

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

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NOTES TO THE FINANCIAL STATEMENTS

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NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation of financial report

This general purpose financial report has been prepared in accordance with Corporations Act 2001, applicable Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Consensus Views and the Australian Stock Exchange Listing Rules, except as described in note 24(c)(i). These financial statements are presented in Australian dollars.

The accounting policies adopted in the preparation of this financial report have been consistently applied by each entity in the consolidated entity and are consistent with those of the previous year unless otherwise mentioned. Except for certain assets, which, as noted in the financial statements, are measured at fair value, the financial statements have been prepared on the basis of historical cost.

The statement of financial position has been prepared using the liquidity format of presentation and differs from the presentation as disclosed in the 30 June 2004 Annual Financial Report. The change has been made as it is considered more meaningful to emphasise the importance of liquidity to the users of the financial report. Certain reclassifications have been made from the prior year's financial report to conform to the current year's presentation.

(b) Principles of consolidation

The consolidated financial report incorporates the assets and liabilities of all entities controlled by Insurance Australia Group Limited as at 30 June 2005 and the results of all controlled entities for the period then ended. 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 balances and effects of transactions between group entities are eliminated on consolidation.

Outside equity interests represent the equity interests held by external parties in controlled entities of the IAG Group and are shown as a separate item in the consolidated financial statements.

(c) Premium revenue

Premium revenue comprises amounts charged to policyholders including fire service levies, but excluding stamp duties and taxes collected on behalf of third parties. Premium is recognised as earned from the date of attachment of risk 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 on unclosed business (business written close to reporting date where attachment of risk is prior to reporting date and there is insufficient information to accurately identify the business) is brought to account based on previous 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 statement of financial position.

Premium receivable is stated at the amount due and is normally settled between 30 days and 12 months. The collectibility of debt is assessed and provision is made for doubtful debts having regard to past default experience.

(d) 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 recorded as deferred reinsurance expense in the statement of financial position at the reporting date.

(e) Claims

The outstanding claims liability includes the estimated cost of all unsettled claims, which includes claims incurred but not yet reported, the anticipated direct and indirect costs of settling these claims and an appropriate risk margin, based on the advice of the Group's Approved Actuary. The liability is measured as the present value of the estimated ultimate cost of settling claims and takes into account the effect on the ultimate claim size of future inflation as well as increases in the real levels of compensation awarded by the courts. In determining the liability, allowance is also made for future investment earnings. Details of the discount and inflation rates used are included in note 9.

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

The estimation of the outstanding claims liability is the IAG Group's most critical accounting estimate. The IAG Group takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing the liability, it is likely that the final outcome will be different from the original liability established.

(f) Reinsurance and other recoveries

Reinsurance and other recoveries on paid claims, reported claims not yet paid and incurred claims not yet reported are recognised as revenue. Recoveries receivable are measured as the present value of the expected future receipts, after provisioning for doubtful debts, calculated on the same basis as the outstanding claims liability. Details of the discount and inflation rates used are included in note 10.

(g) 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 unearned premium. The capitalised costs, or deferred acquisition costs, are amortised on the same basis as the earning pattern of the premium over the period of the related insurance contracts. Deferred acquisition costs are 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, exceeds related unearned premium, the deferred acquisition costs are written down to recoverable amount and the write down is recognised as an expense. This test is conducted at the reporting entity level.

(h) 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 recorded as deferred levies and charges. 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 in the statement of financial performance.

(i) Leased assets

The IAG Group leases certain premises, motor vehicles and computer equipment. Payments relating to operating leases, where the lessor effectively retains substantially all the risks and benefits of ownership of the leased items, are charged as an expense in the period in which they are incurred.

(j) Borrowing costs

Borrowing costs, being interest and other ongoing costs incurred in connection with the borrowing of funds, including foreign exchange differences, are expensed as incurred. Where interest rates are hedged or swapped, the borrowing costs are recognised net of any effect of the hedge or the swap. Transaction costs incurred in connection with the arrangement of borrowings are capitalised and amortised as borrowing costs expense over the lesser of the life of the borrowings or 5 years.

(k) Taxation

(i) Income tax

The IAG Group adopts the income statement liability method of tax effect accounting. Income tax is calculated on the operating result adjusted for permanent differences between taxable and accounting income. Any future income tax benefit relating to tax losses or other timing differences is not carried forward as an asset unless the benefit can be regarded as being virtually certain of realisation or beyond reasonable doubt of realisation, respectively. Income tax on net cumulative timing differences is set aside to the deferred income tax and future income tax benefit accounts at the tax rates which are expected to apply when those timing differences reverse. Deferred tax assets and liabilities are not discounted to present value.

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For the year ended 30 June 2005

(k) Taxation (continued)

(ii) Tax consolidation

Insurance Australia Group Limited ("head entity") and its Australian resident wholly-owned subsidiaries adopted the tax consolidation legislation effective from 1 July 2002. The Company is the head entity and recognises all of the current and deferred tax assets and liabilities of the tax-consolidated group (after elimination of intragroup transactions).

The tax-consolidated group has entered into a tax funding agreement that requires wholly-owned subsidiaries to make contributions to the head entity for current tax assets and liabilities and movements in deferred tax balances arising from external transactions during the year.

Under the tax funding agreement, the contributions are calculated on a "stand alone taxpayer basis" so that the contributions are equivalent to the tax balances generated by external transactions entered into by each wholly-owned subsidiary. The contributions are payable as set out in the agreement and reflect the timing of the head entity's obligations to make payments for tax liabilities to the relevant tax authorities. The assets and liabilities arising under the tax funding agreement are recognised as intercompany receivables and payables with a consequential adjustment to income tax expense/credit.

(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 in the statement of financial position. Cash flows are included in the statement of cash flows 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.

(l) Other receivables

Other receivables are stated at the amounts to be received in the future and are normally settled between 30 days and 12 months. The balance is not discounted because the effect of the time value of money is not material. The collectibility of debts is assessed and provision is made for doubtful debts having regard to past default experience.

(m) Investments

Investments comprise assets held to back insurance liabilities and assets that represent shareholders' funds. The IAG Group maintains segregated portfolios for those assets.

Investments are initially recorded at fair value (being cost of acquisition including transaction costs) and are subsequently measured at net market value (fair value less estimated costs to sell) at each reporting date. Changes in the net market value from the previous reporting date (or cost of acquisition, if acquired during the financial year) are recognised as revenue or expense in the statement of financial performance as investment gains and losses.

For listed securities, fair value is determined by reference to market quotations. For unlisted securities, fair value is determined by reference to a valuation based on current economic conditions and the latest available information on the particular securities.

Investment income, comprising dividends, trust distributions and interest, is brought to account on an accruals basis. Income 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.

(n) Investments in controlled entities

Investments in controlled entities are initially recorded at cost and are carried in the Company's financial statements at the lower of cost and recoverable amount. Income from these investments, comprising dividends and trust distributions, are brought to account on an accruals basis. Dividends are accrued on the date they are declared.

(o) Derivatives

The IAG Group uses a variety of derivatives for the sole purpose of managing risk exposures of the IAG Group. Derivatives are not held for speculative purposes.

There is no Australian accounting standard setting out the measurement requirements for these financial instruments, and so the IAG Group accounts for them in accordance with developed market practice.

Investment operations:

All of the derivatives used in relation to the investment operations are recognised on the statement of financial position (disclosed together with the underlying instrument) at fair value with movements in fair value being recorded in the statement of financial performance. This matches the accounting for the derivatives with the accounting for the underlying investments.

The fair value is determined by reference to market quotes. Derivatives used in investments operations include share price index futures, equity swap agreements, exchange traded options and bank bill and bond futures.

Treasury operations:

There are various derivatives used by the IAG Group to hedge its exposure to foreign currency and interest rate movements in relation to treasury transactions (which include borrowings). These are:

Cross currency swaps – The IAG Group enters into cross currency swaps to hedge foreign currency borrowings. Interest receipts and payments on the swaps are charged to the statement of financial performance on a daily basis over the term for which the swap is effective as a hedge of the underlying borrowing and are included within the interest expense on borrowings. Revaluation gains and losses are recognised in the statement of financial performance against the revaluation losses and gains of the underlying hedged items.

Interest rate swaps – The IAG Group enters into interest rate swaps to hedge its exposure to interest rate movements on its borrowings. The interest income and expense associated with the swap agreements are charged to the statement of financial performance on a daily basis over the term for which the swap is effective as a hedge of the underlying borrowings. The net amounts receivable or payable are recognised in the statement of financial position on a daily basis over the term for which the swap arrangement is effective as a hedge of the underlying borrowings.

Forward foreign exchange contracts – The IAG Group enters into forward foreign exchange contracts to hedge foreign currency exposures recognised on its statement of financial position. The net amounts receivable or payable under forward foreign exchange contracts and the associated deferred gains or losses are recorded on the statement of financial position from the date of inception of the hedge transaction. When recognised, the net receivables or payables are revalued using the foreign currency exchange rate current at reporting date.

Anticipated transactions – The IAG Group also uses derivatives in relation to anticipated transactions. Transactions are designated as a hedge of an anticipated specific acquisition of controlled foreign entities, or an anticipated transaction, only when they are expected to reduce exposure to the risks being hedged, are designated prospectively so that it is clear when an anticipated transaction has or has not occurred, and it is probable the anticipated transaction will occur. Gains or losses on the hedge arising up to the date of the anticipated transaction, together with any costs arising at the time of entering into the hedge, are deferred and included in the measurement of the transaction. Any gains or losses on the hedge transaction after the transaction date are included in the statement of financial performance. If the transaction does not occur as anticipated, the costs are immediately expensed.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(p) Property, plant and equipment

Plant and equipment is initially recorded at cost which is the fair value of consideration provided plus incidental costs directly attributable to the acquisition. All items of plant and equipment are carried at the lower of cost less accumulated depreciation and recoverable amount. Items of plant and equipment 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 for appropriateness. The depreciation rates used currently for each class of asset are as follows:

Motor vehicles	12.5% – 20%
Office and other plant and equipment	6.67% – 40%

All land and buildings are measured at net market value at each reporting date based on independent valuations using market-based evidence. Changes in the net market value from the previous reporting date (or cost of acquisition, if acquired during the financial year) are recognised as revenue or expense in the statement of financial performance.

(q) Goodwill

Acquisitions of a controlled entity or business are accounted for using the acquisition method. Goodwill, representing the excess of the purchase consideration plus incidental costs over the fair value of the identifiable net assets acquired, including any liability for restructuring costs, is amortised on a straight line basis over the period during which benefits are expected to arise subject to a maximum of 20 years. The recoverability of the carrying value of each of the components of goodwill is reviewed for impairment at each reporting date by determining the present value 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 which are consistent with long term industry averages. If the carrying value exceeds the recoverable amount, the carrying value is reduced through an impairment charge to the statement of financial performance.

(r) Intangible assets

Acquired intangible assets, representing mainly contractual rights, 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 are amortised on a straight line basis over the period in which the related benefits are expected to be realised, being 3 to 6 years. The amortisation periods are subject to review annually. The recoverability of the carrying value of these assets is reviewed for impairment at each reporting date using the present value of the expected net cash flows. If the carrying value exceeds the recoverable amount, the carrying value is reduced through an impairment charge to the statement of financial performance.

(s) Trade and other creditors

Trade and other creditors are stated at the amounts to be paid in the future for goods or services received and are normally settled within 30 days. The balance is not discounted because the effect of the time value of money is not material.

(t) 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 for 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 the expected future increases in remuneration rates, experience of employee departures and period of service, are incorporated in the measurement.

(iii) Share based incentive arrangements

The IAG Group provides share based remuneration in different forms to eligible employees and directors. The different arrangements are discussed in note 30. To satisfy IAG Group's 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. The cost of shares acquired is carried as a prepayment in the statement of financial position. This prepayment is expensed in full through the statement of financial performance generally over a period approximating the period during which the related employment services are provided.

There remains one plan, the Performance Share Rights Plan, which while now closed to new entitlements, has rights outstanding which if the relevant conditions are met and the rights vest, is satisfied through the provision of newly issued shares. There is no recognition of these rights in the financial statements until the rights are exercised and the shares are issued, at which time the shares are measured at cost and recognised as share capital in the statement of financial position.

(iv) Superannuation

The IAG Group contributes to both defined contribution and defined benefit superannuation plans. Contributions are reflected in the statement of financial performance as they fall due. The IAG Group contributes to the various superannuation plans in accordance with their governing rules and 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. Any surplus or deficit from defined benefit superannuation plans is not recognised in the statement of financial position.

(u) Provision for dividends

Provision for dividends are made in respect of all types of contributed equity where the dividends are declared on or before the reporting date but have not yet been distributed at that date.

(v) 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 the ongoing activities of the IAG Group. The adequacy of the provision is reviewed regularly and adjusted if required.

Where the provision is established as part of the cost of an acquisition, and certain requirements are met, the amount is capitalised as goodwill. Provisions established under other circumstances are expensed. The provision is not discounted because the effect of the time value of money is not material.

(w) Interest-bearing liabilities

Senior term notes and subordinated term notes are stated at cost and have a residual contractual maturity of between 2 months to 10 years. Interest expense is brought to account on an accruals basis. Transaction costs are included as a prepayment and are amortised as borrowing costs expense over the lesser of the life of the borrowings or 5 years. Any difference between the proceeds (net of transaction costs) and the settlement or redemption of borrowings (ie the premium or discount) is expensed over the term of the liabilities as borrowing costs expense.

