer, industry, geography and credit rating.

Information regarding access to unutilised credit facilities is available in note 23(d).

The reset exchangeable securities (refer note 1(ff)) are a part of the liquidity management of the Consolidated entity. The ability to access external sources of liquidity from domestic and international capital market raisings is assisted by the strong financial strength rating of the IAG Group.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 36. CAPITAL MANAGEMENT

(a) Capital management strategy

The capital management strategy plays a central role in managing risk to create shareholder value whilst meeting the crucial and equally important objective of providing an appropriate level of capital to protect policyholders' and lenders' interests and satisfy regulators. Capital finances growth, capital expenditure and business plans and also provides support in the face of adverse outcomes from insurance and other activities and investment performance.

The determination of the capital amount and mix is built around three core considerations:

(i) Regulatory minimum capital requirements

All insurers within the Consolidated entity that carry on insurance business in Australia are registered with the Australian Prudential Regulation Authority ("APRA") and are subject to the prudential standards which set out the basis for calculating the minimum capital requirement ("MCR") which is a minimum level of capital that the regulator deems must be held to meet policyholder obligations. The MCR utilises a risk-based approach to capital adequacy and is determined to be the sum of the capital charges for insurance, investment, investment concentration and catastrophe concentration risk. It is IAG Group policy to ensure that each of the licensed insurers maintains an adequate capital position from an entity perspective. The IAG Group also voluntarily applies the MCR prudential standards to the IAG Group as a whole, as if the Consolidated entity was an APRA regulated entity (refer note 36(c)).

It is IAG Group policy to hold capital levels in excess of the MCR. The current target capital multiple for the Consolidated entity is 1.55 times (1.55x) the MCR. The policy also requires management to not take any action that would further reduce the capital multiple if an identified minimum capital multiple is reached, currently set as 1.35x MCR for the Consolidated entity.

Capital calculations for regulatory purposes are based on the premium liabilities model which is different to the deferral and matching model which underpins the measurement of assets and liabilities in the financial statements. The premium liabilities model assesses future claims payments arising from future events insured under existing policies, assessed on a prospective basis. This differs to the measurement of the outstanding claims liability on the balance sheet which considers claims relating to events that occur only up to and including the reporting date.

(ii) Rating agency capital guidelines and expectations

The IAG Group aims to maintain the capital strength of the IAG Group by reference to a target financial strength rating from an independent ratings agency. The ratings are important because they reflect the 'very strong' financial strength of the IAG Group and demonstrate to stakeholders the ability to pay claims for the long term.

Key wholly owned insurers within the IAG Group had the following ratings published by Standard and Poor's Rating Services at 30 June 2006:

Entity	Issuer credit rating	Financial strength rating
Parent		
Insurance Australia Group Limited	AA- / Stable	AA- / Stable
Licensed insurers		
Insurance Australia Limited	AA / Stable	AA / Stable
IAG New Zealand Limited	AA / Stable	AA / Stable
CGU Insurance Limited	AA / Stable	AA / Stable
Swann Insurance (Aust) Pty Ltd	AA / Stable	AA / Stable

The objective is to retain the 'AA' category rating for the key wholly owned insurers within the IAG Group which is considered in the long term interests of shareholders in view of the security it provides to lenders, reinsurers, policyholders and shareholders in an industry that is, by its nature, subject to risk and volatility outside the participants' control.

(iii) Capital needs of the business

In conjunction with the considerations set out above, which are important to the functioning of the business, consideration is given to the operational capital needs of the business. Targeting a capital multiple above the minimum regulatory requirement aims to ensure the ongoing strength and security of the IAG Group whilst suitably protecting policyholders and lenders. The objective is to maintain capital levels and mix commensurate with 1:750 year risk of absolute ruin.

The maintenance of the target financial strength rating referred to above impacts directly on the cost of capital. When accessing funds in the market, the strong rating improves both the availability of capital and the cost at which it can be secured as potential investors generally demand a lower risk premium.

An important influence on the capital levels is the payment of dividends. The Consolidated entity aims to maintain normalised earnings payouts within a ratio range approved by the IAG Board. As part of the management of capital, a special dividend was declared and paid during the year ended 30 June 2006.

The capital objectives are achieved through dynamic management of the balance sheet and capital mix, the use of a risk-based capital adequacy framework for capital needs that relies on explicit quantification of uncertainty or risk, and the use of modelling techniques such as Dynamic Financial Analysis which provide valuable input to the capital management process and provide the capacity to quantify and understand this risk / return trade-off. The influence on capital needs of product mix, the reinsurance programme, catastrophe exposure, investment strategy, profit margins and capital structure are all assessed through the Dynamic Financial Analysis modelling.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

The capital management processes comprise two main aspects:

- *Balance sheet management* – fundamentally concerned with the IAG Group's long term target capital mix in terms of equity, hybrid equity and debt capital. This includes establishing appropriate balance sheet criteria in terms of shareholder objectives (eg. dividend objectives and overall return criteria) and cost of capital considerations (availability, rating and appetite for risk).
- *Asset and liability management* – seeks to quantify the levels of overall capital needed to accommodate any given risk tolerance, taking account of any factors considered relevant to capital needs. This is accomplished using Dynamic Financial Analysis modelling which comprises integrated asset and liability models, which simulate experience over future periods.

(b) Capital composition

The IAG Group's capital comprises ordinary shares and interest-bearing liabilities. The interest-bearing liabilities include reset preference shares which are a hybrid security having characteristics of both debt and equity. The balance sheet capital mix was:

	CONSOLIDATED		
	Target %	2006 %	2005 %
Ordinary equity	68	73	71
Hybrid securities	12	11	12
Debt	20	16	17
	100	100	100

As at 30 June 2006, the balance sheet capital mix held more ordinary equity than targeted due to the level of surplus capital held. A special dividend was paid to shareholders during the year as a return of excess capital in line with the commitment to ensure capital is managed efficiently. The capital disclosed above does not include the \$550 million of contingent capital made available through the reset exchangeable securities (refer note 1(ff)).

(c) Regulatory capital compliance

The insurers within the Consolidated entity have at all times during the current and prior financial year complied with the externally imposed capital requirements to which they are subject. The MCR calculation for the Consolidated entity provided below is based on applying in principle the APRA standards for individual entities to the consolidated position, pending the publication by APRA of a comprehensive standard to determine prudential capital at a consolidated level (such a standard is expected during the 2007 financial year). A similar basis is used for both the Australian and international insurance businesses.

APRA requires general insurers to report capital adequacy based on previous Australian GAAP. The Parent has received approval from APRA to apply AIFRS accounting treatments for certain items. For all other items the previous Australian GAAP treatment is applied. Changes in the MCR calculation methodology do not apply retrospectively for the determination of regulatory compliance. For this reason, the MCR calculation for the comparative period is disclosed as it was at that date, as reported to APRA, and has not been restated for current period changes in the calculation.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 36. CAPITAL MANAGEMENT (CONTINUED)

	CONSOLIDATED	
	2006 \$m	2005 \$m
(c) Regulatory capital compliance (continued)		
Statutory capital		
<i>Tier 1 capital</i>		
Ordinary shares	3,263	3,263
Treasury shares	(40)	–
Reset preference shares ⁽ⁱ⁾	550	550
Reset preference shares transaction costs	(3)	(11)
Reserves	(6)	(6)
Retained earnings	274	59
Excess technical provisions (net of tax) ⁽ⁱⁱ⁾	421	499
	4,459	4,354
Less deductions from capital for APRA purposes:		
Goodwill	(1,486)	(1,371)
Intangibles	(57)	(7)
Net deferred tax assets	(123)	(100)
Other	(62)	–
	2,731	2,876
<i>Tier 2 capital</i>		
Subordinated term notes	624	616
Total statutory capital	3,355	3,492
Minimum capital requirements (MCR)		
Australian general insurance businesses	1,574	1,511
International insurance businesses	260	235
Total MCR	1,834	1,746
MCR multiple	1.83	2.00

(i) While the presentation of the reset preference shares has changed from equity to debt under AIFRS, it is expected that such shares will continue to qualify as Tier 1 capital for capital adequacy purposes.

