

INSURANCE AUSTRALIA GROUP LIMITED

ABN 60 090 739 923

HALF YEAR REPORT 31 DECEMBER 2005

APPENDIX 4D

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INSURANCE AUSTRALIA GROUP LIMITED

APPENDIX 4D – HALF YEAR REPORT 31 DECEMBER 2005

RESULTS FOR ANNOUNCEMENT TO THE MARKET

	Up/down	% change	\$m
Revenue from ordinary activities	Down	-1%	4,234
Profit from ordinary activities after tax attributable to shareholders	Down	-1%	461
Net profit attributable to shareholders of Insurance Australia Group Limited	Down	-1%	461

Dividends – ordinary shares	Amount per share	Franked amount per share
Interim dividend	13.5 cents	13.5 cents

The record date of the dividend is 8 March 2006. The dividend is to be paid on 10 April 2006. The last date for the receipt of an election notice for participation in the company's Dividend Reinvestment Plan is 8 March 2006.

INSURANCE AUSTRALIA GROUP LIMITED

APPENDIX 4D – HALF YEAR REPORT 31 DECEMBER 2005

OTHER INFORMATION

During the half year the Insurance Australia Group held an interest in the following joint ventures:

	% Held
NTI Limited	50

The company's aggregate share of profits of these entities is not material.

INSURANCE AUSTRALIA GROUP LIMITED

APPENDIX 4D – HALF YEAR REPORT 31 DECEMBER 2005

APPENDIX 4D COMPLIANCE MATRIX

Appendix 4D disclosure requirements	Insurance Australia Group Appendix 4D	Page Number	Note Number
1. Details of the reporting period and the previous corresponding period.	All financial data headings		
2. Key information in relation to the following. This information must be identified as “Results for announcement to the market”. 2.1 The amount and percentage change up or down from the previous corresponding period of revenue from ordinary activities. 2.2 The amount and percentage change up or down from the previous corresponding period of profit (loss) from ordinary activities after tax attributable to members. 2.3 The amount and percentage change up or down from the previous corresponding period of net profit (loss) for the period attributable to members. 2.4 The amount per security and franked amount per security of final and interim dividends or a statement that it is not proposed to pay dividends. 2.5 The record date for determining entitlements to the dividends (if any). 2.6 A brief explanation of any of the figures in 2.1 to 2.4 necessary to enable the figures to be understood.	“Results for announcement to the market” page 1 Appendix 4D		
3. Net tangible assets per security with the comparative figure for the previous corresponding period.	Attachment A: Half year financial report 31 December 2005: <ul style="list-style-type: none"> • Notes to the financial statements - Net tangible assets. 	P.43	Note 13
4. Details of entities over which control has been gained or lost during the period, including the following. 4.1 Name of the entity. 4.2 The date of the gain or loss of control. 4.3 Where material to an understanding of the report – the contribution of such entities to the reporting entity’s profit from ordinary activities during the period and the profit or loss of such entities during the whole of the previous corresponding period.	Attachment A: Half year financial report 31 December 2005: <ul style="list-style-type: none"> • Notes to the financial statements - Changes in the composition of the consolidated entity 	P.41	Note 11