(x) Reset preference shares

The reset preference shares have no fixed maturity, are redeemable and convertible only at the option of IAG, dividends are at the Directors' discretion and the shares have no cumulative dividend obligations. Accordingly, they are classified as equity with related distributions classified as dividends.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

(y) Foreign currency

(i) Foreign currency transactions

Foreign currency transactions are initially translated into the reporting currency at the rates of exchange at the dates of the transactions. At reporting date, amounts payable to and by the IAG Group in foreign currencies are translated to Australian currency at rates of exchange current at reporting date. Resulting exchange differences are brought to account in the statement of financial performance except for those relating to controlled foreign entities and hedging transactions as per (ii) and (iii) below.

(ii) Translation of controlled foreign operations

The financial position and performance of controlled foreign entities are translated into Australian currency for inclusion in the IAG Group's consolidated financial report. The assets and liabilities are translated using reporting date exchange rates while equity items are translated using historical rates. The statements of financial performance are translated using weighted average rates for the reporting period. Exchange differences arising from the translations are recorded directly in the foreign currency translation reserve until the disposal, or part disposal, of a foreign operation.

The balance of the foreign currency translation reserve relating to a foreign operation that is disposed of, or partially disposed of, is transferred to retained profits in the year of disposal.

(iii) Hedge transactions

Derivatives are used to hedge the foreign exchange risk relating to certain transactions. Refer to note 1(o) for details of the relevant accounting policies.

(z) Earnings per share

(i) Basic earnings per share

Basic earnings per share is determined by dividing the earnings attributable to shareholders of the Company, excluding any costs of servicing equity (other than ordinary shares and reset preference shares classified as ordinary shares for basic earnings per share calculation purposes), by the weighted average number of shares of the Company outstanding during the financial year.

(ii) Diluted earnings per share

Diluted earnings per share is determined by dividing the amount used in the calculation of basic earnings per share, adjusted by the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares, by the weighted average number of ordinary shares and dilutive potential ordinary shares.

(aa) Reset exchangeable securities

Reset exchangeable securities ("RES") are initially measured at face value plus transaction costs incurred in issuing the securities. Interest expense on the reset exchangeable securities is brought to account on an accruals basis and payable quarterly subject to the terms of issue. Transactions costs are disclosed separately as deferred borrowing costs and are amortised over 5 years from the date of issue. In the statement of financial position, 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 IAG Group's intention to realise the Portfolio and settle the RES liability simultaneously.

	PARENT 2005 \$m	PARENT 2004 \$m	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 2. REVENUE				
Revenue from ordinary activities				
(a) General insurance revenue				
Direct gross written premium	-	-	6,674	6,421
Movement in unearned premium liability	-	-	(112)	(162)
Direct premium revenue	-	-	6,562	6,259
Inwards reinsurance premium revenue	-	-	(1)	6
Premium revenue	-	-	6,561	6,265
Reinsurance and other recoveries	-	-	660	550
Total general insurance revenue	-	-	7,221	6,815
(b) Investment revenue				
Dividend income	585	812	96	52
Interest income	-	-	394	420
Trust income	-	-	15	13
Total investment income	585	812	505	485
Changes in net market values of investments				
– realised gains	-	64	209	116
– unrealised gains	-	-	341	212
Total investment revenue	585	876	1,055	813
(c) Other operating revenue				
Fee based business revenue	-	-	178	216
Life insurance business revenue	-	-	-	70
	-	-	178	286
Proceeds from disposal of plant and equipment	-	-	9	9
Total other operating revenue	-	-	187	295
Total revenue from operating and ordinary activities	585	876	8,463	7,923

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 3. ANALYSIS OF TOTAL EXPENSES		
Expenses (excluding borrowing costs expense) disclosed on the face of the statements of financial performance:		
Reinsurance expense	417	402
Claims expense	4,729	4,365
Acquisition costs	1,075	1,029
Other underwriting expenses	339	318
Fire service levies	177	153
Corporate, administration and other expenses	390	438
Total expenses	7,127	6,705
Analysis of expenses by function:		
General insurance business expenses	6,737	6,267
Life insurance business expenses	-	52
Corporate and administration expenses	390	386
Total expenses	7,127	6,705

	NOTES	PARENT 2005 \$m	PARENT 2004 \$m	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 4. PROFIT FROM ORDINARY ACTIVITIES BEFORE INCOME TAX					
(a) Profit from ordinary activities before income tax includes the following items whose disclosure is relevant in explaining the financial performance of the IAG Group:					
Profit on sale of ClearView retirement services businesses and NRMA Health Pty Limited	27	-	(64)	-	(59)
Restructuring / integration costs	20	-	-	12	52
Insurance protection tax levied by the NSW State Government		-	-	20	20
(b) Profit from ordinary activities before income tax includes the following specific net (gains) and expenses:					
Depreciation of motor vehicles		-	-	11	9
Depreciation of office and other plant and equipment		-	-	28	29
Amortisation of goodwill		-	-	92	91
Amortisation of intangibles		-	-	13	27
Net loss on disposal of plant and equipment		-	-	3	4
Operating lease rentals		-	-	191	130
Transfer to employee benefits provision		-	-	67	59
Foreign exchange losses / (gains)		-	-	27	(4)
Bad and doubtful debts		-	-	1	6

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	NOTE	PARENT 2005 \$m	PARENT 2004 \$m	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 5. INCOME TAX					
The income tax for the financial year differs from the amount calculated on the profit from ordinary activities. The differences are reconciled as follows:					
Profit from ordinary activities before income tax		585	876	1,258	1,152
Income tax calculated at 30% (2004 – 30%)		176	263	377	346
Tax effect of permanent differences:					
Rebateable dividends		(176)	(246)	(22)	(14)
Capital profits not subject to income tax		-	(15)	(4)	(18)
Other non-deductible items		-	-	34	39
Other		(2)	-	(2)	3
Income tax (credit) / expense applicable to current year		(2)	2	383	356
Adjustment to prior year		-	(2)	-	3
Income tax (credit) / expense attributable to profit from ordinary activities before impact of tax consolidation		(2)	-	383	359
Effect of resetting tax values on entering tax consolidation	(i)	-	-	(4)	(13)
Income tax expense related to current and deferred tax transactions of the tax-consolidated group subsidiaries upon implementation of tax consolidation		-	196	-	-
Recovery of income tax expense under a tax funding agreement at transition		-	(196)	-	-
Income tax (credit) / expense attributable to profit from ordinary activities after impact of tax consolidation		(2)	-	379	346

Note:

(i) The head entity was required to establish the tax cost of the assets of certain subsidiaries it acquired after the formation of the tax-consolidated group by using the Allocable Cost Amount method. As a result, an income tax credit of \$4 million (2004 – \$13 million) was recognised by these subsidiaries entering the tax-consolidated group.

NOTE 6. SEGMENT REPORTING

(a) Primary reporting – business segments

On 20 July 2004, the IAG Group announced an organisational restructure along four business lines. The consequential management restructuring and changes to internal reporting systems to the Chief Executive Officer and the Board were implemented in the half year ended 31 December 2004. Comparative segment information has been restated to reflect the new structure.

The IAG Group operated in the general insurance industry throughout the year. Revenue from the general insurance industry is derived from the underwriting of personal, commercial and international insurance

businesses and these form separate reportable segments. The international insurance business comprised all personal and commercial business underwritten outside Australia and by the controlled entity, IAG Re Limited. Other activities, including corporate services, investment management and investment of the IAG Group's capital funds form a separate segment. In the year ended 30 June 2004, the IAG Group also operated businesses in the retirement services industry, which were sold on 21 January 2004. For the purposes of the comparatives, this segment (with external revenues of \$53 million and profit from ordinary activities before income tax of \$15 million for the year ended 30 June 2004) has been amalgamated in the corporate and investments segment.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 6. SEGMENT REPORTING (CONTINUED)

(a) Primary reporting – business segments (continued)

	PERSONAL INSURANCE 2005 \$m	COMMERCIAL INSURANCE 2005 \$m	INTERNATIONAL INSURANCE 2005 \$m	CORPORATE AND INVESTMENTS 2005 \$m	INTERSEGMENT ELIMINATION 2005 \$m	TOTAL 2005 \$m
External revenue	4,552	2,102	1,193	616	-	8,463
Intersegment revenue	-	-	267	-	(267)	-
Total revenue	4,552	2,102	1,460	616	(267)	8,463
Underwriting profit	291	68	125	-	-	484
Investment revenue net of investment fees – technical reserves	303	179	34	-	-	516
Insurance profit	594	247	159	-	-	1,000
Investment revenue net of investment fees – shareholders' fund	-	-	-	501	-	501
Other net operating result	-	(14)	(5)	(224)	-	(243)
Profit from ordinary activities before income tax	594	233	154	277	-	1,258
Income tax expense						(379)
Net profit						879
Segment assets	5,992	3,755	679	6,721	-	17,147
Unallocated assets						-
Total assets						17,147
Segment liabilities	5,992	3,755	679	2,281	-	12,707
Unallocated liabilities						-
Total liabilities						12,707
Acquisitions of property, plant and equipment, intangibles and other non-current segment assets	-	-	-	85	-	85
Depreciation expense*	15	10	7	7	-	39
Amortisation of goodwill and intangibles	-	-	-	105	-	105
Total depreciation and amortisation expense	15	10	7	112	-	144
Other non-cash expenses	44	22	9	5	-	80

* Depreciation expense is allocated to different business segments as management fees from the corporate segment. Therefore all property, plant and equipment is treated as part of the corporate segment.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	PERSONAL INSURANCE 2004 \$m	COMMERCIAL INSURANCE 2004 \$m	INTERNATIONAL INSURANCE 2004 \$m	CORPORATE AND INVESTMENTS 2004 \$m	INTERSEGMENT ELIMINATION 2004 \$m	TOTAL 2004 \$m
External revenue	4,155	2,045	994	729	-	7,923
Intersegment revenue	-	-	251	6	(257)	-
Total revenue	4,155	2,045	1,245	735	(257)	7,923
Underwriting profit	432	69	47	-	-	548
Investment revenue net of investment fees – technical reserves	162	61	21	-	-	244
Insurance profit	594	130	68	-	-	792
Investment revenue net of investment fees – shareholders' fund	-	-	-	543	-	543
Other net operating result	-	21	-	(204)	-	(183)
Profit from ordinary activities before income tax	594	151	68	339	-	1,152
Income tax expense						(346)
Net profit						806
Segment assets	5,625	3,474	700	6,492	-	16,291
Unallocated assets						-
Total assets						16,291
Segment liabilities	5,625	3,474	700	2,268	-	12,067
Unallocated liabilities						-
Total liabilities						12,067
Acquisitions of property, plant and equipment, intangibles and other non-current segment assets	-	-	-	92	-	92
Depreciation expense*	15	9	6	8	-	38
Amortisation of goodwill and intangibles	-	-	-	118	-	118
Total depreciation and amortisation expense	15	9	6	126	-	156
Other non-cash expenses	53	29	5	7	-	94

* Depreciation expense is allocated to different business segments as management fees from the corporate segment. Therefore all property, plant and equipment is treated as part of the corporate segment.

(b) Secondary reporting – geographical segments

The consolidated entity operates mainly in the Australian and New Zealand general insurance industry. It also operated in the retirement services industry in Australia before the sale of the ClearView retirement

services businesses effective 21 January 2004. In the Australian market the IAG Group operates in all states and territories. Australia and international (primarily New Zealand) markets are therefore separate reportable geographical segments.

	AUSTRALIA		INTERNATIONAL		INTERSEGMENT ELIMINATION		TOTAL	
	2005 \$m	2004 \$m	2005 \$m	2004 \$m	2005 \$m	2004 \$m	2005 \$m	2004 \$m
External revenue	7,216	6,882	1,247	1,041	-	-	8,463	7,923
Segment assets	15,854	15,254	2,169	1,908	(876)	(871)	17,147	16,291
Acquisitions of property, plant and equipment, intangibles and other non-current segment assets	70	90	15	2	-	-	85	92

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	CONSOLIDATED 2005 cents	CONSOLIDATED 2004 cents
NOTE 7. EARNINGS PER SHARE		
(a) Ordinary shares		
Basic earnings per share	45.89	37.87
Diluted earnings per share	45.83	37.74

	2005 NUMBER OF SHARES million	2004 NUMBER OF SHARES million
(i) Reconciliation between basic earning per share denominator and diluted earnings per share denominator		
Weighted average number of ordinary shares outstanding during the financial year used in calculation of the basic earnings per share	1,593	1,681
Potential ordinary shares under the Performance Share Rights Plan (note 30(d)(ii)):		
Expiry date 21 December 2010	-	1
Expiry date 30 April 2011	1	4
Expiry date 13 December 2011	1	1
Expiry date 5 March 2012	1	1
Cancelled potential ordinary shares	(1)	(1)
Weighted average number of ordinary shares and potential ordinary shares outstanding during the financial year used in calculation of the diluted earnings per share	1,595	1,687

Subsequent to reporting date, on 29 July 2005, a total of 0.2 million ordinary shares were issued as a result of the exercise of vested

Performance Share Rights. At 30 June 2005, these shares were included as potential ordinary shares used in calculation of diluted earnings per share.