(ii) The excess technical provisions represent the difference between the insurance liabilities incorporating a risk margin (refer note 11(f)) on the balance sheet based on the deferral and matching model and the insurance liabilities incorporating a risk margin equivalent to a probability of adequacy of 75% used for regulatory reporting purposes based on the premium liabilities model.

The increase in the total minimum capital requirement for the year ended 30 June 2006 is principally due to the increase of \$100 million in the maximum event retention from 1 January 2006.

The MCR calculation does not include the \$550 million of contingent capital made available through the reset exchangeable securities (refer note 1 (ff)), which if exchanged, would bring the MCR multiple to 2.13 (2005 – 2.32).

The elements of the MCR calculation are as follows:

Insurance risk	1,085	1,091
Investment risk	549	555
Investment concentration risk	–	–
Catastrophe concentration risk	200	100
Total MCR	1,834	1,746

The investment concentration risk charge is zero reflecting that the holding of particular assets, including reinsurance recoveries, and exposure to a particular obligor, are sufficiently diversified for the purposes of the regulatory capital calculations.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 37. NET TANGIBLE ASSETS

	CONSOLIDATED	
	2006 \$	2005 \$
Net tangible asset per ordinary share ⁽ⁱ⁾	1.22	1.18
Net tangible asset per reset preference share ⁽ⁱⁱ⁾	n/a	100.00

- (i) Net tangible assets per ordinary share has been determined after adjusting for minority interests, goodwill (note 20) and other intangible assets (note 19) and the value of reset preference shares on issue (only for reporting date at 30 June 2005, refer (ii) below for further details).
- (ii) While for accounting purposes the reset preference shares were previously presented as equity under Australian GAAP they are presented as debt from 1 July 2005 onwards (refer to note 38 for further details) and hence the net tangible assets disclosure is not relevant. When presented as equity, the net tangible assets per reset preference share were reflected at the face value of \$100, as the entitlement to the net assets in all circumstances is limited to the face value of the reset preference shares.

NOTE 38. EXPLANATION OF TRANSITION TO AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

This financial report is the first annual financial report to be prepared in accordance with AIFRS. In this note we provide reconciliations and explanations of the differences to Australian GAAP to assist readers in understanding the impact of the transition on the financial position and performance of the Parent and the Consolidated entity. The only impact on the cash flow statements was with the distributions on the reset preference shares, previously presented as dividends paid, in the financing activities section, now presented as finance costs paid, in the operating activities section. The net movement in cash held has not changed.

(a) Income statement

Provided below are reconciliations of the income statements under Australian GAAP to that under AIFRS for the year ended 30 June 2005.

Notes	PARENT			CONSOLIDATED		
	AGAAP Year ended 30 June 2005 \$m	Adj \$m	AIFRS Year ended 30 June 2005 \$m	AGAAP Year ended 30 June 2005 \$m	Adj \$m	AIFRS Year ended 30 June 2005 \$m
Premium revenue	–	n/a	–	6,561	n/a	6,561
Reinsurance expense	–	n/a	–	(417)	n/a	(417)
Net premium revenue	–	n/a	–	6,144	n/a	6,144
Claims expense (ii)(v)	–	n/a	–	(4,729)	(21)	(4,750)
Reinsurance and other recoveries	–	n/a	–	660	n/a	660
Net claims expense	–	n/a	–	(4,069)	(21)	(4,090)
Acquisition costs (ii)(v)	–	n/a	–	(1,075)	5	(1,070)
Other underwriting expenses (ii)(v)	–	n/a	–	(339)	(38)	(377)
Fire service levies	–	n/a	–	(177)	n/a	(177)
Underwriting expenses	–	n/a	–	(1,591)	(33)	(1,624)
Underwriting profit	–	n/a	–	484	(54)	430
Investment income on assets backing insurance liabilities	–	n/a	–	525	n/a	525
Investment expenses on assets backing insurance liabilities	–	n/a	–	(9)	n/a	(9)
Insurance profit	–	n/a	–	1,000	(54)	946
Investment income on equity holders' funds (vi)	585	n/a	585	530	(12)	518
Other income	–	n/a	–	178	1	179
Finance costs	–	n/a	–	(69)	n/a	(69)
Corporate, administration and other expenses (i)(v)(vi)	–	n/a	–	(381)	92	(289)
Profit before income tax	585	–	585	1,258	27	1,285
Income tax credit / (expense)	2	n/a	2	(379)	22	(357)
Profit for the year	587	–	587	879	49	928
Profit for the year attributable to:						
Equity holders of the Parent	587	–	587	760	51	811
Minority interests	n/a	n/a	n/a	119	(2)	117
Profit for the year	587	–	587	879	49	928

Certain items have been reclassified from the prior year's financial reports to conform to the current year's presentation (refer to note 1(b)(iv) for further details). These items do not represent a change in recognition and measurement criteria arising from the transition to AIFRS and so have been incorporated into the AGAAP figures rather than being disclosed as AIFRS adjustments.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 38. EXPLANATION OF TRANSITION TO AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED)

(b) Balance sheet (the Consolidated entity only)

Provided below are reconciliations of the balance sheets under Australian GAAP (referred to in the tables as AGAAP) and AIFRS together with narrative descriptions explaining the adjustments. The AIFRS adjustments applicable for the first time from 1 July 2005 represent a change in accounting policy made in accordance with the provisions of AASB 1. A balance sheet reconciliation is not provided for the Parent because the only adjustment prior to 1 July 2005 related to taxation.

		AGAAP 30 June 2005 \$m	AIFRS Adj \$m	AIFRS 30 June 2005 \$m	AIFRS Adj \$m	AIFRS 1 July 2005 \$m	AGAAP 30 June 2004 \$m	AIFRS Adj \$m	AIFRS 1 July 2004 \$m
	Notes								
Assets									
Cash and cash equivalents		456	n/a	456	n/a	456	424	n/a	424
Investments	(viii)	10,370	n/a	10,370	1	10,371	9,686	n/a	9,686
Premium receivable		1,710	n/a	1,710	n/a	1,710	1,606	n/a	1,606
Trade and other receivables		827	n/a	827	–	827	912	n/a	912
Current tax assets		4	–	4	–	4	–	–	–
Reinsurance and other recoveries receivable on outstanding claims		883	n/a	883	n/a	883	745	n/a	745
Inventories		2	n/a	2	n/a	2	2	n/a	2
Prepayments	(iii)(iv)	54	(16)	38	n/a	38	56	(14)	42
Deferred levies and charges		105	n/a	105	n/a	105	104	n/a	104
Deferred reinsurance expense		194	n/a	194	n/a	194	184	n/a	184
Deferred acquisition costs		621	n/a	621	n/a	621	558	n/a	558
Deferred tax assets	(x)	264	(133)	131	2	133	296	(115)	181
Property, plant and equipment	(vi)	258	1	259	n/a	259	231	13	244
Investment in joint ventures and associates		8	n/a	8	n/a	8	7	n/a	7
Intangible assets	(v)	7	24	31	n/a	31	18	n/a	18
Goodwill	(i)	1,371	92	1,463	n/a	1,463	1,455	n/a	1,455
Total assets		17,134	(32)	17,102	3	17,105	16,284	(116)	16,168
Liabilities									
Trade and other payables	(vii)	721	n/a	721	1	722	803	n/a	803
Reinsurance premiums payable		195	n/a	195	n/a	195	134	n/a	134
Restructuring provision		11	n/a	11	n/a	11	29	n/a	29
Current tax liabilities		193	–	193	–	193	222	–	222
Unearned premium liability		3,586	n/a	3,586	n/a	3,586	3,472	n/a	3,472
Lease provision	(vi)	–	21	21	n/a	21	–	21	21
Employee benefits provision	(ii)	206	23	229	n/a	229	188	(57)	131
Minority interests in unitholders' funds	(xi)	–	n/a	–	421	421	–	n/a	–
Deferred tax liabilities	(x)	163	(139)	24	–	24	99	(99)	–
Outstanding claims liability		6,840	n/a	6,840	n/a	6,840	6,327	n/a	6,327
Interest-bearing liabilities	(vii)(ix)	779	n/a	779	552	1,331	786	n/a	786
Total liabilities		12,694	(95)	12,599	974	13,573	12,060	(135)	11,925
Net assets		4,440	63	4,503	(971)	3,532	4,224	19	4,243
Equity									
Share capital	(vii)	3,802	n/a	3,802	(539)	3,263	3,802	n/a	3,802
Treasury shares held in trust	(iv)	–	(34)	(34)	n/a	(34)	–	(21)	(21)
Reserves	(iii)(ix)	(6)	13	7	(5)	2	(5)	5	–
Retained earnings		59	83	142	(5)	137	(259)	32	(227)
Parent interest		3,855	62	3,917	(549)	3,368	3,538	16	3,554
Minority interests	(xi)	585	1	586	(422)	164	686	3	689
Total equity		4,440	63	4,503	(971)	3,532	4,224	19	4,243