INSURANCE AUSTRALIA GROUP LIMITED

APPENDIX 4D – HALF YEAR REPORT 31 DECEMBER 2005

<p>5. Details of individual and total dividends or distributions and dividend or distribution payments. The details must include the date on which each dividend or distribution is payable and (if known) the amount per security of foreign sourced dividend or distribution.</p>	<p>Attachment A: Half year financial report 31 December 2005:</p> <ul style="list-style-type: none"> • Notes to the financial statements <ul style="list-style-type: none"> - Dividends note 	<p>P.35</p>	<p>Note 8</p>
<p>6. Details of any dividend or distribution reinvestment plan in operation and the last date for the receipt of an election notice for participation in any dividend or distribution reinvestment plan.</p>	<p>Attachment A: Half year financial report 31 December 2005:</p> <ul style="list-style-type: none"> • Notes to the financial statements <ul style="list-style-type: none"> - Dividend note 	<p>P.35</p>	<p>Note 8</p>
<p>7 Details of associates and joint venture entities including the name of the associate or joint venture entity and details of the reporting entity's percentage holding in each of these entities and - where material to an understanding of the report - aggregate share of profits (losses) of these entities, details of contributions to net profit for each of these entities, and with comparative figures for each of these disclosures for the previous corresponding period.</p>	<p>"Other information" page 2 Appendix 4D</p>		
<p>8. For foreign entities, which set of accounting standards is used in compiling the report (e.g. International Accounting Standards).</p>	<p>Not applicable</p>		
<p>9. For all entities, if the accounts are subject to audit dispute or qualification, a description of the dispute or qualification.</p>	<p>Not applicable</p>		

INSURANCE AUSTRALIA GROUP LIMITED

APPENDIX 4D – HALF YEAR REPORT 31 DECEMBER 2005

ATTACHMENT A

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

HALF YEAR FINANCIAL REPORT – 31 DECEMBER 2005

INSURANCE AUSTRALIA GROUP LIMITED
ABN 60 090 739 923
AND CONTROLLED ENTITIES
HALF YEAR FINANCIAL REPORT - 31 DECEMBER 2005

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Insurance Australia Group Limited is a publicly listed company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is level 26, 388 George Street, Sydney, NSW 2000.

This half year financial report does not include all of the notes normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2005 and any public announcements made by Insurance Australia Group Limited during the half year reporting period in accordance with the continuous disclosure requirements of the Corporations Act 2001.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

DIRECTORS' REPORT

The Directors present their report together with the consolidated financial report of Insurance Australia Group Limited ("IAG" / "Parent" / "Company") and the entities it controlled ("IAG Group") for the half year ended 31 December 2005 and the review report thereon.

Directors

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

Mr JA Strong (Director since 2 August 2001), Ms YA Allen (Director since 10 November 2004), Mr JF Astbury (Director since 25 July 2000), Mr GA Cousins (Director since 25 July 2000), Mr ND Hamilton (Director since 19 June 2000), Mr RA Ross (Director since 25 July 2000), Mr BM Schwartz (Director since 1 January 2005) and Mr MJ Hawker (Director since 1 December 2001).

Operating and financial review

Operating result for the year

The IAG Group's net profit after tax for the half year was \$513 million (2004 - \$524 million). After adjusting for outside equity interests in the IAG Group result, net profit attributable to shareholders of the Company was \$461 million (2004 - \$467 million).

The current period result has been determined based on the adoption of the Australian equivalents of the International Financial Reporting Standards and where applicable, the prior period information has been updated to reflect this change. Notes 1 and 2 of the financial statements provide detailed information on the accounting policies applied and the resultant impact on the prior period financial performance and financial position.

Underwriting result

The IAG Group produced an underwriting profit before investment income on technical reserves of \$274 million (2004 - \$219 million). The underwriting profit is affected by interest rate movements which change the discount rate applicable to claims reserves. In 2005, this resulted in a decrease in claims expense by \$16 million compared to an expense of \$65 million in 2004. This resulted in a decrease in the loss ratio to 63.8% (2004 - 66.9%) and the combined ratio to 91.2% (2004 - 93.0%). Excluding the impact of the movement in interest rates on claims expense, the underlying loss ratio improved modestly to 64.4% (2004 - 64.8%) whilst the combined ratio was negatively impacted by an increase to 91.7% (2004 - 90.9%) as a result of an increase in the expense ratio. The increase in the expense ratio to 27.4% (2004 - 26.1%) was mainly attributable to an adverse fire service levy adjustment and an increase in advertising costs.

The insurance profit of \$469 million (2004 - \$482 million), which is considered to be a sound insurance trading result, equated to an insurance margin of 15.1% (2004 - 15.5%).

The following discussion of underwriting result by business segments, being the Australian personal and commercial lines and the New Zealand insurance operations, incorporates an allocation of profit from the IAG Group's Captive reinsurer. This allocation was based on the net contribution of the business segments to the Captive result.