	2005 \$m	2004 \$m
(ii) Reconciliation of earnings used in calculating earnings per share		
Net profit	879	806
Net profit attributable to outside equity interests	(119)	(141)
Net profit attributable to shareholders of Insurance Australia Group Limited	760	665
Net profit attributable to reset preference shares	(29)	(29)
Earnings used in calculating basic and diluted earnings per share	731	636

	2005 cents	2004 cents
(b) Reset preference shares		
Basic earnings per share	533.09	532.30

	2005 NUMBER OF SHARES million	2004 NUMBER OF SHARES million
Weighted average number of reset preference shares outstanding during the financial year used in calculation of the basic earnings per share	6	6

	2005 \$m	2004 \$m
Net profit used in calculating basic earnings per share (based on dividends paid or payable on reset preference shares)	29	29

(c) In respect of the reset exchangeable securities ("RES") issued by IAG Finance (New Zealand) Limited, a wholly-owned subsidiary of IAG, during the financial year, there are no dilutive potential ordinary shares

or dilutive potential reset preference shares arising from the issue of RES as at 30 June 2005.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	PARENT 2005 \$m	PARENT 2004 \$m	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 8. DIVIDENDS AND DIVIDEND FRANKING ACCOUNT				
(a) Dividends				
(i) Ordinary shares				
Final dividend for year ended 30 June 2004 of 14 cents (year ended 30 June 2003 – 7 cents) per share, paid on 18 October 2004, fully franked at 30% (year ended 30 June 2003 – 30%)	222	118	222	118
Interim dividend of 12 cents (2004 – 8 cents) per share, paid on 18 April 2005, fully franked at 30% (2004 – 30%)	191	135	191	135
(ii) Reset preference shares				
Dividend paid on IAGPA* at 5.80% per annum and IAGPB* at 4.51% per annum, fully franked at 30% (2004 – 30%)	29	29	29	29
Total dividends declared and paid by cash	442	282	442	282

* – Refer to note 23(ii) for more details on the two issues of reset preference shares.

Subsequent to reporting date, on 19 August 2005, a final dividend of 14.5 cents per ordinary share, 100% franked, was declared by the Company. The dividend reinvestment plan (“DRP”) will operate using

shares acquired on-market with no discount applied. The dividend will be paid on 17 October 2005. The last date for the receipt of an election notice for participation in any DRP is 14 September 2005.

(b) Dividend franking account

The amount of franking credits available for the subsequent annual reporting period are:

Franking account balance at reporting date at 30%	343	260	354	262
Franking credits to arise from payment of income tax payable	165	147	205	203
Franking debits to arise from receipt of income tax refundable	(20)	-	(20)	-
Franking credits to arise from receipt of dividends receivable	3	-	4	-
Franking credits available for future reporting periods	491	407	543	465
Franking account impact of dividends declared after reporting date but before issuance of financial report	(99)	(96)	(99)	(96)
Franking credits available for subsequent financial years	392	311	444	369

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 entity if distributable profits of non-wholly owned controlled entities were paid as dividends.

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 9. CLAIMS		
(a) Claims expense		
Direct business	4,067	3,797
Inwards reinsurance business	2	18
Net claims expense incurred	4,069	3,815

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 9. CLAIMS (CONTINUED)

(b) Claims development

Given the uncertainty in establishing the outstanding claims liability, it is likely that the final outcome will be different from the original liability established.

	CONSOLIDATED					
	2005			2004		
	CURRENT YEAR \$m	PRIOR YEARS \$m	TOTAL \$m	CURRENT YEAR \$m	PRIOR YEARS \$m	TOTAL \$m
Direct business						
Gross claims and related expenses – undiscounted	5,093	(236)	4,857	4,923	(292)	4,631
Discount	(247)	118	(129)	(249)	(44)	(293)
Gross claims and related expenses – discounted	4,846	(118)	4,728	4,674	(336)	4,338
Reinsurance and other recoveries – undiscounted	(609)	(168)	(777)	(537)	(58)	(595)
Discount	19	97	116	24	30	54
Reinsurance and other recoveries – discounted	(590)	(71)	(661)	(513)	(28)	(541)
Net claims expense incurred	4,256	(189)	4,067	4,161	(364)	3,797

Current year claims relate to risks borne in the current financial year. Prior year claims relate to a reassessment of the risks borne 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).

Claims development refers to the financial adjustment in the current period relating to claims incurred in previous periods because of new and better information that has become available and to reflect changes in inflation and discount assumptions.

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
(c) Outstanding claims liability		
Expected future payments for claims incurred		
– central estimate	5,785	5,380
– claims handling costs	451	416
– risk margin	2,018	1,854
	8,254	7,650
Discount to present value	(1,414)	(1,323)
Outstanding claims liability	6,840	6,327

(d) Risk margin

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, general statistical uncertainty, the general insurance environment, and the impact of legislative reform. The probability of 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 IAG Group.

As at 30 June 2005, the IAG Group's percentage risk margin applied to expected and discounted future payments for claims incurred net of expected recoveries is 25.6%, representing a probability of adequacy of 92.5%.

(e) Actuarial assumptions

The following actuarial assumptions were used in the measurement of outstanding claims and recoveries at reporting date:

	2005 %	2004 %
For the succeeding year:		
– normal inflation rate	3.0 – 4.0	3.0 – 4.0
– superimposed inflation rate	2.5 – 8.0	2.5 – 6.0
– discount rate	4.0 – 5.4	5.3 – 5.5
For subsequent years:		
– normal inflation rate	3.0 – 4.0	3.0 – 4.0
– superimposed inflation rate	2.5 – 8.0	2.5 – 6.0
– discount rate	5.0 – 5.2	5.3 – 6.4

(f) The weighted average expected term to settlement of the gross outstanding claims from the reporting date is estimated to be 3.0 years (2004 – 2.8 years).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 10. REINSURANCE AND OTHER RECOVERIES		
(a) Reinsurance and other recoveries receivable		
Reinsurance and other recoveries receivable on outstanding claims liability	1,196	987
Reinsurance and other recoveries receivable on paid claims	170	169
Entitled future reinsurance and other recoveries	1,366	1,156
Provision for doubtful debts	(8)	(8)
Expected future recoveries	1,358	1,148
Discount to present value	(305)	(233)
Reinsurance and other recoveries receivable	1,053	915
(b) Actuarial assumptions		
Refer to note 9(e) for the actuarial assumptions used in the measurement of reinsurance and other recoveries receivable.		
(c) Reinsurance programme		
Reinsurance has two principal goals, being to protect an insurer's balance sheet from excess risk and to facilitate the efficient use of an insurer's capital. To facilitate this and to create economies of scale, IAG has established a captive insurance company, IAG Re Limited		
		("IAG Re"). The operations of IAG Re are intended to manage reinsurance and earnings volatility and the IAG Group's exposure to catastrophe risk. In addition to the overall IAG Group reinsurance programme, individual business units are permitted to purchase additional reinsurance protection. The creditworthiness of reinsurers is considered on an ongoing basis by reviewing their financial strength.
NOTE 11. DEFERRED ACQUISITION COSTS		
Deferred acquisition costs at the beginning of the financial year	558	513
Acquisition costs deferred	1,138	1,074
Amortisation charged	(1,075)	(1,029)
Deferred acquisition costs at the end of the financial year	621	558
NOTE 12. UNEARNED PREMIUM LIABILITY		
Unearned premium liability at the beginning of the financial year	3,472	3,301
Deferral of premiums on contracts written in the financial year	3,500	3,394
Earning of premiums written in previous years	(3,386)	(3,223)
Unearned premium liability at the end of the financial year	3,586	3,472
NOTE 13. INVESTMENTS		
Listed		
<i>Money market securities</i>		
– Australian government and semi-government	2,698	3,093
– foreign government	181	140
– financial institutions and corporate	159	119
<i>Equity and trust securities</i>		
– Australian	2,381	2,345
– international	532	212
	5,951	5,909
Unlisted		
<i>Money market securities</i>		
– financial institutions and corporate	4,215	3,634
<i>Equity and trust securities</i>		
– Australian	129	120
– international	80	23
	4,424	3,777
	10,375	9,686

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 14. OTHER RECEIVABLES		
Trade debtors	46	158
Provision for doubtful debts	(10)	(10)
	36	148
Premium funding loans secured on policies (net of unearned interest)	130	91
Provision for doubtful debts	(2)	(1)
	128	90
GST recoverable on outstanding claims liability	300	270
Investment income receivable	99	100
Other debtors	91	134
	654	742

	CONSOLIDATED				TOTAL \$m
	LAND \$m	BUILDINGS \$m	MOTOR VEHICLES \$m	OFFICE AND OTHER PLANT AND EQUIPMENT \$m	
NOTE 15. PROPERTY, PLANT AND EQUIPMENT					
2005					
Cost	-	-	70	298	368
Accumulated depreciation	-	-	(19)	(160)	(179)
Net market value	37	32	-	-	69
Balance at the end of the financial year	37	32	51	138	258
Balance at the beginning of the financial year	35	31	46	119	231
Additions	-	-	22	53	75
Disposals	(4)	(1)	(6)	(6)	(17)
Depreciation expense	-	-	(11)	(28)	(39)
Movement in net market value	6	2	-	-	8
Balance at the end of the financial year	37	32	51	138	258
2004					
Cost	-	-	63	265	328
Accumulated depreciation	-	-	(17)	(146)	(163)
Net market value	35	31	-	-	66
Balance at the end of the financial year	35	31	46	119	231

The properties were valued by the independent valuer, Mr Scott Fullarton FAPI of Scott Fullarton Valuations Pty Limited

	PARENT 2005 \$m	PARENT 2004 \$m	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 16. DEFERRED TAX ASSETS				
Future income tax benefits relating to				
– tax losses carried forward	-	-	-	19
– other	239	246	264	277
	239	246	264	296

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 17. INTANGIBLE ASSETS		
Contractual arrangements	102	102
Trademark	3	1
	105	103
Accumulated amortisation	(98)	(85)
	7	18

All of the intangible assets have finite useful lives.

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 18. GOODWILL		
Goodwill	1,643	1,635
Accumulated amortisation	(283)	(191)
Exchange rate movements	11	11
	1,371	1,455

Of the net goodwill amount, \$298 million is denominated in NZ dollars (2004 – \$307 million) and so is subject to foreign exchange rate movements.

	NOTES	PARENT 2005 \$m	PARENT 2004 \$m	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 19. PAYABLES					
Trade creditors		-	-	529	525
Other creditors		1	-	303	329
Loan from other party		-	-	83	83
		1	-	915	937

	NOTES	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 20. RESTRUCTURING PROVISION			
Balance at the beginning of the financial year		29	53
Additional provisions recognised	4	12	52
Paid during the financial year		(30)	(76)
Balance at the end of the financial year		11	29

In the financial year ended 30 June 2003, a provision of \$48 million was established for restructuring the operations of the acquired entities, being CGU/NZI. This provision was capitalised as goodwill on consolidation. No further provisions were raised in the acquired entities during the financial year ended 30 June 2005. The provision was fully utilised at 30 June 2005 (2004 – \$18 million).

The additional provisions of \$12 million recognised in 2005 relate to restructuring of customer-facing outlets in Insurance Australia Limited and Insurance Manufacturers of Australia Pty Limited. A balance of

\$11 million remains in this provision as at 30 June 2005. The provision for restructuring of customer-facing outlets is expected to be utilised within the next 12 months.

The additional provisions of \$52 million recognised in 2004 related to restructuring activities in the entities which acquired CGU/NZI, being Insurance Australia Limited and IAG New Zealand Limited. The 2004 restructuring provision was fully utilised as at 30 June 2005 (2004 – \$11 million).

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	NOTES	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 21. INTEREST-BEARING LIABILITIES			
<i>Unsecured</i>			
NZ senior term notes	(i)	91	91
Subordinated term notes	(ii)	301	301
US subordinated term notes	(iii)	315	345
Cross currency swaps hedge payable	(iii)	86	56
		793	793

Notes:

- (i) The NZ senior term notes were issued through IAG (NZ) Holdings Limited's medium term note programme. NZ\$100 million of notes were issued, of which NZ\$50 million mature in August 2005 and NZ\$50 million mature in August 2008. This programme is denominated in NZ dollars and translated into the equivalent A\$ using the reporting date exchange rate.
- (ii) The subordinated term notes were issued principally through Insurance Australia Limited's debt issuance programme (\$300 million face value) and mature in November 2012. \$250 million is at a fixed rate and \$50 million is at floating rate. These notes qualify as Lower Tier 2 capital for the purposes of Insurance Australia Limited's Australian Prudential Regulation Authority ("APRA") regulatory capital position.
- (iii) The US subordinated term notes (US\$240 million) are on issue from NRMA Insurance Funding 2003 Limited (a wholly-owned subsidiary of Insurance Australia Limited) and mature in April 2015. These notes qualify as Lower Tier 2 capital for the purposes of Insurance Australia Limited's APRA regulatory capital position. They are fixed rate notes with the principal and interest flows denominated in US dollars, which are hedged with cross currency swaps.

NOTE 22. CURRENT AND NON-CURRENT INFORMATION

While the IAG Group presents the statement of financial position using

the liquidity format, there are specific disclosure requirements regarding current / non-current classifications for certain items.

	CONSOLIDATED CURRENT \$m	CONSOLIDATED NON-CURRENT \$m	CONSOLIDATED TOTAL \$m
2005			
Assets			
Investments	2,869	7,506	10,375
Reinsurance and other recoveries receivable	366	687	1,053
Deferred levies and charges	105	-	105
Deferred reinsurance expense	194	-	194
Deferred acquisition costs	588	33	621
Deferred tax assets	-	264	264
Liabilities			
Unearned premium liability	3,485	101	3,586
Employee benefits provision	162	44	206
Deferred tax liabilities	-	163	163
Outstanding claims liability	2,375	4,465	6,840
Interest-bearing liabilities	46	747	793
2004			
Assets			
Investments	2,474	7,212	9,686
Reinsurance and other recoveries receivable	368	547	915
Deferred levies and charges	104	-	104
Deferred reinsurance expense	184	-	184
Deferred acquisition costs	527	31	558
Deferred tax assets	-	296	296
Liabilities			
Unearned premium liability	3,386	86	3,472
Employee benefits provision	151	37	188
Deferred tax liabilities	-	99	99
Outstanding claims liability	2,202	4,125	6,327
Interest-bearing liabilities	-	793	793

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

All items of property, plant and equipment, investments in joint ventures and associates, intangible and goodwill assets are non-current assets. Cash assets, receivables and other assets are all current assets. All other liabilities are current liabilities.