Certain items have been reclassified from the prior year's financial reports to conform to the current year's presentation (refer to note 1(b)(iv) for further details). These items do not represent a change in recognition and measurement criteria arising from the transition to AIFRS and so have been incorporated into the AGAAP figures rather than being disclosed as AIFRS adjustments.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

(c) Total equity

Provided below are reconciliations of total equity under Australian GAAP to that under AIFRS. The adjustments disclosed for each date are cumulative of all adjustments up to and including that date. The adjustments applicable for the first time from 1 July 2005 represent a change in accounting policy made in accordance with the provisions of AASB 1.

Notes	PARENT			CONSOLIDATED		
	1 July 2005 \$m	30 June 2005 \$m	1 July 2004 \$m	1 July 2005 \$m	30 June 2005 \$m	1 July 2004 \$m
Total equity under Australian GAAP as reported in the 2005 annual financial report	4,440	4,440	4,295	4,440	4,440	4,224
Adjustments applicable from 1 July 2004						
<i>Adjustments to retained earnings</i>						
Reversal of goodwill amortisation (i)	n/a	n/a	n/a	92	92	n/a
Recognition of defined benefit plans (ii)	n/a	n/a	n/a	(23)	(23)	57
Adjustment to share based remuneration expense (iii)	n/a	n/a	n/a	5	5	2
Capitalisation of software development costs (v)	n/a	n/a	n/a	24	24	n/a
Reversal of market value movement on property (vi)	n/a	n/a	n/a	(8)	(8)	–
Recognition of depreciation on buildings (vi)	n/a	n/a	n/a	(1)	(1)	n/a
Recognition of lease provision amortisation (vi)	n/a	n/a	n/a	(11)	(11)	(8)
Net tax impact of AIFRS adjustments (x)	n/a	n/a	n/a	6	6	(16)
Adjustment for minority interests	n/a	n/a	n/a	(1)	(1)	(3)
				83	83	32
<i>Adjustments to reserves</i>						
Recognition of share based payment reserve (iii)	n/a	n/a	n/a	13	13	5
<i>Adjustments to treasury shares</i>						
Consolidation of share based remuneration trusts (iv)	n/a	n/a	n/a	(34)	(34)	(21)
<i>Adjustments to minority interests</i>						
Net adjustments impacting minority interests	n/a	n/a	n/a	1	1	3
Adjustments applicable from 1 July 2005						
<i>Adjustments to retained earnings</i>						
Adjustment to valuation of investments (viii)	n/a	n/a	n/a	1	n/a	n/a
Amortisation of reset preference shares transaction costs (vii)	(6)	n/a	n/a	(6)	n/a	n/a
Accrual for distribution on reset preference shares (vii)	(1)	n/a	n/a	(1)	n/a	n/a
Net tax impact of AIFRS adjustments (x)	–	n/a	n/a	–	n/a	n/a
Adjustment for minority interests	n/a	n/a	n/a	1	n/a	n/a
	(7)	n/a	n/a	(5)	n/a	n/a
<i>Adjustments to reserves</i>						
Adjustment for cash flow hedge accounting (ix)	–	n/a	n/a	(7)	n/a	n/a
Net tax impact of AIFRS adjustment (x)	–	n/a	n/a	2	n/a	n/a
	–	n/a	n/a	(5)	n/a	n/a
<i>Adjustments to share capital</i>						
Reclassification of reset preference shares (vii)	(550)	n/a	n/a	(550)	n/a	n/a
Reclassification of reset preference shares transaction costs (vii)	11	n/a	n/a	11	n/a	n/a
	(539)	n/a	n/a	(539)	n/a	n/a
<i>Adjustments to minority interests</i>						
Reclassification of minority interests in unitholders' funds (xi)	n/a	n/a	n/a	(421)	n/a	n/a
Net other adjustments impacting minority interests	n/a	n/a	n/a	(1)	n/a	n/a
	n/a	n/a	n/a	(422)	n/a	n/a
Total equity under AIFRS	3,894	4,440	4,295	3,532	4,503	4,243

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 38. EXPLANATION OF TRANSITION TO AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED)

(d) Profit for the year

Provided below are reconciliations of profit under Australian GAAP to that under AIFRS for the year ended 30 June 2005.

	Notes	PARENT	CONSOLIDATED
		Year ended 30 June 2005 \$m	Year ended 30 June 2005 \$m
Profit for the year as reported under Australian GAAP		587	879
Reversal of goodwill amortisation	(i)	–	92
Movement in defined benefit plans	(ii)	–	(80)
Adjustment to share based remuneration expense	(iii)	–	3
Capitalisation of software development costs	(v)	–	24
Reversal of market value movement on property	(vi)	–	(8)
Recognition of depreciation on buildings	(vi)	–	(1)
Recognition of lease provision amortisation	(vi)	–	(3)
Net tax impact of AIFRS adjustments	(x)	–	22
Profit for the year under AIFRS		587	928

(e) Notes to the reconciliations for sections (a) to (d) above

(i) Goodwill (transition adjustment is relevant to the Consolidated entity only)

The elimination of the requirement to amortise goodwill under AIFRS resulted in the reversal of the goodwill amortisation expense for the year to 30 June 2005 of \$92 million. There was a corresponding increase in goodwill of \$92 million as at 30 June 2005 on the balance sheet.

(ii) Defined benefit plans (transition adjustment is relevant to the Consolidated entity only)

Under AIFRS the relevant net position of defined benefit plans is recognised on the balance sheet. The movement in the net position is recognised in profit or loss, except for actuarial gains and losses, which are recognised directly in retained earnings. This is the result of an accounting policy selection made.

There are five arrangements that qualify as defined benefit plans under AIFRS. These consist of a defined benefit superannuation plan in Australia, two defined benefit superannuation plans in New Zealand, and two pension schemes, both of which are unfunded. The net position of the three defined benefit superannuation plans was previously not recognised on the balance sheet under Australian GAAP. The present value of each of the two unfunded pension liabilities was previously recognised on the balance sheet, however the measurement and accounting treatment under AIFRS is different.

All cumulative actuarial gains and losses on defined benefit plans have been recognised in equity at the date of transition to AIFRS.

The adjustments required to recognise the defined benefit plans upon transition to AIFRS involved an increase in retained earnings and a reduction in employee benefits provision as at 1 July 2004 of \$57 million. Recognising the movement in the net positions of the plans for the year to 30 June 2005 involved recognition of an expense through the AIFRS income statement for the year to 30 June 2005 of \$80 million, with a corresponding impact to retained earnings which was rounded to zero as at 30 June 2005 and an increase in employee benefits provision of \$23 million as at 30 June 2005. The net result of these changes was a reduction of \$23 million in retained earnings as at 30 June 2005.

(iii) Share based remuneration (transition adjustment is relevant to the Consolidated entity only)

IAG shares are acquired on-market and held in trust to satisfy future obligations for share based remuneration. The shares are purchased on or near grant date at the then market price. Previously under Australian GAAP the cost of acquiring the shares was recorded as a prepayment and then expensed in full, generally over the period during which the employees provided related services.