(a) Australian personal lines insurance operations

The personal lines insurance operations produced an insurance margin of 13.1% for the financial period (2004 - 18.3%). The decline in the insurance margin is attributable to the competitive price pressures in all segments, an increase in claims reserves in the NSW CTP portfolio to reflect an increasing trend in average weekly earnings in NSW, additional fire service levies and an increase in advertising costs. Despite these pressures and the reduction of insurance margin, the strength in the underlying performance was a result of the continued focus on adhering to underwriting discipline and risk selection.

Gross written premiums decreased by 3.3% to \$1,936 million (2004 - \$2,002 million), due to strong competition.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

DIRECTORS' REPORT

Operating and financial review (continued)

(b) Australian commercial lines insurance operations

The commercial lines insurance operations produced an insurance margin of 18.5% for the financial period (2004 – 9.2%). The significant increase in the margin over prior period was due to claims reserve releases reflecting the recognition of tort law reform on both prior year reserves and current year claims experience. This was partially offset by additional fire service levies and an increase in frequency of large fire related losses in the short-tail commercial portfolio.

Gross written premiums decreased by 8.0% to \$761 million (2004 - \$827 million) due to strong competition in a softening rate environment.

Fee based income produced a profit of \$2 million (2004 - \$11 million). The profitable performance from premium funding activities and the non-risk workers' compensation scheme in Victoria was offset by further provisioning required in the NSW workers' compensation business arising from the reassessment of the fee income relating to prior periods.

(c) International insurance operations

New Zealand insurance operations:

The New Zealand insurance operations produced an insurance margin of 18.6% for the financial period (2004 – 15.0%). The improved result is despite slowing economic growth, strong competition amongst consolidated players and increasing capital capacity from foreign players entering the New Zealand market. In order to maintain market share and margins, IAG New Zealand has implemented a number of sales and service initiatives focused on delivering improvements in underwriting, product development and partnering with distributors to enhance processing and product delivery to customers.

Gross written premiums decreased by 1.0% to \$494 million (2004 - \$499 million), which includes a negative impact of \$5 million or 1% from unfavourable exchange rate movements in the current financial period.

Thailand insurance operations:

The IAG Group acquired IAG Insurance (Thailand) Ltd (formerly Royal and Sun Insurance Alliance (Thailand) Ltd) on 4 July 2005. Gross written premium for the period to 31 December 2005 was \$16 million with a combined ratio of 77.7%.

Captive reinsurer:

The Captive acts solely as the IAG Group's reinsurer assuming risk from other parts of the business and obtaining reinsurance protections for the IAG Group in the open market. The insurance result decreased by \$18 million to \$22 million in the financial period. This was mainly driven by higher retention levels by business units, facilitated in part through the issue of contingent capital in the form of reset exchangeable securities by the IAG Group in January 2005, resulting in lower premiums being earned by the Captive. As previously discussed, the Captive's financial performance has been allocated to the Australian personal and commercial lines and the New Zealand insurance operations.

(d) Corporate and investments

Investment income on corporate and equity holders' funds (net of investment expenses) increased by 16.7% to \$342 million. The increase was due to the strong investment performance by all the major asset classes, particularly Australian equities, in the current financial period.

The net corporate expenses have increased by \$22 million (40%) to \$77 million. This increase was mainly attributable to:

- increase in borrowing costs by \$17 million in the current financial period due to the reclassification of reset preference shares as debt under AIFRS; and
- increase in head office corporate expenses by \$3 million to \$18 million in the current financial period due to the implementation of the international growth strategy.

Review of financial condition

(a) Financial position

Assets:

The total assets of the IAG Group as at 31 December 2005 are \$16,894 million (30 June 2005 - \$17,102 million).