NOTE 23. CONTRIBUTED EQUITY

Refer to note 24, statement of changes in equity for details of movement on contributed equity.

(i) Ordinary shares

Ordinary shares entitle the holder to a vote at a general meeting of the Company and 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.

(ii) Reset preference shares

The reset preference shares entitle the holder to a preferred, but not cumulative, dividend (currently 5.80% per annum for the first issue in June 2002 ("IAGPA") and 4.51% per annum for the second issue in June 2003 ("IAGPB")).

Dividends, if declared, are subject to similar conditions as those for ordinary shares. However, reset preference share dividends will be paid in priority to any dividends on ordinary shares. If dividends are not paid for reset preference shares, no dividends can be paid and no return of capital can be made on ordinary shares unless:

- two consecutive dividends stated to be payable on the reset preference shares (or an equivalent amount of dividends if the frequency of payment is other than semi-annual); or
- an optional dividend ("Optional Dividend") has been paid to the reset preference shareholders equal to the unpaid amount (if any) of the two immediately preceding dividends prior to the date of payment of the Optional Dividend (or equivalent dividends if the frequency of payment is other than semi-annual); or

- all reset preference shares have been converted, redeemed, bought back or cancelled.

The rate, frequency and timing of the payment of dividends can be reset by the Company on a reset date. The first reset dates are 15 June 2007 for IAGPA and 15 June 2008 for IAGPB.

Reset preference shares rank before ordinary shares in the event of the Company being wound up. The reset preference shares do not carry voting rights at general meetings. Further information is contained in note 39.

(iii) Dividend reinvestment

The Company operates a Dividend Reinvestment Plan ("DRP") which allows shareholders to elect to receive their dividend entitlement in the form of 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 DRP share price in both 2005 and 2004 carried no discount. Shares allocated to shareholders participating in the DRP were purchased on market (2005 – 20 million shares; 2004 – 19 million shares).

(iv) Share buy-back

The share buy-back enables capital to be managed more efficiently while returning surplus funds and distributing excess franking credits to shareholders.

There was no share buy-back during the year ended 30 June 2005. During the year ended 30 June 2004 an off-market share buy-back of 94 million ordinary shares was conducted representing 5.6% of issued share capital. The shares were bought back and cancelled under the terms of a share buy-back tender. The share buy-back price was at \$4.40 per share comprising a capital component of \$1.78 per share (charged to paid up capital) and a fully franked dividend component of \$2.62 per share (charged to retained profits).

(v) Performance share rights

Refer to note 30(d)(ii) for details on the Performance Share Rights Plan.

	PARENT / CONSOLIDATED			
	2005 NUMBER OF SHARES million	2004 NUMBER OF SHARES million	2005 \$m	2004 \$m
NOTE 24. STATEMENT OF CHANGES IN EQUITY				
Contributed equity				
<i>Ordinary shares</i>				
Balance at the beginning of the financial year	1,591	1,683	3,263	3,434
Shares issued under Performance Share Rights Plan	3	2	-	-
Share buy-back	-	(94)	-	(168)
Share buy-back transaction costs	-	-	-	(3)
Balance at the end of the financial year	1,594	1,591	3,263	3,263
<i>Reset preference shares</i>				
Balance at the beginning and end of the financial year	6	6	539	539
Total contributed equity at the end of the financial year	1,600	1,597	3,802	3,802

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	NOTE	PARENT 2005 \$m	PARENT 2004 \$m	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 24. STATEMENT OF CHANGES IN EQUITY (CONTINUED)					
(a) Contributed equity		3,802	3,802	3,802	3,802
(b) Reserves					
<i>Foreign currency translation reserve</i>					
Balance at the beginning of the financial year		-	-	(5)	(2)
Currency translation adjustments		-	-	(1)	(3)
Balance at the end of the financial year		-	-	(6)	(5)
(c) Retained profits / (accumulated losses)⁽ⁱ⁾					
Balance at the beginning of the financial year		493	145	(259)	(396)
Net profit attributable to shareholders of Insurance Australia Group Limited		587	876	760	665
Utilised in share buy-back		-	(246)	-	(246)
Dividends declared and paid	8	(442)	(282)	(442)	(282)
Balance at the end of the financial year		638	493	59	(259)
Total equity attributable to shareholders of Insurance Australia Group Limited		4,440	4,295	3,855	3,538
(d) Outside equity interests in controlled entities					
- contributed equity		-	-	124	124
- retained profits		-	-	40	39
- unitholders' funds		-	-	421	523
Balance at the end of the financial year		-	-	585	686
Total equity		4,440	4,295	4,440	4,224

Outside equity interests in the consolidated net profit for the year ended 30 June 2005 are \$119 million (2004 - \$141 million) and in the

consolidated total revenue, expenses and valuation adjustments recognised directly in equity are \$Nil (2004 - \$Nil).

Note:

- (i) Insurance Australia Group Limited obtained an order, dated 14 February 2000, from the Australian Securities & Investments Commission exempting the Company from compliance with certain sections of the Corporations Act 2001. These exemptions allowed the Company to acquire the shares in Insurance Australia Limited at an amount equal to the sum of the carrying amounts of the assets and liabilities as shown in the consolidated statement of financial position of Insurance Australia Limited immediately prior to the date of acquisition. This order also allows dividends paid by Insurance Australia Limited to the Company out of distributable reserves of Insurance Australia Limited at the time of acquisition of its shares by the Company to be treated as income by the Company. However, the order restricts the amount of such dividends that can be paid by Insurance Australia Limited to the Company to \$575 million, of which \$575 million in total (2004 - \$575 million) has been paid by Insurance Australia Limited from pre-demutualisation retained profits. During the year ended 30 June 2005, the Company received dividends of \$Nil (2004 - \$14 million) from Insurance Australia Limited from pre-demutualisation retained profits. This amount has been fully eliminated in the consolidated results.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	PARENT 2005 \$m	PARENT 2004 \$m	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 25. RECONCILIATION OF NET CASH PROVIDED BY OPERATING ACTIVITIES TO PROFIT FROM ORDINARY ACTIVITIES AFTER INCOME TAX				
Net cash provided by operating activities	431	762	897	1,169
Depreciation of property, plant and equipment	-	-	(39)	(38)
Amortisation of goodwill and intangibles	-	-	(105)	(118)
Realised gains on disposal of investments	-	64	225	129
Unrealised gains on revaluation of investments	-	-	352	229
Loss on disposal of plant and equipment	-	-	(3)	(4)
Foreign exchange (losses) / gains	-	-	(27)	4
Bad and doubtful debts	-	-	(1)	(6)
Other	-	-	5	18
Increase / (decrease) in operating assets:				
Premium and other receivables	73	167	251	151
Prepayments and deferred levies and expenses	-	-	81	67
Deferred tax assets	(7)	246	(32)	-
Decrease / (increase) in operating liabilities:				
Payables	140	(154)	(63)	(13)
Restructuring and employee benefits provisions	-	-	-	(197)
Current tax liabilities	3	(143)	29	-
Deferred tax liabilities	(53)	(66)	(64)	-
Outstanding claims liability	-	-	(513)	(351)
Unearned premium liability	-	-	(114)	(186)
Gross life insurance policy liabilities	-	-	-	(48)
Profit from ordinary activities after income tax	587	876	879	806

NOTE 26. RECONCILIATION OF CASH

For the purposes of the statements of cash flows, cash includes cash on hand and in banks, deposits at call and money market investments readily convertible to cash within two working days, net of outstanding bank overdrafts.

Cash	1	1	456	424
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NOTE 27. CHANGES IN COMPOSITION OF THE IAG GROUP

(a) Businesses acquired

(i) Parent entity 2005

There was no acquisition by the parent entity during the year ended 30 June 2005.

2004

On 30 September 2003, the parent entity acquired 100% of the ordinary shares of NRMA Financial Management Limited, NRMA Information Services Pty Limited and IAG Asset Management Limited and its controlled entities from Insurance Australia Group Services Pty Limited (a subsidiary of the parent entity) at a total purchase price of \$287 million. Immediately after this acquisition on 30 September 2003, the parent entity disposed 100% of the ordinary shares in Insurance Australia Group Services Pty Limited to Insurance Australia Limited (a subsidiary of the parent entity) for \$2 million. This disposal was effected after a return of capital by Insurance Australia Group Services Pty Limited of \$285 million. This change had no impact on goodwill in the consolidated entity.

(ii) Consolidated entity 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 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 investments (net of cash acquired) was \$7 million. As these acquisitions are not significant to the consolidated entity no further detailed disclosure is required.

2004

There was no acquisition from external parties by the consolidated entity during the year ended 30 June 2004.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 27. CHANGES IN COMPOSITION OF THE IAG GROUP (CONTINUED)

(b) Businesses disposed

(i) Parent entity 2005

There was no disposal by the parent entity during the year ended 30 June 2005.

2004

During the year ended 30 June 2004, the parent entity disposed 100% of the ordinary shares in NRMA Life Limited and its controlled entities, NRMA Financial Management Limited and Insurance Australia Group Services Pty Limited.

(ii) Consolidated entity 2005

There was no disposal by the consolidated entity during the year ended 30 June 2005.

2004

During the year ended 30 June 2004, the consolidated entity disposed 100% of the ordinary shares in NRMA Health Pty Limited (effective 25 July 2003), and NRMA Life Limited and its controlled entities and NRMA Financial Management Limited (effective 21 January 2004).

	PARENT 2005 \$m	PARENT 2004 \$m	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
Details of the disposals are as follows (in aggregate):				
Sale proceeds:				
Cash	-	220	-	317
Fair value of net assets of controlled entities disposed:				
Cash assets	-	320	-	357
Receivables	-	22	-	11
Investments	-	1,020	-	1,028
Plant and equipment	-	-	-	1
Payables	-	(30)	-	(12)
Unearned premium liability	-	-	-	(18)
Outstanding claims liability	-	(3)	-	(27)
Gross life insurance policy liabilities	-	(958)	-	(958)
Provisions	-	(56)	-	(4)
Other	-	28	-	12
Outside equity interests	-	(188)	-	(188)
	-	155	-	202
Add: goodwill written off in respect of NRMA Health Pty Limited	-	-	-	51
Add: costs associated with disposals	-	1	-	5
	-	156	-	258
Profit on disposals	-	64	-	59
Net cash flow on disposal of controlled entities:				
Cash proceeds received (net of disposal costs)	-	220	-	312
Cash balance disposed	-	-	-	(357)
Inflow/(outflow) of cash	-	220	-	(45)
Profit from ordinary activities before income tax that the disposed entities contributed to the IAG Group:				
For the year ended 30 June 2004	-	-	-	15

The profit from ordinary activities before income tax that the disposed entities contributed to the IAG Group has been determined based on the

results of the entities up to the date of disposal after allowing for amortisation of goodwill.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 28. DETAILS OF CONTROLLED ENTITIES

The following entities constitute the IAG Group:

	NOTES	INCORPORATION / COUNTRY OF FORMATION	EXTENT OF BENEFICIAL INTEREST IF NOT 100%	
			2005 %	2004 %
Parent entity				
Insurance Australia Group Limited		Australia	n/a	n/a
Controlled entities				
<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 Re Limited	B	Ireland		
IAG International Pty Limited		Australia		
IAG (NZ) Holdings Limited	B	New Zealand		
IAG New Zealand Limited	B	New Zealand		
Mike Henry Travel Insurance Limited	B	New Zealand	50.10	-
National Auto Club Underwriters Agency (NZ) Limited	B	New Zealand		-
Clipper Club Underwriters Limited	B	New Zealand		-
New Zealand Car Parts Limited	B	New Zealand		
New Zealand Insurance Limited (formerly NZI – State Finance Limited)	B	New Zealand		
State Insurance Limited	B	New Zealand		
Direct Insurance Services Limited	B	New Zealand		
Swann Insurance (NZ) Limited	B	New Zealand		-
IAG (NZ) Share Plan Nominee Limited	B	New Zealand		
NZI Staff Superannuation Fund Nominees Limited	B	New Zealand		
Belves Investments Limited	B	New Zealand		
NHCT Limited	(ii), B	Thailand	49.00	49.00
Beijing Continental Automobile Association Limited	B, C	China		
<i>Investment operations</i>				
IAG Asset Management Limited		Australia		
IAG Asset Management Cash Management Trust	(i)	Australia	72.54	60.64
IAG Asset Management Private Equity Trust	(i)	Australia	82.85	89.74
IAG Asset Management Fund of Hedge Funds	(i)	Australia		-
IAG Nominees Pty Limited		Australia		
IAG Portfolio Limited		Australia		-
<i>Corporate operations</i>				
NRMA Information Services Pty Limited		Australia		
NRMA Insurance Funding 2003 Limited		Australia		
IAG Finance (New Zealand) Limited		Australia		-
Insurance Australia Group Services Pty Limited		Australia		
Sitrof Life Holdings Limited		Australia		
Sitrof Superannuation Pty Ltd		Australia		
ACN 069 065 158 Pty Limited (formerly SGIC General Insurance Limited)	A	Australia		
IAG & NRMA Staff Superannuation Pty Limited (formerly NRMA Staff Superannuation Pty Limited)	A	Australia		
IAG Share Plan Nominee Pty Limited	A	Australia		
SWAPL Pty Limited	A	Australia		
ACN 007 078 140 Pty Limited	A	Australia		