Under AIFRS the fair value at grant date of the equity instruments granted as share based remuneration is expensed over the relevant period rather than the actual cost of acquiring the shares to support the arrangements. The fair value is expensed over the period from grant date until the equity instruments vest fully to the employee. For equity settled share based payments, an equity reserve is created as the expense is recognised. At each reporting date the total accumulated expense is adjusted through profit or loss based on the latest estimate of the number of equity instruments that will vest, considering only employee turnover, and taking into account the expired portion of the vesting period. The AIFRS accounting policy has not been retrospectively applied to share based payments granted prior to 7 November 2002 and / or that vested prior to 1 January 2005 as permitted under the transitional provisions for first time adoption of AIFRS.

A transitional adjustment for the Consolidated entity was made to increase retained earnings as at 1 July 2004 by \$2 million representing the accumulated reduction in the expense up to that date. An adjustment for the Consolidated entity was made to increase retained earnings as at 30 June 2005 by \$5 million representing the accumulated reduction in the expense up to that date. The adjustments involved the recognition of a share based remuneration reserve in equity of \$5 million as at 1 July 2004 and \$13 million as at 30 June 2005.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

(iv) Consolidation of share based remuneration trusts (transition adjustment is relevant to the Consolidated entity only)

The equity based remuneration trusts used to manage the share based remuneration arrangements are subsidiaries of the Consolidated entity under AIFRS. Two trusts are consolidated directly by the Parent while one trust is consolidated directly by a subsidiary. The amount previously recognised as a prepayment in relation to the share based remuneration plans has converted into an investment in subsidiary under AIFRS which eliminates against the unitholders' funds in the trusts upon consolidation. The Consolidated entity recognises the consolidated IAG shares, the major asset of the trusts, as treasury shares. The treasury shares are measured at cost (total amount paid to acquire the shares), and are presented as a deduction from equity. The shares controlled by the trusts as at 30 June 2005, were acquired on different dates at a total cost of \$33 million for the Parent and \$34 million for the Consolidated entity (30 June 2004 – \$20 million for the Parent and \$21 million for the Consolidated entity). When the relevant rights are exercised, the shares will effectively be reissued and recognised as equity measured at the net expense incurred in providing the shares.

(v) Intangible assets (transition adjustment is relevant to the Consolidated entity only)

Certain software development expenditure has been capitalised as an intangible asset under AIFRS that was previously expensed under the application of Australian GAAP. Only software development expenditure incurred after 1 July 2004, the AIFRS transition date, was eligible for capitalisation under AIFRS. The adjustment relating to software development expenditure was a net reduction in the expense for the year to 30 June 2005 of \$24 million (capitalised expenditure of \$24 million less an amount of amortisation which rounded to zero). There was a corresponding increase in intangible assets on the balance sheet of the Consolidated entity for the same amount.

(vi) Property, plant and equipment (transition adjustment is relevant to the Consolidated entity only)

All of the property within the Consolidated entity is classified as owner occupied property under AIFRS. Prior to transition to AIFRS, all land and buildings were carried at fair value with movements in fair value recognised in profit or loss. Under AIFRS, land and buildings are measured at cost with the cost of the buildings being depreciated over their useful life. The carrying value of land and buildings is subject to impairment testing. For land and buildings held as at 30 June 2004, the fair value at that date is used as the deemed cost as allowed upon first time adoption of AIFRS. This required reversal of the movement in the market value of the property recognised in the reported profit for the year to 30 June 2005 of \$8 million. There was a corresponding decrease in property, plant and equipment on the balance sheet of the same amount.

Depreciation of the buildings introduced a depreciation expense for the year to 30 June 2005 of \$1 million.

Certain of the operating leases for property require that the land and / or building be returned to the lessor in its original condition. Under AIFRS, the present value of the estimated future cost for the plant and equipment to be removed and the premises to be returned to the lessor in its original condition are recognised as a lease provision when the relevant alterations are made to the premises, capitalised as part of the cost of plant and equipment, and depreciated over the useful lives of the assets.

Under Australian GAAP these costs were not recognised until it was probable that the expenditure would be incurred generally referring to when a decision was made to cancel or not renew a lease.

At 1 July 2004, a lease provision of \$21 million was recognised for the Consolidated entity with a corresponding increase in property, plant and equipment. The net carrying amount of this provision remained the same at 30 June 2005 and 1 July 2005. The initial recognition of the addition to property, plant and equipment was accompanied by a depreciation expense of \$8 million up to 1 July 2004 as a reduction to retained earnings. The net balance capitalised as part of property, plant and equipment upon AIFRS transition at 1 July 2004 was \$13 million. The net balance capitalised as part of property, plant and equipment fell to \$10 million as at 30 June 2005 as a result of additional depreciation expense recognised for the year to 30 June 2005 of \$3 million.

Under AIFRS the definition of income includes both revenue and gains. Gains are determined on a net basis (proceeds less the carrying amount and / or costs of achieving the proceeds). Under Australian GAAP the net gain or loss from the disposal of property, plant and equipment items were presented on a gross basis. Hence, upon the disposal of the items, under previous Australian GAAP the gross proceeds from the disposal were included in revenue while under AIFRS only the net gain would be included. The disposal of property for the Consolidated entity for the year ended 30 June 2005 involved recognition of a gain on sale of \$4 million recognised as a realised gain on investments. The disposal of plant and equipment for the Consolidated entity for year ended 30 June 2005 involved gross proceeds of \$9 million, the carrying amount of the items prior to disposal of \$12 million, and a net loss of \$3 million. The net impact on profit for the year under both Australian GAAP and AIFRS was a net income of \$1 million. The adjustment to recognise the net gain on the sale of property, plant and equipment as other income under AIFRS reduced the realised gain on investments by \$4 million, reduced the revenue for the year ended 30 June 2005 by \$9 million and reduced the expenses for the period by the same amount. There was no impact on profit for the year then ended and no consequential tax effect.

(vii) Reset preference shares (applied from 1 July 2005) (transition adjustment is relevant to the Parent and the Consolidated entity)

The reset preference shares ("RPS") were presented as equity under Australian GAAP as they are not considered a mandatory convertible instrument, are perpetual, and there is no obligation to pay distributions. The RPS are presented as debt under AIFRS because there are circumstances under which the holder can demand conversion of the instruments, and are carried at amortised cost using the effective interest method. This involved a reclassification of \$550 million from share capital to interest-bearing liabilities as at 1 July 2005.

The transaction costs incurred from the issuance of the two tranches of RPS, totalling \$11 million, were recognised directly in equity under Australian GAAP as a reduction in the proceeds of the instruments. With the RPS presented as debt under AIFRS those transaction costs are capitalised, presented together with the related liability, and recognised on an effective yield basis (amortised over the period to the first reset date). This required an adjustment as at 1 July 2005 of \$11 million to recognise the capitalisation of the transaction costs, and a reduction in retained earnings of \$6 million representing the portion of the transaction costs that have been effectively amortised up to that date.

Distributions on the instruments made after 1 July 2005 are treated as interest rather than dividends and so have a negative impact on reported profit. With the distributions treated as interest under AIFRS, the distributions are recognised on an accruals basis, which is different to the previous policy of recognising a provision for the distributions only when the distributions were declared. The adjustment to recognise the interest payable as at 1 July 2005 was a decrease in retained earnings of \$1 million.

(viii) Investments (applied from 1 July 2005) (transition adjustment is relevant to the Consolidated entity only)

Upon transition to AIFRS, the Consolidated entity has continued to measure all investments at market value with movements in market value being recognised in profit or loss. This is the result of an accounting policy selection made. This includes all derivatives used in relation to investment activities. This has basically been a continuation of previous practice with small adjustments for disposal costs (Australian GAAP used net market value rather than gross market value) and a change in market price determination (Australian GAAP used last sale price rather than bid / offer price). The net adjustment for the change was a \$1 million increase in investments with a corresponding increase in retained earnings as at 1 July 2005.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2006

NOTE 38. EXPLANATION OF TRANSITION TO AUSTRALIAN EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (CONTINUED)

(e) Notes to the reconciliations for sections (a) to (d) above (continued)

(ix) *Derivatives (applied from 1 July 2005) (transition adjustment is relevant to the Consolidated entity only)*

All of the derivative contracts selected for hedge accounting as at 1 July 2005 qualified as a cash flow hedge. The adjustment required to recognise the application of cash flow hedge accounting under AIFRS for these transactions involved an increase in the measurement of the derivatives recognised on the balance sheet of \$7 million (\$8 million increase in interest-bearing liabilities and a \$1 million increase in trade and other receivables) with a corresponding net decrease to an equity reserve.