The decrease is mainly attributable to a general decrease in growth of gross written premium during the financial period, reflecting the decrease in insurance balances held at 31 December 2005.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

DIRECTORS' REPORT

Operating and financial review (continued)

Liabilities:

The total liabilities of the IAG Group as at 31 December 2005 are \$13,125 million (30 June 2005 - \$12,599 million) with the major component being general insurance liabilities of \$10,366 million (30 June 2005 - \$10,426 million). The increase is attributable to the reclassification, under AIFRS, of reset preference shares to interest-bearing liabilities (from equity) and of unitholders' funds to liabilities (from minority interests) from 1 July 2005.

Equity:

Total equity decreased by \$734 million mainly due to the reclassification, under AIFRS, of reset preference shares (\$539 million) to interest-bearing liabilities (from equity) and of unitholders' funds (\$421 million) to liabilities (from minority interests) from 1 July 2005. Total equity has also been impacted by the following activities during the year:

Increase:

- Net profit of \$461 million.

Decrease:

- payment of dividends of \$231 million.

(b) Cash from operations

Cash flows from operating activities:

Cash inflows from operating activities have decreased by \$267 million to \$164 million.

The decrease is mainly attributable to:

- an increase in claims costs paid;
- higher income taxes paid;
- higher finance costs paid due to the reclassification of reset preference shares; and
- an increase in other operating payments (such as fire services levies and advertising costs as mentioned in underwriting results above); and

The decrease was offset to some extent by the:

- increase in reinsurance and other recoveries received; and
- an increase in other operating receipts.

Cash flows from investing activities:

Cash inflows from investing activities have increased by \$616 million to \$592 million.

The increase is largely attributable to the higher level of redemption of investments to cash to fund the surplus capital fund as a result of a reduction in cash generated from operating activities (refer details above). This fund is used for income tax and dividend payments and other capital transactions. In addition, there was a net redemption of trust units in the IAG controlled trusts by third party unitholders.

Cash flows from financing activities:

Cash outflows from financing activities have increased by \$116 million to \$482 million.

This increase is attributable to the:

- repayment of \$46 million of NZ senior term notes which matured in August 2005; and
- net redemptions of trust units in the IAG controlled trusts of \$161 million in the current financial period compared with net redemption of \$76 million in the prior period.

(c) Capital adequacy / minimum capital requirements

The IAG Group minimum capital requirement ("MCR") multiple, calculated by applying APRA standards for individual licensed insurers to the relevant consolidated results, is 2.04 times as at 31 December 2005 (30 June 2005 – 2.00 times). The multiple remains above the IAG Group's current benchmark multiple of 1.55 times MCR.

Further information on the IAG Group's result and review of operations can be found in the 31 December 2005 Investor Report on the Company's website, www.iag.com.au.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

DIRECTORS' REPORT

Lead auditor's independence declaration under section 307C of the Corporations Act 2001

The lead auditor's independence declaration is set out on page 5 and forms part of the directors' report for the half year ended 31 December 2005.

Events subsequent to reporting date

Details of matters subsequent to the end of the financial period are set out in note 14. These include:

- a dividend declared of 13.5 cents per ordinary share. The Dividend Reinvestment Plan will operate using shares acquired on market with no discount applied;
- on 9 December 2005, the IAG Group announced that it had agreed to acquire a 30% interest in a general insurer in Malaysia, AmAssurance Berhad ("AmAssurance"). Approval for the acquisition was received from the Malaysia Ministry of Finance on 16 January 2006. The acquisition is still however subject to final regulatory approval from Malaysia's Foreign Investment Committee.
- on 7 February 2006, the IAG Group announced it had signed an exclusive memorandum of understanding regarding a proposed investment in China Pacific Property Insurance Co, Ltd (CPIC Property), a China based general insurance business. The IAG Group will negotiate with CPIC Property to purchase an initial 24.9% interest, as well as an option to increase its ownership to 40% subject to certain regulatory approvals.
- on 10 February 2006, the IAG Group acquired an additional 16.7% interest in Safety Insurance Public Company Limited ("Safety Insurance"), taking its existing 21.6% shareholding to 38.3%. The IAG Group announced on 13 February 2006 that it intends to further increase its interest in Safety Insurance through a general tender offer to all Safety Insurance shareholders.
- on 23 February 2006, IAG announced it would return \$200 million to shareholders by 30 June 2006.