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 28. DETAILS OF CONTROLLED ENTITIES (CONTINUED)

	NOTES	COUNTRY OF INCORPORATION / FORMATION	EXTENT OF BENEFICIAL INTEREST IF NOT 100%	
			2005 %	2004 %
<i>Controlled entities de-registered during the year ended 30 June 2005</i>				
NRMA (Western Australia) Pty Limited	(iii)	Australia	-	
SGIO Insurance Limited	(iii)	Australia	-	
SGIC Holdings Limited	(iii)	Australia	-	
SGIC Insurance Limited	(iii)	Australia	-	
SGIC Brand Pty Ltd	(iii), A	Australia	-	
Help Insurance Limited		Australia	-	
NRMA Insurance Services Limited		Australia	-	
151 Insurance Limited (formerly New Zealand Insurance Limited)	B	New Zealand	-	
NZI Passive Funds Limited	B	New Zealand	-	
NZI – State Capital Limited	B	New Zealand	-	
ACN 003 151 120 Pty Limited	A	Australia	-	
ACN 003 287 965 Pty Limited		Australia	-	
ACN 060 317 571 Pty Limited		Australia	-	
ACN 081 979 053 Pty Limited	A	Australia	-	
ACN 093 614 147 Pty Limited	A	Australia	-	
ACN 091 050 396 Pty Limited (formerly ACN 091 050 396 Limited)		Australia	-	
ACN 006 633 567 Pty Limited	A	Australia	-	70.00
ACN 004 478 979 Pty Limited (formerly ACN 004 478 979 Limited)		Australia	-	
ACN 006 577 724 Pty Limited	A	Australia	-	
ACN 004 729 088 Pty Limited	A	Australia	-	
ACN 005 065 207 Pty Limited		Australia	-	
ACN 006 268 926 Pty Limited	A	Australia	-	
<i>Controlled entities put into liquidation during the year ended 30 June 2005</i>				
NZI Investment Nominees Limited	B	New Zealand	-	
NZIB Investments Limited	B	New Zealand	-	

A Small proprietary companies that are not required to prepare, and have not prepared, audited financial statements.

B All controlled entities are audited by KPMG, however these entities are audited by overseas KPMG firms.

C All controlled entities have a 30 June financial year end, except this company has a 31 December year end.

Notes:

- (i) As at the reporting date, the IAG Group has a majority holding, 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 a controlled entity of IAG International Pty Limited.
- (iii) These entities were de-registered as part of an internal restructuring that involved a rationalisation of the legal entity structure and the transfer of key businesses into other operational entities.

NOTE 29. DETAILS OF JOINT VENTURES AND ASSOCIATES

The IAG Group has a significant but non-controlling interest in the following joint ventures and associates:

	NOTES	REPORTING DATE	COUNTRY OF FORMATION	PRINCIPAL ACTIVITY	OWNERSHIP INTEREST	
					2005 %	2004 %
Joint venture						
NTI Limited	(i), A	31 December	Australia	Managing co-insurance arrangement	50.00	50.00
Associates						
First Rescue and Emergency (NZ) Limited	A	31 March	New Zealand	Roadside assistance	50.00	50.00
Loyalty New Zealand Limited	A	31 March	New Zealand	Loyalty programme	25.00	25.00
Sureplan NZ Limited	A	31 March	New Zealand	Fleet risk management	30.00	-
AR Hub Pty Ltd		30 June	Australia	Software development	33.33	33.33

A Audited by accounting firms not affiliated with KPMG.

Note:

- (i) CGU Insurance Limited, a controlled entity of the IAG Group, 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 IAG Group's portion of the results of the co-insurance arrangement is recorded directly in the Group's accounting records.

Further details are not disclosed as the financial impact of these investments is not significant to the IAG Group.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 30. EMPLOYEE BENEFITS		
(a) Employee benefits provision		
Annual leave	70	58
Long service leave	49	60
Cash based incentive arrangements	74	60
Defined benefit pensions ⁽ⁱ⁾	13	10
	206	188

(i) There is one defined benefit pension arrangement in Australia with a discounted liability as at 30 June 2005 of \$9 million (2004 – \$6 million) involving 93 participants (2004 – 93), and one defined benefit pension arrangement in New Zealand with a discounted liability as at 30 June 2005 of \$4 million (2004 – \$4 million) involving 55 participants (2004 – 59).

(ii) A liability of \$nil (2004 – \$3 million) for termination benefits remains in the restructuring provision established on acquisition of CGU/NZI (refer to note 20).

(b) Employee numbers

The IAG Group had 11,502 employees (on full time equivalent basis) as at 30 June 2005 (2004 – 11,858).

(c) Cash based incentive arrangements

(i) Short term incentive plan

The short term incentive plan continued in operation during the year ended 30 June 2005. Eligible employees have the capacity to earn a proportion of their base pay (generally up to 10%, 15%, 20% or 30%) depending on an employee's role and responsibility, as a cash incentive annually. The incentive payments are determined based on a range of corporate, divisional and individual measures and goals.

Employees, with 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 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 employment with the IAG Group, 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 (d)(i) below). 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 incentive payment, if any, in the form of cash, superannuation contributions, or a combination of these.

(d) Share based incentive arrangements

The provision of share based remuneration creates a link between shareholder value creation, financial performance and rewarding employees. The IAG Group's share based remuneration encourages the retention of key personnel and links employee reward to the performance of the IAG Group.

The IAG Group's obligations under share based payment arrangements, that involve the provision of existing shares, are covered by the on-market purchase of IAG ordinary shares which are then held in trust. The shares are purchased on or near grant date at the then market price. The arrangements are managed using in-house trusts, one for Australia and two for New Zealand, which are not controlled for accounting purposes and so are not consolidated by the IAG Group. The trustee for each trust is a controlled entity of the IAG Group.

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 11,373,883 shares as at 30 June 2005 (2004 – 9,189,709 shares) representing 0.71% (2004 – 0.58%) of the ordinary shares on issue. The fair market value of those shares at reporting date was \$68.3 million (2004 – \$45.9 million) which were acquired at different dates at a combined cost of \$43.0 million (2004 – \$30.5 million).

Trading in IAG shares that are awarded under the share based payment arrangements is covered by the same restrictions as applies to all forms of share ownership by employees. These restrictions limit the ability of an IAG employee 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.

The IAG Group provides share based remuneration through four different plans each of which have different purposes and different rules.

(i) Performance award rights ("PARs") plan

The PARs Plan continued in operation during the year ended 30 June 2005. 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 ordinary share of IAG 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 employment with the IAG Group. 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. 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 in 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 which include retrenchment of the participant, and takeover of the IAG Group. 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.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 30. EMPLOYEE BENEFITS (CONTINUED)

(d) Share based incentive arrangements (continued)

(i) Performance award rights ("PARs") plan (continued)

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	3,850,345	-	-	29,753	3,820,592	-
22/09/2003	\$2.840	4,083,097	-	-	74,119	4,008,978	-
10/12/2003	\$2.764	400,000	-	-	-	400,000	-
26/03/2004	\$3.287	955,999	-	-	7,241	948,758	-
17/09/2004	\$2.715	-	4,292,000	-	54,000	4,238,000	-
30/11/2004	\$2.718	-	905,500	-	-	905,500	-
30/03/2005	\$3.269	-	41,000	-	-	41,000	-
		9,289,441	5,238,500	-	165,113	14,362,828	-

The latest estimate, as at reporting date, of the number of rights on issue but not yet vested, that will vest, based on turnover only, is 11,299,933 (2004 – 6,851,396).

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 2005, the following significant factors and assumptions were used:

GRANT DATE	17/9/2004	30/11/2004	30/3/2005
Share price on grant date (\$)	5.17	5.84	6.26
Exercise price (\$)	\$1 per tranche exercised	\$1 per tranche exercised	\$1 per tranche exercised
Risk free interest rate (%)	5.6%	5.5%	6.1%
Expected share price volatility (%)	25%	25%	25%
Expected dividend yield (%)	4.26%	3.77%	4.15%
Expected life of rights (years)	4.132	4.116	3.698

Some of the assumptions are based on historical data which is not necessarily indicative of future trends.

(ii) 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 rights were granted for nil consideration, are non-transferable, and can be settled only with new ordinary shares. The rights expire ten years from grant date where they have not previously lapsed or been exercised.

On the satisfaction of a performance hurdle, participating employees are able to exercise those rights, which convert into new ordinary shares of IAG that rank equally with other ordinary shares of IAG. The exercise price is \$1 per tranche of rights exercised. For all rights issued prior to 13 December 2001, the performance hurdle related to the TSR of IAG shares over a defined period. For all rights issued on or after 13 December 2001 the performance hurdle is based on a comparison of IAG's TSR with the TSR of the relevant companies in the S&P/ASX 100 index.

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	28,640	28,640	-	-	-
30/04/2001	\$1.67	2,441,100	2,104,500	-	336,600	336,600
02/08/2001	\$2.14	190,700	77,500	-	113,200	113,200
22/10/2001	\$1.84	135,000	135,000	-	-	-
13/12/2001	\$2.30	1,000,000	940,000	-	60,000	60,000
05/03/2002	\$2.68	501,897	195,880	-	306,017	306,017
15/07/2002	\$2.28	102,222	-	-	102,222	-
		4,399,559	3,481,520	-	918,039	815,817

Further details are not disclosed because the PSRs Plan is a closed plan and the financial impact is not significant to the IAG Group.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

(iii) Non-executive directors' share plan

The Non-executive Directors' Share Plan continued in operation during the year ended 30 June 2005, having been approved at the 2001 Annual General Meeting, for all continuing Non-executive Directors for the period from December 2002 to November 2005. 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. 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. 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 to the IAG Group.

(iv) Employee share plan

There are two employee share plans in place, one for Australia and one for New Zealand. These plans involve the granting of restricted shares to a substantial percentage of employees.

Australia

The last grant date under this plan was 19 March 2001 and the vesting period for that tranche has passed. There is no expense for this plan relevant to the year ended 30 June 2005.

New Zealand

The last grant date under this plan was 11 October 2002. Participation in the plan was open to employees that were not directors and that had completed at least three months of service at the grant date. They were invited to offer to purchase shares under the terms of the plan during a prescribed period commencing in September 2002. Eligible employees who accepted the offer to subscribe received an allocation of IAG shares to the equivalent value of NZ\$1,500, for a total subscription consideration of NZ\$1. Shares subscribed under this plan were purchased on-market and are held in trust during the three year vesting period on behalf of the participants. The average price of the shares purchased was used to determine the number of shares allocated to each staff member. The IAG Group provided funds to the trust to meet the cost of the purchase of the shares over and above the NZ\$1 consideration received from each participating employee.

Employees that left the IAG Group 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.

(e) Superannuation

The IAG Group contributes to a number of superannuation plans both in Australia and New Zealand. The majority of employees are defined

contribution members with fewer than 9% (2004 – 8%) of employees participating on a defined benefit basis. Entry into defined benefit plans is closed across the IAG Group 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 employment with the IAG Group.

(i) 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 contributions paid during the year in relation to defined contribution members were low because the IAG & NRMA Superannuation Plan (the "Plan"), which is the principal superannuation plan for the Australian employees, was on a contribution holiday for most of the financial year, with contributions to the Plan only recommencing in June 2005 following the recommendations of the actuary (2004 – contribution holiday). 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.

The IAG Group is not exposed to risks or rewards of the defined contribution arrangements and the IAG Group has no obligations beyond the payment of contributions.

(ii) Defined benefit superannuation arrangements

Employees who are entitled to defined benefit superannuation arrangements are members of one of three funded superannuation plans. The defined benefit sections of those plans are closed to new members and so membership will reduce 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. 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 not recognised in the statement of financial position of the IAG Group.

Two of the plans are in New Zealand with 32 defined benefit members as at 30 June 2005 (2004 – 32) with a combined surplus of \$2.4 million (2004 – \$2.2 million), calculated in accordance with the valuation methodology of AASB 119 Employee Benefits issued December 2004. As these New Zealand defined benefit arrangements are not material to the IAG Group, they are not disclosed in more detail.

All Australian employees with defined benefit superannuation arrangements are members of the IAG & NRMA Superannuation Plan (the "Plan"). The Plan was in surplus at the beginning of the year and so was on a contribution holiday until June 2005 from which time contributions recommenced following the recommendations of the actuary (2004 – contribution holiday).

The following information has not been audited and relates only to the part of the Plan for IAG Group employees that are entitled to defined benefit superannuation arrangements. The financial position has been determined in accordance with AAS25 Financial Reporting by Superannuation Plans, using the Attained Age Actuarial Funding method.

	IAG & NRMA SUPERANNUATION PLAN 2005 \$m
	30 June 2005
Date of actuarial valuation	Mercer Human Resource Consulting
Actuarial firm	Guy Holley, BEc FIAA
Name and qualifications of actuary	980
Number of defined benefit members	169
Net market value of net assets	163
Present value of accrued benefits	6
Excess of net assets over accrued benefits	152
Vested benefits	

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 30. EMPLOYEE BENEFITS (CONTINUED)

(e) Superannuation (continued)

(ii) Defined benefit superannuation arrangements (continued)

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 actuaries to the Plan. The principal actuarial assumptions used in determining the financial position of the Plan and the contribution recommendation include:

	2005
Expected investment returns – pension assets / other assets	7.5% / 7.0%
Expected future salary increases	4.0%
Future pension increases – adult / child	2.5% / 0.0%

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.

In determining the contribution recommendation, the actuarial valuation method focuses on the funding of benefits, 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.