(x) *Taxation (transition adjustment is relevant to both the Parent and the Consolidated entity only)*

The transition to AIFRS involved three types of tax adjustments. There were adjustments arising from the different methodology used for the determination of tax adjustments, consequential tax impacts arising from the different recognition treatments of certain assets and liabilities under AIFRS, and adjustments relating to changes in the tax consolidation system.

Impact from change in methodology

Income tax is calculated based on the "balance sheet approach" replacing the "income statement approach" previously used. The AIFRS treatment focuses on the closing balances rather than the movements for the period. This method recognises deferred tax balances when there is a difference between the carrying value of an asset or liability, and its tax base (being the amount attributed to an asset or liability for tax purposes) rather than for differences between accounting and taxable profit or loss. Deferred tax assets under AIFRS are recognised based on a 'probable' criterion rather than the 'beyond reasonable doubt' criterion, or 'virtually certain' criterion for unused tax losses, under previous Australian GAAP. In addition, current and deferred taxes attributable to amounts recognised directly in equity are recognised in equity. Deferred tax balances continue to be undiscounted under AIFRS. This change in methodology had no impact on the recognition of tax related assets and liabilities. However, the tax effect of the AIFRS transition adjustments relating to items that were recognised directly in equity was also recognised in equity which would not have been in accordance with previous Australian GAAP.

Impact of consequential tax impacts arising from other AIFRS transition adjustments

Apart from the change in methodology, the transition to AIFRS also involved consequential tax impacts arising from the different recognition treatments of certain assets and liabilities under AIFRS. These consequential tax impacts involved a net reduction in retained earnings at 1 July 2004 of \$16 million and a net increase in retained earnings at 30 June 2005 of \$6 million and at 1 July 2005 of \$6 million. There were also some tax amounts recognised directly in equity.

Tax consolidation

Under previous Australian GAAP the Parent recognised current and deferred tax amounts relating to transactions and balances of the Australian tax-consolidated subsidiaries as if those transactions and balances were its own. Under AIFRS, the Parent only recognises the current tax payable and deferred tax assets arising from unused tax losses assumed from wholly-owned subsidiaries in the tax-consolidated group. There is no impact on the Consolidated entity. For the Parent, net deferred tax assets decreased by \$120 million with an equivalent net adjustment to intercompany loan balances.

(xi) *Minority interests in unitholders' funds (applied from 1 July 2005) (transition adjustment is relevant to the Consolidated entity only)*

The Consolidated entity includes IAG Asset Management Wholesale Trusts in which the Consolidated entity has a controlling interest for accounting purposes. Previously, when consolidating the trusts, an amount was recognised in equity for the minority interest in the trusts, being the value attributable to unitholders outside the Consolidated entity. Under AIFRS, the residual interests in the trusts qualify as a liability on the balance sheets of the trusts and is not recognised as equity. Therefore, upon consolidation of the trusts under AIFRS, the value attributable to unitholders outside the Consolidated entity is recognised as a liability on the balance sheet of the Consolidated entity and not in equity as a minority interest. The change has also resulted in the distributions from the trusts to those unitholders, previously presented as net profit attributable to minority interests, forming part of the profit for the period. The change has no impact on the equity attributable to equity holders of the Parent.

These changes required a reclassification of \$421 million as at 1 July 2005 from minority interest presented as equity on the balance sheet to minority interest in unitholders' funds presented as a liability on the balance sheet. The adjustment also impacts on the treatment of net income attributable to minority interests in unitholders' funds in the income statement which is applicable for the first time for the year ended 30 June 2006 and involves no prior period adjustment.

NOTE 39. EVENTS SUBSEQUENT TO REPORTING DATE

As the following transactions occurred after reporting date and did not relate to conditions existing at reporting date, no account has been taken of them in the financial statements for the year ended 30 June 2006.

(a) Declaration of final dividend

On 25 August 2006, a final dividend of 16.0 cents per share, 100% franked, was declared by the Company. The dividend will be paid on 9 October 2006.

(b) Progress of negotiations with a China based general insurance business

IAG announced on 7 February 2006 that it had signed a memorandum of understanding with a view to acquiring 24.9% of China Pacific Property Insurance Co., Ltd. ("CPPI"). IAG announced on 3 July 2006 that draft transaction agreements had been confirmed for the purposes of lodgement with the China Insurance Regulatory Commission for preliminary review. Under the terms of the draft transaction agreements, IAG will acquire 24.9% of CPPI for approximately \$350 – 375 million.

The parties intend to proceed to signing the transaction agreements as soon as possible following formal approval by relevant regulators.

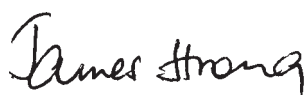
DIRECTORS' DECLARATION

In the opinion of the Directors of Insurance Australia Group Limited:

- (a) the financial statements and notes 1 to 39, including the remuneration disclosures that are contained in the Remuneration Report in sections A to D of the Directors' report, are in accordance with the Corporations Act 2001 including:
 - (i) giving a true and fair view of the financial position of the Company and Consolidated entity as at 30 June 2006 and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date; and
 - (ii) complying with Accounting Standards and the Corporations Regulations 2001; and
- (b) the Remuneration Report in sections A to D of the Directors' report complies with Australian Accounting Standard AASB 124 *Related Party Disclosures*; and
- (c) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

The Directors have been given the declaration required by section 295A of the Corporations Act 2001 from the chief executive officer and chief financial officer for the financial year ended 30 June 2006.

Signed at Sydney this 25th day of August 2006 in accordance with a resolution of the Directors.



James Strong
Director



Michael Hawker
Director

INDEPENDENT AUDIT REPORT ON FINANCIAL REPORT

to the shareholders of Insurance Australia Group Limited

SCOPE

The financial report, remuneration report and directors' responsibility

The financial report comprises the income statements, statements of recognised income and expense, balance sheets, cash flow statements, accompanying notes 1 to 39 to the financial statements, and the directors' declaration for both Insurance Australia Group Limited (the "Company") and Insurance Australia Group Limited and its controlled entities (the "Consolidated Entity"), for the year ended 30 June 2006. The Consolidated Entity comprises both the Company and the entities it controlled during that year.

As permitted by the Corporations Regulations 2001, the Company has disclosed information about the remuneration of directors and executives ("remuneration disclosures"), including those required by Australian Accounting Standard AASB 124 *Related Party Disclosures*, under the heading "Remuneration Report" in sections A to D of the directors' report and not in the financial report.

The directors of the Company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report. The directors are also responsible for preparing the relevant reconciling information regarding the adjustments required under the Australian Accounting Standard AASB 1 *First-time Adoption of Australian equivalents to International Financial Reporting Standards*. The directors are also responsible for the Remuneration Report contained in the directors' report.

Audit approach

We conducted an independent audit in order to express an opinion to the shareholders of the Company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement and that the remuneration disclosures comply with AASB 124. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, Australian Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Company's and the Consolidated Entity's financial position, and of their performance as represented by the results of their operations and cash flows and whether the remuneration disclosures comply with Australian Accounting Standard AASB 124.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report; and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

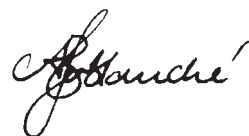
AUDIT OPINION

In our opinion:

- 1) the financial report of Insurance Australia Group Limited is in accordance with:
 - a) the Corporations Act 2001, including:
 - i. giving a true and fair view of the Company's and Consolidated Entity's financial position as at 30 June 2006 and of their performance for the financial year ended on that date; and
 - ii. complying with Australian Accounting Standards and the Corporations Regulations 2001; and
 - b) other mandatory financial reporting requirements in Australia; and
- 2) the Remuneration Report in sections A to D of the directors' report complies with Australian Accounting Standard AASB 124 *Related Party Disclosures*.