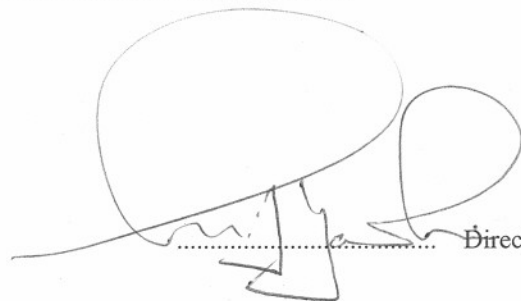
Dividends

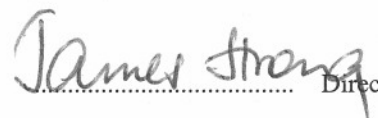
Details of dividends declared are set out in note 8.

Rounding of amounts

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

Signed at Sydney this 23rd day of February 2006 in accordance with a resolution of the Directors.


..... Director


..... Director



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

To: the directors of Insurance Australia Group Limited

I declare that, to the best of my knowledge and belief, in relation to the review for the half year ended 31 December 2005 there have been:

- (a) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the review;
and
- (b) no contraventions of any applicable code of professional conduct in relation to the review.

KPMG

KPMG

A handwritten signature in cursive script, appearing to read 'A. Terblanché', written in black ink.

Dr Andries B Terblanché
Partner

Sydney
23rd February 2006

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES
CONSOLIDATED INCOME STATEMENT FOR THE HALF YEAR ENDED 31 DECEMBER 2005

	Notes	CONSOLIDATED	
		31 Dec 2005	31 Dec 2004
		\$m	\$m
Premium revenue	3(a)	3,320	3,311
Reinsurance expense		(209)	(202)
Net premium revenue (i)		3,111	3,109
Claims expense		(2,245)	(2,361)
Reinsurance and other recoveries	3(a)	259	282
Net claims expense (ii)		(1,986)	(2,079)
Acquisition costs		(542)	(533)
Other underwriting expenses		(186)	(191)
Fire service levies		(123)	(87)
Underwriting expenses (iii)		(851)	(811)
Underwriting profit (i) + (ii) + (iii)		274	219
Investment income on technical reserves	3(b)	202	270
Investment expenses on technical reserves		(7)	(7)
Insurance profit		469	482
Investment income on equity holders' funds	3(b)	352	299
Other income	3(c)	101	109
Finance costs		(45)	(28)
Net income attributable to minority interests in unitholders' funds		(11)	-
Corporate, administration and other expenses		(133)	(133)
Profit before income tax		733	729
Income tax expense		(220)	(205)
Profit for the period		513	524
Profit for the period attributable to:			
Equity holders of the Parent		461	467
Minority interests		52	57
Profit for the period		513	524
		31 Dec 2005	31 Dec 2004
		cents	cents
Basic earnings per ordinary share	7	29.06	28.54
Diluted earnings per ordinary share	7	28.89	28.35

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

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES
CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE FOR THE HALF YEAR ENDED
31 DECEMBER 2005

	CONSOLIDATED	
	31 Dec 2005	31 Dec 2004
	\$m	\$m
Initial recognition of AIFRS adjustments directly to retained earnings at 1 July 2005, net of tax		
- Adjustment to valuation of investments	1	-
- Amortisation of reset preference shares transaction costs	(6)	-
- Accrual for distribution on reset preference shares	(1)	-
- Net tax impact of AIFRS adjustments to retained earnings	-	-
Initial recognition of AIFRS adjustments directly to reserves at 1 July 2005, net of tax		
- Recognition of hedging reserve	(5)	-
Net AIFRS adjustments at 1 July 2005	(11)	-
Actuarial gains / (losses) on defined benefit plans, net of tax	8	-
Net exchange difference on translation of foreign operations	3	(1)
Movement in hedging reserve, net of tax	(4)	-
Net income recognised directly in equity	(4)	(1)
Profit for the period	513	524
Total recognised income and expense for the period	509	523
Total recognised income and expense for the period attributable to:		
Equity holders of the Parent	458	466
Minority interests	51	57
Total recognised income and expense for the period	509	523

Other movements in equity arising from transactions with equity holders acting in their capacity as equity holders are set out in note 10.