Assets of the Plan are managed by the IAG Group. The assets of the Plan do not include any shares issued by the IAG Group nor any property or other assets used by the IAG Group.

	CONSOLIDATED 2005 \$000	CONSOLIDATED 2004 \$000
NOTE 31. AUDITORS' REMUNERATION		
(a) Audit services		
Auditing the financial statements and consolidated financial statements	3,611	3,284
Audit of statutory returns in accordance with regulatory requirements	792	1,030
Other assurance services	2,472	2,264
	6,875	6,578
(b) Non-audit services		
Taxation services	563	595
Due diligence and other services on acquisitions, divestment and capital transactions	2,790	883
Other	78	64
	3,431	1,542

	NOTES	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 32. FINANCING ARRANGEMENTS					
		Facilities available		Facilities drawn at reporting date	
(a) Standby letter of credit facility	(i)	7	7	2	3
(b) Standby facility	(ii)	30	50	-	-
(c) Debt issuance programme	(iii)	750	750	300	300
(d) NZ medium term note programme	(iv)	91	91	91	91

Notes:

- (i) The standby letter of credit facility is denominated in US dollars and is translated into equivalent A\$ 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\$100 million medium term note programme. 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 NZ dollars and is translated into equivalent A\$ using the reporting date exchange rate.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
NOTE 33. COMMITMENTS		
(a) Capital commitments		
Property		
– due within 1 year	5	1
(b) Lease and rental commitments		
Property		
– due within 1 year	89	89
– due within 1 to 2 years	85	78
– due within 2 to 5 years	112	151
– due after 5 years	21	19
Plant and equipment		
– due within 1 year	34	28
– due within 1 to 2 years	24	21
– due within 2 to 5 years	7	12
	372	398
(c) Software licence and rental commitments		
– due within 1 year	41	40
– due within 1 to 2 years	26	36
– due within 2 to 5 years	3	23
	70	99
(d) Other commitments		
– due within 1 year	4	10
– due within 1 to 2 years	2	8
– due within 2 to 5 years	2	8
	8	26

NOTE 34. CONTINGENCIES

(a) In the normal course of business, the IAG Group enters into transactions 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 exchange contracts, financial futures, interest rate swaps, exchange traded options and forward rate agreements, usually as part of the management of the IAG Group's investment portfolios; and
- (iii) guarantees for performance obligations and undertakings for maintenance of net worth and liquidity support to controlled entities in the IAG Group.

Notes 32 and 37 make reference to the IAG Group's exposures under (ii) and (iii) above. The Directors do not believe there are any other potential material exposures to the IAG Group.

(b) 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 intra group 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 a 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 RES.

(iii) in the event of an interest payment on RES being unfranked, the Company must pay an amount into IAG Portfolio Limited to fund a gross-up of the interest payment on RES.

(iv) the Company may exchange some or all RES for preference shares issued by the Company at any time.

(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) the Company has an obligation to pay all costs, charges and expenses in managing the Portfolio including the Trustee and custodian.

(ix) the Company 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 RES or from excess net assets of the Portfolio after the payment of aggregate redemption amounts on RES.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 35. NEW SOUTH WALES WORKERS' COMPENSATION MANAGED FUND

CGU Workers Compensation (NSW) Limited, a wholly-owned subsidiary of IAG Group, maintains a statutory fund in respect of the issue and renewal of policies of insurance in accordance with the requirements of the NSW Workers' Compensation Act 1987 (the "Act").

The application of the statutory fund is restricted to the payment of claims, related expenses and other payments authorised under the Act.

The licensed insurer is not liable for any deficiency in the statutory fund, or entitled to any surplus, and the statutory fund is exempt from income tax. The IAG Group does not control nor have the capacity to control the statutory fund for accounting purposes and for this reason the statutory fund is not consolidated and the information provided below in respect of the statutory fund is not included in the IAG Group's financial statements.

	2005 \$m	2004 \$m
Unaudited statutory fund statement of financial position		
Assets		
Cash and short term deposits	31	17
Receivables	73	77
Investments, at market value	1,552	1,154
Total assets	1,656	1,248
Liabilities		
Payables	23	16
Unearned premium liability	91	96
Statutory fund to meet outstanding claims liability and statutory transfers	1,542	1,136
Total liabilities and statutory fund	1,656	1,248

NOTE 36. RELATED PARTY DISCLOSURES

(a) Wholly-owned group

The wholly-owned group consists of Insurance Australia Group Limited

and its wholly-owned controlled entities (refer note 28). All transactions that have occurred within the wholly-owned group have been eliminated for consolidation purposes.

	PARENT 2005 \$m	PARENT 2004 \$m
Aggregate amounts included in the determination of profit from ordinary activities before income tax that resulted from transactions with related parties within the wholly-owned group were as follows:		
Dividend revenue	585	812
Aggregate amounts receivable from, and payable to, related parties in the wholly-owned group were as follows:		
Amounts receivable	215	162
Amounts payable	73	11
Loans receivable	25	5
Loans payable	324	456

The loans receivable and payable are non-interest bearing and are repayable on demand.

(b) Non wholly-owned controlled entities

Transactions with Insurance Manufacturers of Australia Group

Insurance Manufacturers of Australia Group ("IMA"), which is 70% owned

by the IAG Group, refers to Insurance Manufacturers of Australia Pty Limited and its controlled entity being World Class Accident Repairs (Cheltenham North) Pty Limited.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

The following entities in the IAG Group had the following transactions with IMA.

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
Aggregate amounts included in the determination of profit from ordinary activities before income tax that resulted from transactions with IMA were as follows:		
Insurance Australia Limited		
– Reinsurance premiums paid or payable	1,452	1,434
– Claims recoveries received or receivable	948	862
– Underwriting expenses received or receivable	54	53
– Management fees received	156	160
– Rental income	4	5
Swann Insurance (Aust) Pty Ltd		
– Reinsurance premiums paid or payable	3	-
– Claims recoveries received or receivable	2	-
– Management fees received	1	1
CGU Insurance Limited		
– Management fees paid	31	9
IAG Re Limited		
– Reinsurance claims paid or payable	62	75
– Reinsurance premiums received or receivable	98	99
SGIO Insurance Limited		
– Reinsurance premiums paid or payable	-	3
– Claims recoveries received or receivable	-	5
– Management fees paid	-	4
ACN 069 065 158 Pty Limited (formerly SGIC General Insurance Limited)		
– Management fees paid	-	2
NRMA Personal Lines Holdings Pty Limited		
– Dividend revenue	224	168
NRMA Information Services Pty Limited		
– Information services and communication recoveries received	83	76
IAG Asset Management Limited		
– Investment management fees received	4	3
IAG Nominees Pty Limited		
– Custody fees received	1	1
The transactions referred to above were made on either normal commercial terms and conditions, a direct and actual cost recovery basis or time allocation basis.		
The following entities in the IAG Group had the following outstanding balances at reporting date with IMA:		
Amounts receivable		
– NRMA Information Services Pty Limited	3	4
– Insurance Australia Limited	41	2
– SGIO Insurance Limited	-	1
– IAG Re Limited	2	-
Amounts payable		
– IAG Asset Management Cash Management Trust	1	1
– IAG Asset Management Private Equity Trust	1	-
– Swann Insurance (Aust) Pty Ltd	1	1

There are two entities in the IAG Group, being Insurance Australia Group Services Pty Limited and Insurance Manufacturers of Australia Pty Limited, with employees that are defined benefit members of the IAG & NRMA Superannuation Plan (refer note 30(e)). 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.

(c) Other transactions

IAG Asset Management Wholesale Trusts (disclosed as controlled entities in note 28), 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 were on normal commercial terms and conditions.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 37. FINANCIAL INSTRUMENTS

The IAG Group is exposed to interest rate risk, equity risk, exchange rate risk and credit risk from its business, investment activities and foreign currency borrowings. To effectively manage the risk of significant negative movement, specifically in interest rates and equity prices, a combination of derivatives has been used.

(a) Interest rate risk

The IAG Group's exposure to interest rate risk results from the holding of financial assets and liabilities in the normal course of business.

(i) Interest rate swap agreements

Insurance Australia Limited has entered into interest rate swap agreements ("swap agreements") to manage the interest rate exposure

on the IAG Group's borrowings. Insurance Australia Limited 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 charged to the statement of financial performance on a daily basis over the term for which the swap is effective as a hedge of the underlying borrowing. As at 30 June 2005, the weighted average fixed interest rate payable under the swap agreements was 6.77% per annum (2004 – 6.77% per annum) and the weighted average floating rate receivable was 7.20% per annum (2004 – 7.02% per annum).

As at reporting date, the notional principal amounts and period of expiry of the swap agreements are as follows:

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
Interest rate swaps		
– within 2 to 5 years	400	50
– within 5 to 7 years	-	350
	400	400

(ii) Futures

At reporting date, the notional principal amounts and period of expiry of the interest rate related contracts were as follows:

Futures		
– within 1 year	2,306	603
– within 1 to 2 years	449	169
	2,755	772

(iii) 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. All other assets and liabilities disclosed on the statement of financial position are non-interest bearing.

	CONSOLIDATED						WEIGHTED AVERAGE INTEREST RATE %
	FLOATING INTEREST RATE \$m	FIXED INTEREST RATE MATURING IN			NON- INTEREST BEARING \$m	TOTAL \$m	
		1 YEAR OR LESS \$m	OVER 1 TO 5 YEARS \$m	MORE THAN 5 YEARS \$m			
2005							
Financial assets							
Cash assets	451	-	-	-	5	456	5.52
Premium funding loans	-	128	-	-	-	128	14.65
Money market securities	26	2,760	3,111	1,356	-	7,253	5.59
	477	2,888	3,111	1,356	5	7,837	
Financial liabilities							
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
	50	46	294	317	-	707	
Net financial assets	427	2,842	2,817	1,039	5	7,130	

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

	CONSOLIDATED						WEIGHTED AVERAGE INTEREST RATE %
	FIXED INTEREST RATE MATURING IN					TOTAL \$m	
	FLOATING INTEREST RATE \$m	1 YEAR OR LESS \$m	OVER 1 TO 5 YEARS \$m	MORE THAN 5 YEARS \$m	NON- INTEREST BEARING \$m		
2004							
Financial assets							
Cash assets	414	-	-	-	10	424	4.47
Premium funding loans	-	90	-	-	-	90	11.56
Money market securities	40	2,432	3,361	1,153	-	6,986	5.53
	454	2,522	3,361	1,153	10	7,500	
Financial liabilities							
Senior term notes	-	-	91	-	-	91	7.12
Subordinated term notes	50	-	249	2	-	301	6.39
US subordinated term notes	-	-	-	345	-	345	5.19
	50	-	340	347	-	737	
Net financial assets	404	2,522	3,021	806	10	6,763	

	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
(iv) Reconciliation of net financial assets to net assets:		
Net financial assets		
– interest-bearing	7,130	6,763
– other	2,652	2,327
– net insurance liabilities	(7,663)	(7,282)
Net non financial assets	2,321	2,416
Net assets	4,440	4,224

(b) Equity price risk

In addition to the effects of movements in interest rate and foreign exchange values, the IAG Group is also exposed to equity market volatility through its investment in equities.

At reporting date, the notional principal amounts and period of expiry of the equity related contracts were as follows:

SPI futures		
– within 1 year	865	356
Options		
– purchased – within 1 year	28	9
– written – within 1 year	35	33
	928	398

(c) Exchange rate risk

(i) Insurance Australia Limited has entered into cross currency swaps to fully hedge the Australian dollar value of principal and interest flows on the IAG Group's US subordinated term notes. The swaps mature in 2010. Over the term of the swaps, the company 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 totalling A\$401 million. On maturity of the swap, the IAG Group will repay the principal amount

totalling A\$401 million and receive US\$240 million based on the original spot exchange rate at inception.

(ii) The IAG Group is exposed to foreign exchange risk on its investments in international equities, receivables and payables in a foreign currency and its net investment in controlled foreign operations. The IAG Group uses derivatives to help manage these exposures. At reporting date, the contractual amount and maturity profile of the derivatives were as follows:

Forward foreign exchange contracts		
– within 1 year	325	312

(d) Credit risk

The credit risk exposures of the IAG Group are in respect of the non-repayment of receivables, loans and advances due from third parties and the amounts are as indicated by the carrying amount of the financial assets. There is no significant concentration of credit risk as the IAG Group transacts with a large number of individual debtors without any single one being material.

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 Board.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 37. FINANCIAL INSTRUMENTS (CONTINUED)

(d) Credit risk (continued)

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.

(e) Net fair value

The IAG Group's financial assets and liabilities are carried in the statement of financial position at amounts that approximate net fair value. The carrying value amounts of all financial assets and liabilities are reviewed to ensure they are not in excess of the net fair value.

The net fair value of financial assets and liabilities arising from the derivatives other than interest rate swaps (being currency and equity swap agreements, Share Price Index futures, equity options, bank bill and bond futures, options and forward foreign exchange contracts) has been determined as the carrying value which represents the amount currently

receivable or payable at the reporting date. The carrying value of all these derivatives is a net payable of \$82 million (2004 – net payable of \$60 million). The net fair value of interest rate swaps is a net receivable of \$3 million (2004 – net receivable of \$14 million) with a carrying value of \$Nil (2004 – \$Nil).

NOTE 38. CAPITAL ADEQUACY

Existing prudential standards sets out the basis for calculating the minimum capital requirement ("MCR") of licensed insurers. The MCR utilises a risk-based approach and is determined as the sum of the capital charges for insurance, investment, investment concentration and catastrophe risk.