KPMG



Dr Andries B Terblanché

Partner

Sydney

25th August 2006

INDEPENDENT REVIEW REPORT

to IAG on sustainability reporting in its Annual Report 2006

INTRODUCTION

We have been engaged by IAG to review selected sustainability performance data (the Performance Data) for the year ended 30 June 2006, as reported in the IAG Annual Report 2006 (the Annual Report) on page 19, and reported in the IAG Concise Annual Report 2006 (also referred to as the Annual Report) on page 19.

SCOPE

Sustainability reporting in the Annual Report and management responsibilities

The management of IAG are responsible for the preparation of the sustainability reporting in the Annual Report and the information and assessments contained within it, for determining IAG's objectives in relation to sustainability performance, and for establishing and maintaining appropriate performance management and internal control systems from which the reported information is derived. Management's assertions about the effectiveness of the performance management and internal control systems are included in a separate letter we have received from management.

Review approach

We have conducted an independent review of the Performance Data set out on page 19 of the Annual Report for the year ended 30 June 2006, for IAG's Australian operations unless otherwise stated. Complaints as a percentage of policies and Funds for community investment as a percentage of Group net profit attributable to shareholders were not included in our review. There are no mandatory requirements for the preparation, publication or review of sustainability performance data. IAG applies its own internal reporting guidelines for sustainability reporting ("the Criteria"), a concise version of which can be found in the Glossary in the Annual Report. The selection and suitability of the Criteria is the responsibility of management and our review did not include an assessment of the adequacy of the Criteria. Further, the internal control structure which management has established and from which the Performance Data has been derived, has not been reviewed and no opinion is expressed as to its effectiveness.

Our review was conducted in accordance with the International Standard on Assurance Engagements ISAE 3000 "Assurance Engagements other than Audits or Reviews of Historical Financial Information" issued by the International Auditing and Assurance Standards Board, and with Australian Auditing Standards AUS 108 "Assurance Engagements" and AUS 902 "Review of Financial Reports". A review is limited primarily to inquiries of company personnel and other procedures applied to the compilation and presentation of the quantitative data. A review does not provide all evidence that would be required in an audit thus the level of assurance provided is less than that given in an audit. We have not performed an audit and, accordingly, do not express an audit opinion.

We performed procedures in order to obtain all the information and explanations that we considered necessary to provide sufficient evidence for us to state whether anything has come to our attention that would indicate the Performance Data has not been presented fairly in accordance with the Criteria established by management.

The Performance Data

We have reviewed the following quantitative Performance Data reported on page 19 in the Annual Report for the year ended 30 June 2006: business volume measure, overall customer satisfaction index, employee engagement score, staff turnover, lost time injury frequency rate, funding of the OH&S department, recycled commingled waste, number of employee volunteer hours, funds for community investment, head count and CO₂e emissions.

INDEPENDENCE

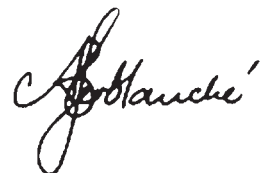
In conducting our review, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

STATEMENT

Based on our review, which is not an audit, nothing came to our attention to indicate that the Performance Data set out on page 19 of the Annual Report for the year ended 30 June 2006 has not been presented fairly in accordance with the Criteria established by management.



KPMG



Dr Andries B Terblanché

Partner

Sydney

1st September 2006

SHAREHOLDER INFORMATION

You can access information about Insurance Australia Group Limited including company announcements, presentations and reports at www.iag.com.au.

ASX CODES

Insurance Australia Group Limited's shares are listed on the ASX under:

IAG Ordinary Shares;

IAGPA Reset Preference Shares – RPS1; and

IAGPB Reset Preference Shares – RPS2.

Insurance Australia Group Limited's wholly owned subsidiary IAG Finance (New Zealand) Limited's New Zealand branch issued Reset Exchangeable Securities in January 2005 and they are listed on the ASX under:

IANG Reset Exchangeable Securities – RES.

ANNUAL REPORT

There are a number of options available concerning the Annual Report. You can choose:

- to not receive it;
- to view or download it from our website; or
- to receive it by mail.

Any change to the annual report election details recorded on your holding(s) can be made at www.iag.com.au/shareholdercentre or by contacting the Share Registry on 1300 360 688 and, if you have registered with their Investor Centre, on their website.

If there are multiple shareholders at your registered address and you wish to receive just one copy of the Annual Report please contact the Share Registry on 1300 360 688.

ANNUAL GENERAL MEETING (AGM)

The 2006 AGM of Insurance Australia Group Limited will be held on Wednesday, 15 November 2006 at 10:00am at the Wesley Conference Centre, 220 Pitt Street, Sydney NSW 2000. The AGM will be webcast live on the internet at www.iag.com.au/agm2006 and an archive version will be placed on the website to enable the AGM to be viewed at a later time.

ONLINE PROXY VOTING

Shareholders can lodge proxies electronically for the 2006 AGM at www.iag.com.au/agm2006. You will need your Securityholder Reference Number (SRN) or Holder Identification Number (HIN), which is shown in the top right corner of your Proxy Form.

QUESTIONS TO THE AUDITOR

If you would like to submit a written question to the company's auditor relating to the auditor's report or the conduct of the audit please use the reply paid envelope provided or fax to (02) 8235 8220 by 5:00pm on Wednesday 8 November 2006. Alternatively you may submit a question, after completing your proxy online at www.iag.com.au/agm2006. Members will also be given a reasonable opportunity to ask questions of the auditor at the AGM.

DIVIDEND PAYMENT METHODS

Insurance Australia Group Limited no longer pays Australian resident shareholders' dividend payments by cheque. Shareholders are urged to provide the Share Registry with their alternative instructions as detailed below.

IAG – Ordinary Shareholders:

- paid directly into your Australian bank, credit union or building society account; or

- eligible ordinary shareholders can choose to participate in IAG's Dividend Reinvestment Plan (DRP) providing the option to increase your shareholding without incurring brokerage or GST.

IAGPA and IAGPB – Reset Preference Shareholders:

- paid directly into your Australian bank, credit union or building society account.

For further details and forms visit www.iag.com.au/shareholdercentre or call the Share Registry on 1300 360 688.

SHAREHOLDER CENTRE

Shareholders can view and amend details of their holding at www.iag.com.au/shareholdercentre. Using your SRN or HIN and postcode of your registered address to log in, you will be able to:

- view your holding balance;
- view your payment and dividend history or download your dividend payment advice;
- sign up for electronic shareholder communications, including the Annual Report via email;
- confirm or lodge your Tax File Number (TFN), Australian Business Number (ABN) or exemption; and
- access personalised shareholder forms.

Shareholders can also manage their shares online at www.computershare.com.au by clicking on 'Investor Centre'. To access this secure site for registration you will need to enter your Securityholder Reference Number (SRN) or Holder Identification Number (HIN) and postcode. Once registered, you can:

- change your address;
- set up payment instructions;
- add/change TFN/ABN details;
- retrieve holding statements, including your dividend payment advice; and
- sell qualified shares without a broker.

EMAIL ENQUIRIES

If you have a query concerning your shareholding, you can email your enquiry directly to iag@computershare.com.au. If your query relates to an IAG company matter and the response is not on the IAG website, you can email your query to investor.relations@iag.com.au.

CHANGE OF ADDRESS

Individual (single) shareholders can now change their address over the phone by contacting the Share Registry on 1300 360 688 or by downloading a form from the website.

Joint and company shareholdings need to download a form or write a letter to the Share Registry.

TFN, ABN OR EXEMPTION

You are strongly advised to lodge your TFN, ABN or exemption. If you choose not to lodge these details with the Share Registry, then Insurance Australia Group Limited is obliged to deduct tax at the highest marginal tax rate (plus the Medicare levy) from any unfranked portion of any dividend payment.

SHAREHOLDER INFORMATION

ORDINARY SHARES INFORMATION

IMPORTANT DATES	2006
IAG year end	30 June
Full year results and dividend announced	25 August
Record date for final dividend	6 September
Annual Report and Notice of Meeting mailout commences	3 October
Final dividend paid	9 October
Written questions for the auditor close (5:00pm)	8 November
Proxy return closes (10:00am)	13 November
Annual General Meeting (10:00am)	15 November
IAG half-year end	31 December

Please note, dates are subject to change.

TWENTY LARGEST SHAREHOLDERS AS AT 31 AUGUST 2006	NO OF SHARES	% OF ISSUED CAPITAL
J P Morgan Nominees Australia Limited	241,784,276	15.16
National Nominees Limited	123,223,103	7.73
Westpac Custodian Nominees Limited	68,094,394	4.27
ANZ Nominees Limited <Cash Income A/C>	42,122,663	2.64
Citicorp Nominees Pty Limited	34,035,205	2.13
UBS Nominees Pty Ltd	20,735,026	1.30
Cogent Nominees Pty Limited	20,612,909	1.29
RBC Dexia Investor Services Australia Nominees Pty Limited <BKCUST A/C>	16,982,997	1.06
Citicorp Nominees Pty Limited <CFS Wsle 452 Aust Share A/C>	14,437,754	0.91
Citicorp Nominees Pty Limited <CFS Wsle Geared Shr Fnd A/C>	14,043,687	0.88
RBC Dexia Investor Services Australia Nominees Pty Limited <Pipooled A/C>	11,205,232	0.70
AMP Life Limited	9,873,014	0.62
Australian Reward Investment Alliance	9,420,038	0.59
IAG Share Plans Nominee Pty Limited <IAG PAR Unallocated A/C>	7,624,730	0.48
Australian Reward Investment Alliance 1	5,739,633	0.36
Argo Investments Limited	5,213,333	0.33
HSBC Custody Nominees (Australia) Limited	5,171,059	0.32
Woodross Nominees Pty Ltd	5,123,044	0.32
Citicorp Nominees Pty Limited <CFSIL CFSWS Gear 452 AU A/C>	3,888,938	0.24
ANZ Nominees Limited <Income Reinvest Plan A/C>	3,872,666	0.24
Total for top 20	663,203,701	41.58

RANGE OF SHAREHOLDERS AS AT 31 AUGUST 2006	NO OF HOLDERS	NO OF SHARES	% OF ISSUED CAPITAL
1 – 1,000	652,696	343,266,958	21.52
1,001 – 5,000	292,358	432,016,056	27.09
5,001 – 10,000	4,662	33,810,266	2.12
10,001 – 100,000	2,192	49,492,132	3.10
100,001 and over	165	736,445,060	46.17
Total	952,073	1,595,030,472	100.00
Shareholders with less than a marketable parcel of 94 shares as at 31 August 2006	11,347	287,372	

DIVIDEND DETAILS

SHARE CLASS	DIVIDEND	FRANKING	AMOUNT PER SHARE	DRP ISSUE PRICE	PAYMENT DATE
Ordinary	Interim	Fully franked	13.5 cents	\$5.3425	10 April 2006
Ordinary	Special	Fully franked	12.5 cents	\$5.4218	26 June 2006
Ordinary	Final	Fully franked	16.0 cents	*	9 October 2006

* The DRP issue price for the final dividend is scheduled to be announced on 25 September 2006.

SUBSTANTIAL SHAREHOLDINGS AS AT 31 AUGUST 2006

The only shareholder who had a substantial shareholding as at 31 August 2006 was The Capital Group Companies, Inc. who held 133,376,428 ordinary shares representing 8.36% of the ordinary shares on issue (by notice dated 19 July 2006).

SHAREHOLDER INFORMATION

IAGPA RESET PREFERENCE SHARES INFORMATION

IMPORTANT DATES	2006
Record date for interim dividend	29 November
Interim dividend paid	15 December

Please note, dates are subject to change.

TWENTY LARGEST SHAREHOLDERS AS AT 31 AUGUST 2006	NO OF SHARES	% OF ISSUED CAPITAL
J P Morgan Nominees Australia Limited	541,629	15.48
Westpac Custodian Nominees Limited	249,000	7.11
RBC Dexia Investor Services Australia Nominees Pty Limited <JBENIP A/C>	191,744	5.48
National Nominees Limited	177,618	5.07
Cogent Nominees Pty Limited <SMP Accounts>	146,940	4.20
UBS Nominees Pty Ltd	127,663	3.65
Citicorp Nominees Pty Limited	126,775	3.62
AMP Life Limited	100,000	2.86
Share Direct Nominees Pty Ltd <National Nominees A/C>	50,000	1.43
ANZ Nominees Limited <Cash Income A/C>	35,541	1.02
Citicorp Nominees Pty Limited <CFSIL Cwltb Spec 5 A/C>	34,351	0.98
Argo Investments Limited	30,800	0.88
Cambooya Pty Limited	30,650	0.88
M F Custodians Ltd	24,977	0.71
Brencorp No 11 Pty Limited	22,500	0.64
Citicorp Nominees Pty Limited <CMIL Cwltb Income Fund A/C>	20,000	0.57
Armada Investments Pty Ltd	19,500	0.56
Goldman Sachs JBWere Capital Markets Ltd <Hybrid Portfolio A/C>	17,658	0.50
UBS Wealth Management Australia Nominees Pty Ltd	17,165	0.49
Netwealth Investments Limited <Super Services A/C>	14,945	0.43
Total for top 20	1,979,456	56.56

RANGE OF SHAREHOLDERS AS AT 31 AUGUST 2006	NO OF HOLDERS	NO OF SHARES	% OF ISSUED CAPITAL
1 – 1,000	4,221	1,068,358	30.52
1,001 – 5,000	161	337,104	9.63
5,001 – 10,000	14	103,993	2.97
10,001 – 100,000	14	429,176	12.26
100,001 and over	7	1,561,369	44.61
Rounding			0.01
Total	4,417	3,500,000	100.00
Shareholders with less than a marketable parcel of 5 shares as at 31 August 2006	1	4	

DIVIDEND DETAILS

SHARE CLASS	DIVIDEND	FRANKING	AMOUNT PER SHARE	PAYMENT DATE
IAGPA	Interim	Fully franked	\$2.9079	15 December 2005
IAGPA	Final	Fully franked	\$2.8921	15 June 2006

SHAREHOLDER INFORMATION

IAGPB RESET PREFERENCE SHARES INFORMATION

IMPORTANT DATES		2006
Record date for interim dividend		29 November
Interim dividend paid		15 December

Please note, dates are subject to change.

TWENTY LARGEST SHAREHOLDERS AS AT 31 AUGUST 2006	NO OF SHARES	% OF ISSUED CAPITAL
J P Morgan Nominees Australia Limited	464,585	23.23
AMP Life Limited	199,374	9.97
Share Direct Nominees Pty Ltd <National Nominees A/C>	150,000	7.50
Cogent Nominees Pty Limited <SMP Accounts>	123,914	6.20
Citicorp Nominees Pty Limited	83,185	4.16
UBS Nominees Pty Ltd	81,524	4.08
Citicorp Nominees Pty Limited <CFSIL Cwlt Spec 5 A/C>	66,222	3.31
ANZ Nominees Limited <Cash Income A/C>	64,553	3.23
National Nominees Limited	61,110	3.06
RBC Dexia Investor Services Australia Nominees Pty Limited <MLCI A/C>	32,022	1.60
Perpetual Trustee Company Limited	21,086	1.05
Mrs Fay Cleo Martin-Weber	20,000	1.00
Goldman Sachs JBVere Capital Markets Ltd <Hybrid Portfolio A/C>	18,944	0.95
UBS Wealth Management Australia Nominees Pty Ltd	18,715	0.94
Fortis Clearing Nominees P/L <Settlement A/C>	17,987	0.90
Westpac Custodian Nominees Limited	17,300	0.87
Brencorp No 11 Pty Limited	16,000	0.80
Citicorp Nominees Pty Limited <CFSIL CFS WS ENH Yield A/C>	15,556	0.78
Elise Nominees Pty Limited	13,500	0.68
M F Custodians Ltd	12,158	0.61
Total for top 20	1,497,735	74.89

RANGE OF SHAREHOLDERS AS AT 31 AUGUST 2006	NO OF HOLDERS	NO OF SHARES	% OF ISSUED CAPITAL
1 – 1,000	1,140	302,165	15.11
1,001 – 5,000	61	151,431	7.57
5,001 – 10,000	6	48,669	2.43
10,001 – 100,000	16	559,862	27.99
100,001 and over	4	937,873	46.89
Rounding			0.01
Total	1,227	2,000,000	100.00
Shareholders with less than a marketable parcel of 5 shares as at 31 August 2006	0	0	

DIVIDEND DETAILS

SHARE CLASS	DIVIDEND	FRANKING	AMOUNT PER SHARE	PAYMENT DATE
IAGPB	Interim	Fully franked	\$2.2612	15 December 2005
IAGPB	Final	Fully franked	\$2.2488	15 June 2006

GLOSSARY

Actuary

An actuary applies mathematical, economic and financial analyses as well as risk assessment to financial contracts, in a wide range of practical business problems.