The MCR of the IAG Group applying consolidation principles to the prudential standards is as follows:

	NOTES	CONSOLIDATED 2005 \$m	CONSOLIDATED 2004 \$m
Statutory capital			
<i>Tier 1 capital</i>			
Ordinary shares		3,263	3,263
Reset preference shares		539	539
Retained profits / (accumulated losses) and reserves		53	(264)
Excess technical provisions (net of tax)		499	375
		4,354	3,913
Less:			
Goodwill and intangibles		(1,378)	(1,473)
Net deferred tax assets		(100)	(190)
		2,876	2,250
<i>Tier 2 capital</i>			
Subordinated term notes		614	644
Total statutory capital		3,490	2,894
Minimum capital requirements (MCR)			
Australian general insurance businesses		1,511	1,475
International insurance businesses	(i)	235	179
Total MCR		1,746	1,654
MCR multiple		2.00	1.75

(i) The capital requirement for international insurance businesses is calculated on a similar basis to the Australian regulatory requirements.

		2005 \$	2004 \$
NOTE 39. NET TANGIBLE ASSETS			
Net tangible asset per ordinary share	(i)	1.22	0.96
Net tangible asset per reset preference share	(ii)	100.00	100.00

Notes:

- (i) Net tangible assets per ordinary share has been determined after adjusting for outside equity interests, goodwill (note 18) and other intangible assets (note 17) and the value of reset preference shares on issue (note 24).
- (ii) Net tangible assets per reset preference share has been 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 40. 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 2005.

(a) On 19 August 2005, a final dividend of 14.5 cents per share, 100% franked, was declared by the Company. The dividend will be paid on 17 October 2005.

(b) Acquisition of a Thailand based general insurance business
On 14 June 2005, the Company announced that it had agreed to acquire an interest in a general insurer in Thailand, Royal & SunAlliance (Thailand) Limited ("RSA"). RSA underwrites both personal and commercial business and generates approximately A\$35 million in annual gross written premium. The acquisition was completed on 4 July 2005.

(c) International financial reporting standards

(i) Overview

For reporting periods beginning on or after 1 January 2005, the IAG Group must comply with Australian equivalents to International Financial Reporting Standards ("A-IFRS") as issued by the Australian Accounting Standards Board. The IAG Group's financial report will be prepared in accordance with A-IFRS for the first time for the half year ending 31 December 2005 and the year ending 30 June 2006. A-IFRS requires the restatement of comparative financial statements, however, as permitted under the transitional provisions for first time adoption of A-IFRS, the Group has elected to not restate comparatives for certain standards being AASB 132 Financial Instruments: Disclosure and Presentation, AASB 139 Financial Instruments: Recognition and Measurement, and AASB 1023 General Insurance Contracts.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

A-IFRS transition adjustments will be made retrospectively against opening retained earnings at 1 July 2004 except for the above mentioned standards where the transition adjustments will be made at 1 July 2005.

This financial report has been prepared in accordance with Australian accounting standards and other financial reporting requirements ("Australian GAAP"). The differences between Australian GAAP and A-IFRS identified as having a significant effect on the IAG Group's financial performance and financial position are summarised below. There will also be significant changes in the presentation and content of financial reports prepared in accordance with A-IFRS.

Assessments made in respect of the transition to A-IFRS may require adjustment before inclusion in the first financial report prepared in accordance with A-IFRS due to new or revised standards or interpretations or additional guidance on the application of A-IFRS in a particular industry or to a particular transaction.

It is important to understand that while the A-IFRS accounting requirements will change the IAG Group's reported results, this does not represent a change in the strength of the underlying business.

(ii) Management of the IAG Group's transition

The IAG Group established a project team to manage the transition to

the new standards, including training of staff and system and internal control changes necessary to gather all the required financial information. The project team is chaired by the Chief Financial Officer and reports quarterly to the Group Audit Committee. The project team has prepared a detailed timetable for managing the transition to the new standards and is currently on schedule. The Group expects to be able to provide financial reports that are fully compliant with A-IFRS for the 2006 financial year. The project team analysed all of the new standards and identified the changes that impact on the Group's financial reporting. The Group Audit Committee has selected the Group's A-IFRS accounting policies where policy choices are available under A-IFRS.

(iii) Reconciliation of Australian GAAP to A-IFRS

Provided below are reconciliations between the relevant balances under Australian GAAP and A-IFRS together with narrative descriptions explaining the adjustments. The reconciliations do not include the adjustments arising from the transition to the balance sheet approach for the calculation of taxation, because these adjustments had not yet been reliably determined.

Reconciliation of equity under Australian GAAP to that under A-IFRS:

NOTES	PARENT 1 JULY 2005 \$m	PARENT 30 JUNE 2005 \$m	PARENT 1 JULY 2004 \$m	CONSOLIDATED 1 JULY 2005 \$m	CONSOLIDATED 30 JUNE 2005 \$m	CONSOLIDATED 1 JULY 2004 \$m
Total equity under Australian GAAP	4,440	4,440	4,295	4,440	4,440	4,224
Adjustments applicable from 1 July 2004						
<i>Adjustments to retained earnings</i>						
Write-back of goodwill amortisation	1	n/a	n/a	92	92	n/a
Recognition of defined benefit plans	2a	n/a	n/a	(32)	(32)	57
Share based payment expense	2b	-	-	5	5	2
Capitalisation of software development costs	3	n/a	n/a	24	24	n/a
Valuation of property	4	n/a	n/a	(9)	(9)	n/a
<i>Adjustments to contributed equity / reserves</i>						
Recognition of share based payment reserve	2b	-	-	11	11	4
Consolidation of share remuneration trusts	2b	(33)	(33)	(34)	(34)	(21)
Adjustments applicable from 1 July 2005						
<i>Adjustments to retained earnings</i>						
Valuation of investments	8	n/a	n/a	1	n/a	n/a
Reset preference shares transaction costs	7	5	n/a	5	n/a	n/a
Reset preference shares distribution accrual	7	(1)	n/a	(1)	n/a	n/a
<i>Adjustments to contributed equity / reserves</i>						
Reset preference shares	7	(550)	n/a	(550)	n/a	n/a
Hedge accounting	9	n/a	n/a	7	n/a	n/a
Total equity under A-IFRS	3,861	4,407	4,275	3,959	4,497	4,266

The adjustments to equity noted above for the IAG Group include an increase in equity attributable to outside equity interests of \$2 million as at 1 July 2005 and \$5 million as at 1 July 2004.

Reconciliation of net profit under Australian GAAP to that under A-IFRS for the year ended 30 June 2005:

NOTES	PARENT 30 JUNE 2005 \$m	CONSOLIDATED 30 JUNE 2005 \$m
Net profit before tax as reported under Australian GAAP	585	1,258
Write-back of goodwill amortisation	1	92
Movement in defined benefit plans	2a	(79)
Share based payment expense	2b	3
Capitalisation of software development costs	3	24
Valuation of property	4	(9)
Net profit before tax under A-IFRS	585	1,289

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 40. EVENTS SUBSEQUENT TO REPORTING DATE (CONTINUED)

(c) International financial reporting standards (continued)
(iv) Explanation of the key differences

Applicable from 1 July 2004

1) Goodwill

No amortisation resulting in lower expenses, subject to impairment charges

Goodwill supportable at 1 July 2004 and 30 June 2005

The IAG Group will not restate the accounting for business combinations transacted prior to 1 July 2004, as permitted under the transitional provisions for first time adoption of A-IFRS. There are also no additional intangible assets to be recognised separately from goodwill upon first time adoption. Goodwill will not be amortised under A-IFRS and so the carrying value of goodwill as at 1 July 2004 of \$1,455 million will be carried forward under A-IFRS subject to impairment testing. Part of that goodwill balance is denominated in New Zealand dollars and so the balance will continue to change reflecting foreign currency movements.

The net goodwill as at 1 July 2004 has been systematically allocated to cash generating units for the purpose of the recoverability test, which is to be conducted at each reporting date. Any impairment is to be recognised in the statement of financial performance in the period in which it is identified.

Using A-IFRS impairment methodology the \$1,455 million goodwill balance is supportable at 1 July 2004, 31 December 2004, and 30 June 2005. Additional goodwill amounts have arisen through small acquisitions made during the year to 30 June 2005 totalling \$9 million. Those amounts are also supportable at 31 December 2004 and 30 June 2005 using A-IFRS impairment methodology.

The elimination of the requirement to amortise goodwill under A-IFRS will increase reported profits, subject to any impairment charge that may be required at a reporting date. The IAG Group had a goodwill amortisation expense for the year to 30 June 2005 of \$92 million. That amount will be removed from the statement of financial performance under A-IFRS and the 1 July 2004 goodwill balance of \$1,455 million will be reinstated, subject to impairment testing. That balance together with the goodwill amounts that arose from acquisitions made during the year will result in a goodwill balance as at 30 June 2005 of \$1,464 million.

2) Employee benefits

The accounting for employee benefits will remain unchanged except for defined benefit superannuation arrangements and share based payments.

2a) Superannuation plans

Net position of defined benefit superannuation plans to be recognised

The IAG Group has elected to early adopt the version of AASB 119 Employee Benefits issued in December 2004 to be effective from 1 January 2005 in line with the adoption of A-IFRS.

Under A-IFRS the relevant net position of defined benefit plans will be recognised in the statement of financial position. The movement in the net position will be recognised in the statement of financial performance, except for actuarial gains and losses, which will be recognised directly in retained earnings, in line with the accounting option selected under AASB 119.

The IAG Group has five arrangements that qualify as defined benefit plans under A-IFRS. 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 is currently not recognised in the IAG Group's statement of financial position although some information is disclosed in the notes to the annual financial report. The present value of each of the two unfunded pension liabilities is currently recognised in the IAG Group's statement of financial position.

It is important to note that the net position of the defined benefit superannuation plans calculated under A-IFRS is different to that calculated for purposes of note disclosure in accordance with Australian GAAP because of the use of different measurement requirements in the actuarial calculations of obligations to employee members. The principal difference is the discount rate applied to determine the present value of those obligations.

The adjustments required to recognise the defined benefit plans under A-IFRS involve a credit to retained earnings 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 involves recognition of an additional expense through the A-IFRS statement of financial performance for the year to 30 June 2005 of \$79 million and the recognition of a \$10 million debit directly to retained earnings as at 30 June 2005. The net result of these changes is a \$32 million debit adjustment to retained earnings as at 30 June 2005.

The net financial positions of the defined benefit plans as at 30 June 2005 have been calculated by independent actuaries, however the audit of all of the calculations had not been finalised as at the date of this report.

2b) Share based payments

Initial reduction in the expense recognised

The only transactions within the IAG Group that qualify as share based payments are share based remuneration payments. The IAG Group provides share based remuneration through four different plans each of which has different purposes and different rules. The change in accounting treatments has not led to a change in the structure of the share based remuneration because the current arrangements are considered to be most appropriate given the Group's history, environment, culture and objectives.

The IAG Group will not retrospectively apply the A-IFRS expense treatment to the Performance Share Rights Plan or the Employee Share Plan, as permitted under the transitional provisions for first time adoption of A-IFRS, because the last rights provided under those plans were granted prior to 7 November 2002. The A-IFRS transition changes will therefore impact on only the Performance Award Rights Plan ("PARs Plan"), and Non-Executive Director Share Plan ("NED Plan"), both of which are equity settled share based payments.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

The IAG Group's current practice is to acquire IAG shares on-market and hold them in trust to satisfy a future obligation for share based remuneration. The shares are purchased on or near grant date at the then market price. The cost of acquiring the shares is initially recorded as a prepayment and is then expensed in full, generally over the period during which the employees provide related services.

Under A-IFRS the fair value at grant date of share based remuneration is required to be recognised as an expense 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 will be adjusted through the statement of financial performance 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 vesting conditions for the two plans are different with only the PARs Plan incorporating a market based vesting condition. If equity instruments in either of the plans do not vest because the participant ceases to be employed by the IAG Group then the expense charged in relation to that participant will be reversed. If equity instruments in the PARs Plan do not vest only because the market condition is not met, then the expense will not be reversed.

The A-IFRS requirement to expense the fair value of the equity instruments granted may be different to the fair value (on-market purchase price) of acquiring the relevant number of shares to support the arrangements. For the PARs Plan, the fair value of the rights granted is lower than the market value of the shares purchased on or near grant date because of the variables and uncertainty that influence whether the participant will ever receive the share and what the value of the share will be at that time. For the NED Plan, the on-market share price at grant date is used as the fair value of the equity instrument granted because 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 requirement to determine the fair value of the share based remuneration and recognise this expense over the period from grant date to vesting date will result in an initial reduction in the expense recognised for the IAG Group, to that currently recorded in relation to share based payments.

A transitional adjustment for the IAG Group will be made to retained profits as at 1 July 2004 of \$2 million representing the accumulated reduction in the expense up to that date. An additional adjustment for the IAG Group will be made to retained profits as at 1 July 2005 of \$5 million representing the accumulated reduction in the expense up to that date. The expense will be matched by a credit to an equity reserve. It is noted that certain matters in relation to share based payments are still subject to changing interpretation, which may impact on the determination of these adjustments.

Equity remuneration trusts to be consolidated

Under A-IFRS the equity remuneration trusts used to manage the share based arrangements will be consolidated by the IAG Group. Two trusts will be consolidated directly by the parent entity while one trust will be consolidated directly by a subsidiary. The parent and the IAG Group will recognise the IAG shares, the major asset of the trusts, as negative equity (referred to as treasury shares). The treasury shares will be measured at cost (total amount paid to acquire the shares), and will be shown as a deduction from equity. The shares held by the trusts as at 30 June 2004 that are to be consolidated, were acquired on different dates at a total cost of \$20 million for the parent and \$21 million for the IAG Group. The shares held by the trusts as at 30 June 2005 that are to be consolidated, were acquired on different dates at a total cost of \$33 million for the parent and \$34 million for the IAG Group. When the relevant rights are exercised, the Group will effectively reissue the shares, which will be recognised as equity measured at the net expense incurred in providing the shares.

3) Non-goodwill intangibles

All current non-goodwill intangible assets qualify for recognition

Introduction of new software development asset

Existing non-goodwill intangible assets on the IAG Group's statement of financial position at 1 July 2004 and 30 June 2005 meet the recognition and measurement requirements of A-IFRS and so the accounting treatment, including amortisation, will remain unchanged. They will be subject to impairment testing. There are no impairment charges for these assets at 1 July 2004, 31 December 2004, or 30 June 2005.

In certain circumstances under A-IFRS, development phase expenditure will be capitalised and so recognised as an internally generated intangible asset. Software development is the only development expenditure for the IAG Group. The IAG Group is not currently carrying any capitalised software development costs in the statement of financial position but will recognise such an asset under the more prescriptive A-IFRS requirements. Only software development projects with total budgeted expenditure of more than \$2 million will be capitalised. All other software related costs are treated as maintenance expenditure, being an overall part of maintaining an efficient operating environment, and are expensed as incurred.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 40. EVENTS SUBSEQUENT TO REPORTING DATE (CONTINUED)

(c) International financial reporting standards (continued)

3) Non-goodwill intangibles (continued)

Only software development expenditure incurred after 1 July 2004, the Group's A-IFRS transition date, is considered eligible for capitalisation under A-IFRS. For this reason, the first adjustment relating to software development expenditure will be for the year to 30 June 2005 amounting to \$24 million. That amount will be included in the statement of financial position for the year to 30 June 2005 under A-IFRS. This amount is supportable using A-IFRS impairment methodology.

4) Property, plant and equipment

All property classified as owner occupied and depreciated over useful life

Under Australian GAAP, all property (land and buildings), regardless of the purpose for which it is used, must be designated as an investment integral to general insurance activities and so is measured at fair value. This designation will not continue under A-IFRS and property will be classified according to the purpose for which it is held. All of the property within the IAG Group will be classified as owner occupied property under A-IFRS.

The IAG Group has elected to apply the cost approach under which the buildings will be depreciated over the useful life and also be subject to impairment testing. The land will be subject to impairment testing. The IAG Group has elected to apply the optional exemption permitted under the transitional provisions for first time adoption of A-IFRS to use the fair value of the property held as at 30 June 2004 (shown in this report as \$66 million) as the deemed cost of that property moving forward. This requires 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.

Based on the portfolio of properties held at 30 June 2005 this will introduce a depreciation expense of \$1 million to the A-IFRS statement of financial performance for the year ended 30 June 2005. There are no impairment charges for property at 1 July 2004, 31 December 2004 or 30 June 2005.

Plant and equipment to continue to be measured at cost and depreciated over useful life

For plant and equipment, the IAG Group has elected to apply the cost approach under which each item will be depreciated over its useful life and also be subject to impairment testing. The IAG Group has elected to not apply the optional exemption permitted under the transitional provisions for first time adoption of A-IFRS to use the fair value of the plant and equipment as at 30 June 2004 as the deemed cost, and so will continue to depreciate the original cost. There are no impairment charges for plant and equipment at 1 July 2004, 31 December 2004 or 30 June 2005.

5) Taxation

More deferred tax assets and liabilities may be recognised

Income tax will be calculated based on the 'balance sheet approach' replacing the 'income statement approach' currently used. The A-IFRS 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. Deferred tax assets under A-IFRS will be recognised based on a 'probable' criterion rather than the 'beyond reasonable doubt' criterion, or 'virtually certain' criterion for unused tax losses, under Australian GAAP. This may result in more deferred tax assets and liabilities and, as tax effects follow the underlying transaction, some tax effects will be recognised in equity. Deferred tax balances will continue to be undiscounted under A-IFRS.

The transition to A-IFRS involves two types of tax adjustments. There are adjustments arising from the different methodology used for the determination of tax adjustments as discussed above. There are also consequential tax impacts arising from the different recognition treatments of certain assets and liabilities under A-IFRS.

The adjustments arising from the transition to the balance sheet approach for the calculation of taxation had not yet been reliably determined as at the date of finalisation of this report.

Applicable from 1 July 2005

6) Insurance contracts

All of the insurance products meet the accounting definition of an 'insurance contract'

The only change to the accounting treatments for insurance contracts is the expanded liability adequacy test

In respect of the IAG Group's core insurance business, the changes to accounting treatments on conversion to A-IFRS are minimal. A-IFRS allows the IAG Group to basically continue with current accounting treatments for those general insurance products and reinsurance products that meet the A-IFRS definition of an 'insurance contract'. The only change is the introduction of an expanded liability adequacy test.

All of the IAG Group's general insurance products and reinsurance products on offer, or utilised, meet the definition of an insurance contract and none of the contracts contain embedded derivatives or are required to be unbundled. This means that the IAG Group's accounting for premium revenue, reinsurance expense, claims expense, acquisition costs, and reinsurance and other recoveries, together with related balances in the statement of financial position, will continue without change, subject to an expanded liability adequacy test.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

The liability adequacy test is an assessment of whether the carrying amount of an insurance liability is adequate based on a review of future cash flows. It is to be conducted with the inclusion of an explicit risk margin (Australian GAAP version of the test does not refer to a risk margin) and is to be 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 (Australian GAAP version of test conducted at reporting entity level). Any deficiency arising from the test will be recognised first through the write down of any related intangible assets and then the related deferred acquisition costs, with any remaining balance being recognised in the statement of financial position as an unexpired risk liability.

Liability adequacy test passed as at 1 July 2005

The liability adequacy test was passed as at 1 July 2005 demonstrating that the unearned premium liability is adequate.

7) Contributed equity

The reset preference shares to be reclassified as debt

The measurement and treatment of the issued and fully paid ordinary shares will remain unchanged.

Distributions on the reset preference shares to be treated as interest, not dividends

The IAG Group's reset preference shares ("RPS") are currently 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 will be reclassified as debt under A-IFRS and will be measured at amortised cost. Distributions on the instruments (refer note 8(b)) made after 1 July 2005 will be treated as interest rather than dividends and so have a negative impact on reported profit. As the RPS will continue to be treated as equity for tax purposes, there will be no change in the ability to frank the distributions.

The transaction costs incurred from the issuance of the two tranches of RPS, totalling \$11 million, have been recognised directly in equity under Australian GAAP as a reduction in the proceeds of the instruments. When the RPS are reclassified as debt under A-IFRS those transaction costs will be treated as having been capitalised (included into the value of the liability) and recognised on an effective yield basis (amortised over the period to the first reset date). This requires an adjustment to increase retained earnings as at 1 July 2005 by \$11 million to recognise the capitalisation of the costs, offset by a reduction in retained earnings of \$6 million representing the portion of the transaction costs that would have been effectively amortised up to that date.

With the distributions treated as interest under A-IFRS, the distributions will be recognised on an accruals basis, which is different to the current policy of recognising a provision for the distributions only when the distributions are declared. The adjustment to recognise the interest payable as at 1 July 2005 is a decrease in retained earnings of \$1 million.

Reset preference shares will continue to qualify as Tier 1 capital, at least in the near term

This change has a direct impact on the contributed capital of the IAG Group, which is central to the capital adequacy requirements set by APRA. APRA has stated it will continue the current regulatory capital treatment for existing instruments that are adversely affected by the accounting standard change until further notice. If APRA's approach changes, it has indicated it may 'grandfather' the treatment of affected issued securities. This would be considered a likely outcome, as the risk to the policyholders has not changed as a result of the change in accounting standards.

8) Investments

More choices around accounting policies for investments

Under Australian GAAP, the IAG Group is required to measure at net market value (fair value less disposal costs) all investments integral to general insurance activities with movements in the net market value recorded in the statement of financial performance.

Initial accounting policy selection means no immediate change

Under A-IFRS, the IAG Group will be required to measure at fair value those financial assets held to back insurance liabilities. Those financial assets that are not held to back insurance liabilities will move to a system of purpose led accounting. A-IFRS requires classification of the investments based on the purpose for which they are held. The different classifications have different accounting treatments, being fair value through profit or loss, fair value through equity, and amortised cost. There is also an option to measure any financial asset at fair value through profit or loss, regardless of the purpose for which it is held, where certain conditions are met (the application of the conditions arises from the IAG Group's election to early adopt amending standard AASB 2005-4 restricting the application of the fair value option).

The IAG Group has elected to apply the fair value through profit or loss option under its current investment strategy for shareholders' funds and so all investments held will be measured on the same basis. This is basically a continuation of current practice with small adjustments for disposal costs (A-IFRS uses gross market value, not net market value) and a change in market price determination (move from last sale price to bid price). The net adjustment for the change is a \$1 million increase in investments with a corresponding adjustment to retained earnings as at 1 July 2005.

The IAG Group reserves the right to deem further asset acquisitions as held for another purpose and thus be valued on one of the other available bases.

9) Derivatives

All recorded in statement of financial position at fair value

The IAG Group uses a variety of derivatives to manage risk exposures of the IAG Group.

Investment operations

All of the derivatives used in relation to the investment operations are currently recognised on the statement of financial position (disclosed together with the underlying instrument) at fair value, with movements in fair value being recorded through profit or loss. The A-IFRS treatment is basically a continuation of current practice with small adjustments for market valuation differences. The net adjustment for the change is included within the adjustment noted above for investments.

NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2005

NOTE 40. EVENTS SUBSEQUENT TO REPORTING DATE (CONTINUED)

(c) International financial reporting standards (continued)

9) Derivatives (continued)

Treasury operations

There are various derivatives used by the IAG Group to hedge exposure to foreign currency and interest rate movements in relation to treasury transactions, which include borrowings. While the Group has a number of economic hedges in place, only a small number of these transactions have been selected for hedge accounting.

Hedge accounting to be applied to only a small number of transactions

Those derivatives, for which hedge accounting will not be used under A-IFRS, will be recognised on the statement of financial position at fair value, with movements in fair value being recorded through profit or loss. This is basically a continuation of current practice and requires no adjustment as at 1 July 2005.

A-IFRS specifies that hedge accounting can only be applied for fair value hedges, cash flow hedges, and hedges of investments in foreign operations, and only where stringent rules are met. While all derivatives will be measured at fair value, hedge accounting basically provides for the movement in fair value of the derivative to follow the accounting for the underlying instrument. Each of the derivative contracts selected for hedge accounting qualifies as a cash flow hedge.

The adjustment required to recognise the application of cash flow hedge accounting under A-IFRS for these transactions involves an increase in the measurement of the derivative recognised on the statement of financial position of \$7 million with a corresponding credit to an equity reserve.

Embedded derivatives to be measured and recognised in certain circumstances

Under A-IFRS, derivatives embedded in other financial instruments or other non-financial host contracts are to be treated separately when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value with movements recorded through profit or loss. Where an embedded derivative is required to be separated, they are to be measured at fair value. A review conducted of all contracts to which IAG Group entities are a party determined that, while embedded derivatives were identified, they are either not required to be separated from the host contract and/or currently have no material value.

Other information

10) Consolidation

Potential reclassification of outside equity interests in investment trusts controlled for accounting purposes

Other than the equity remuneration trusts (refer 2b above), there are no other entities in the IAG Group that are currently not consolidated that would require consolidation under A-IFRS.

The consolidated Group includes IAG Asset Management Wholesale Trusts in which the Group has a controlling interest for accounting purposes. Currently, when consolidating the trusts, an amount is recognised in equity as the outside equity interests in the trust, being the value attributable to unitholders outside the IAG Group. It is possible, at least for one of the trusts, that under A-IFRS, the residual interest in the trust will qualify as a liability in the statement of financial position of the trust and so will not be recognised as equity. Therefore, upon consolidation of the trust under A-IFRS, the value attributable to unitholders outside the IAG Group would be recognised as a liability in the statement of financial position of the IAG Group and not in equity as an outside equity interest

There are accounting and taxation issues outstanding that need to be resolved before the final treatment can be determined. These issues are expected to be resolved prior to preparation of the first financial report prepared in accordance with A-IFRS. The change will have no impact on the equity attributable to shareholders of Insurance Australia Group Limited.

11) First time adoption – optional exemptions

Upon transition to A-IFRS the general principle is that the financial reports must be prepared as if the new standards had always been applied. There are however optional exemptions that may be applied upon first time adoption. The IAG Group may elect to apply some, all or none of the options. Only seven of the twelve options are relevant to the IAG Group and these are listed below together with the elected treatment.

Business combinations – The IAG Group will not restate the accounting for business combinations transacted prior to 1 July 2004.

Share based payments – The IAG Group will not retrospectively apply the A-IFRS expense treatment to share based payments granted prior to 7 November 2002 and/or that vested prior to 1 January 2005.

Property, plant and equipment – The IAG Group will use the fair value of the property as at 30 June 2004 as the deemed cost of that property moving forward but will continue with original cost for plant and equipment.

Foreign currency translation reserve – The IAG Group will not reset the foreign currency translation reserve to zero.

Insurance contracts – The IAG Group will not apply certain disclosure requirements to prior periods.

Financial instruments options – The IAG Group will use this option to designate financial instruments to the various classifications available under A-IFRS upon transition.

Fair value measurement of financial instruments – The IAG Group will not apply the first time adoption option allowing relief from the retrospective application of 'Day One' recognition requirements as the IAG Group's current practice complies with the requirements.