AGAAP

AGAAP (Australian Generally Accepted Accounting Principles) were used by the Group to prepare financial reports up to and including the year ended 30 June 2005. From 1 July 2005, the financial reports were required to be prepared under AIFRS (defined below).

AIFRS

The Group was required to adopt AIFRS (Australian equivalents of International Financial Reporting Standards) when preparing its financial report for the year ended 30 June 2006.

APRA

APRA (Australian Prudential Regulation Authority) is the prudential regulator of insurance companies, banks, superannuation funds, credit unions, building societies and friendly societies in Australia. APRA is responsible for ensuring that policyholders, depositors and superannuation fund members are protected by, for example, ensuring that companies have enough capital to be able to meet their ongoing business needs, including reserving to pay claims.

Business volume

This measures the volume of business at a point in time. The basis of the measure depends on the class of business. In the personal lines class, the relevant volume measure is 'risks in force'. In commercial classes, the volume measure is 'policies in force'. The difference in the definition is required to capture the distinct nature of IAG's business mix.

Claims reserves

The portion of premium set aside to cover obligations for unexpired insurance contracts, claims and expenses to be incurred. This amount is invested and the returns on these investments form part of pricing and profit from insurance operations.

CO₂e emissions

In this instance, CO₂e emissions are calculated for electricity use, office paper and print paper consumption, tool of trade fuel consumption and air travel using emission factors obtained from the Australian Greenhouse Office (AGO). The 2005 conversion factors are taken from the December 2005 AGO workbook. Green power electricity emissions are not included.

Customer satisfaction index

This measures the end to end customer experience when enquiring, taking out, renewing or making a claim for direct personal insurance. Customer satisfaction levels are determined by a third party through telephone interviews with a random sample of customers contacted. During the year, there has been a change in the survey provider; however only the customer satisfaction index for the retained provider has been included (results for the 6 months to June 2006). The measure for 2006 also includes customer experience when making a claim.

Employee engagement score

Determined through six mandatory questions in the 'Your Voice' employee survey conducted by a third party. The survey assesses the extent to which employees consistently say positive things about working at IAG, want to stay with IAG and strive to achieve above and beyond what is expected of them. Participation in the survey is voluntary but is made available to all employees, with the exception of those who have been employed for less than three months.

FTE

FTE (full-time equivalent) is a measure of the size of employees that takes account of part-time employees. It is determined by dividing working hours (excluding overtime) for all employees by the standard full-time hours. The FTE includes all permanent full-time and part-time employees but excludes casual employees, guests, employees on a fixed-term contract and employees on extended leave (over 28 consecutive calendar days) on the day that we report the data.

Funding of the OH&S department

This measure includes funding of occupational health and safety (OH&S) initiatives such as spending on medical costs for employees, fire protection, first aid training and an employee assistance program, as well as funding of the OH&S department's salaries and on-costs.

Funds for community investment

This measures direct financial support of community groups and programs, as well as indirect support to help promote and raise awareness of these community organisations. This also includes direct IAG management and administration-related costs. Figures reported are exclusive of GST.

Head count

The number of people employed by IAG, regardless of hours worked, excluding casuals, guests and employees on a fixed-term contract.

Insurance cycle

Insurance is a cyclical business. The insurance cycle represents the peaks and troughs of insurance premiums and profitability. When capacity (ie the availability of capital from insurers to underwrite risks) increases in a market, insurers may reduce premiums, which is called a 'soft cycle'. When there is limited capacity, and premiums rise, this is called a 'hard cycle'.

Long-tail and short-tail insurance

In general terms, this name stems from the length of time (the 'tail') that it takes for a claim to be made and settled. For 'short-tail' insurance products, claims are usually known and settled within 12 months, and are generally based around property. For 'long-tail' insurance products, claims may not even be reported within 12 months, and settlements can take many years, and are generally based around injury compensation (eg medical, legal and loss of income) or other risks such as professional indemnity.

Lost time injury frequency rate

This measures the number of work-related injuries resulting in a lost time injury, per million hours worked. A lost time injury is an injury that has resulted in at least one shift/day's absence from work and for which a workers' compensation claim has been lodged as at 30 June 2006. Million hours worked includes all scheduled hours, plus overtime less scheduled leave (ie annual leave) and also includes the hours worked by casual employees.

Market capitalisation

The size of a company is often measured by its market capitalisation. This is calculated by multiplying the total number of shares on issue by the market price of the shares.

GLOSSARY

Minimum capital requirement

APRA (defined above) requires licensed insurers to have a minimum amount of capital to meet its prudential standard. The amount of capital required is determined by APRA based on formulae designed to reflect the risk profile of each insurer's business and balance sheet, and is called the minimum capital requirement (MCR). Licensed insurers must report their MCR and surplus above it, which is generally stated as a multiple of MCR.

Number of employee volunteer hours

This measures the total number of hours that IAG employees have logged for community/charity leave, defence forces leave and emergency services leave for the year. Defence forces leave and emergency services leave were newly included in 2006.

Policies in force

Policies in force is a measure of the total number of policies covered by an insurance company at a point in time.

Recycled commingled waste

This is a measure of paper, cardboard and commingled material collected for recycling at nine IAG sites (in 2005 only two IAG sites were included), as well as documents destroyed on behalf of IAG in Australia.

Reinsurance

Insurers pay premiums to other insurers (reinsurers) to spread their risk or cover major losses from specific events such as large hailstorms. This is called reinsurance.

Risks in force

Risk refers to the subject matter that an insurance policy or contract protects (eg number of vehicles, houses, employees). An insurance policy may cover one risk or many risks, depending on the terms of the policy. 'Risks in force' is a measure of the total number of risks covered by an insurance company at a point in time.

S&P

S&P stands for Standard & Poor's, a global financial ratings company that analyses the financial strength of companies and individual securities, and assigns them ratings. S&P has many ratings categories, the highest of which is AAA.

S&P/ASX-100 and S&P/ASX-200

S&P/ASX 100 and S&P/ASX 200 are indices made up of the top 100 and 200 companies listed on the ASX. The companies are included based on their size in terms of market capitalisation (defined above).

Shareholders' funds

The investment portfolio other than claims reserves and investments in related entities. It essentially represents the shareholders' capital that is not being utilised in day-to-day operations.

Short-tail insurance

See long-tail insurance.

Staff turnover

Turnover percentage is the sum of the monthly turnover rates determined by dividing the total number of terminations by head count each month. Termination includes all permanent full-time and part-time employees but excludes casual employees, guests and employees on a fixed-term contract.

Underwriter

This is the company or person who assumes the risk under an insurance policy.

CORPORATE DIRECTORY

Share Registry Contact Details

Computershare Investor Services Pty Limited
GPO Box 4709
Melbourne VIC 3001

Hand deliveries to:

Level 2, 60 Carrington Street, Sydney NSW 2000

Telephone (within Australia) 1300 360 688

Telephone (outside Australia) 61 3 9415 4210

Fax (general) 03 9473 2470

Fax (for proxies only) 02 8235 8220

Email iag@computershare.com.au

Registered Office

Insurance Australia Group Limited
Level 26, 388 George Street
Sydney NSW 2000

Telephone 02 9292 9222

Fax 02 9292 8072

Website www.iag.com.au

Plantation is an environmentally responsible paper manufactured under environmental management system ISO 14001 containing 100% recycled fibre including a combination of pre-consumer waste and post-consumer waste sourced from printers' waste and converting waste.

Help us help the environment and reduce costs by electing not to receive annual reports by mail. Instead you can access them online.

How?

Fill out the form at www.iag.com.au or call the share registry on 1300 360 688.