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

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2005

	Notes	CONSOLIDATED	
		31 Dec	30 Jun
		2005	2005
		\$m	\$m
Assets			
Cash and cash equivalents		733	456
Investments		10,075	10,375
Premium receivable		1,592	1,710
Trade and other receivables		700	657
Current tax assets		-	4
Reinsurance and other recoveries receivable		999	1,053
Inventories		2	2
Prepayments		21	38
Deferred levies and charges		118	105
Deferred reinsurance expense		143	194
Deferred acquisition costs		601	621
Property, plant and equipment		252	259
Deferred tax assets		118	131
Investment in joint ventures and associates		2	3
Intangible assets		50	31
Goodwill		1,488	1,463
Total assets		16,894	17,102
Liabilities			
Trade and other payables		741	721
Reinsurance premiums payable		113	195
Restructuring provision		-	11
Current tax liabilities		74	193
Unexpired risk liability		3	-
Unearned premium liability		3,487	3,586
Lease provision		21	21
Employee benefits provision		180	229
Minority interests in unitholders' funds		295	-
Deferred tax liabilities		40	24
Outstanding claims liability		6,876	6,840
Interest-bearing liabilities	9	1,295	779
Total liabilities		13,125	12,599
Net assets		3,769	4,503
Equity			
Share capital	10(a)	3,263	3,802
Treasury shares	10(b)	(45)	(34)
Reserves	10(c)	4	7
Retained earnings	10(d)	375	142
Parent interest	10(d)	3,597	3,917
Minority interests	10(e)	172	586
Total equity	10	3,769	4,503

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

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES
CONSOLIDATED CASH FLOW STATEMENT FOR THE HALF YEAR ENDED 31 DECEMBER 2005

	Note	CONSOLIDATED	
		31 Dec 2005	31 Dec 2004
		\$m	\$m
Cash flows from operating activities			
Premium received		3,325	3,347
Reinsurance and other recoveries received		327	237
Claims costs paid		(2,223)	(2,095)
Reinsurance expense paid		(181)	(123)
Dividends received		58	55
Interest and similar items received		239	244
Finance costs paid		(59)	(32)
Income tax refund		7	9
Income tax paid		(313)	(259)
Other operating receipts		657	532
Other operating payments		(1,673)	(1,484)
Net cash provided by operating activities		164	431
Cash flows from investing activities			
Net cash flows on acquisition of a subsidiary	11	(29)	-
Proceeds from disposal of investments and property, plant and equipment		9,757	11,057
Outlays for investments and property, plant and equipment acquired		(9,105)	(11,036)
Repayment of premium funding loans		229	180
Advances of premium funding loans		(260)	(225)
Net cash provided by / (used in) investing activities		592	(24)
Cash flows from financing activities			
Proceeds from issues of trust units		446	468
Outlays for redemption of trust units		(607)	(544)
Proceeds from borrowings		-	-
Repayment of borrowings		(46)	-
Dividends paid to IAG equity holders		(231)	(238)
Dividends paid to minority interests		(44)	(52)
Net cash used in financing activities		(482)	(366)
Net increase in cash held		274	41
Effects of exchange rate changes on balances of cash held in foreign currencies		3	-
Cash and cash equivalents at 1 July		456	424
Cash and cash equivalents at 31 December ⁽ⁱ⁾		733	465

Notes:

(i) Cash and cash equivalents represents cash on hand and in banks, deposits at call and money market investments readily convertible to cash within two working days, net of bank overdraft.

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

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies

This general purpose financial report of Insurance Australia Group Limited (“IAG”) and the entities it controlled (“IAG Group”) for the half year reporting period ended 31 December 2005 has been prepared in accordance with Accounting Standard AASB 134 *Interim Financial Reporting*, the Corporations Act 2001 and the Australian Stock Exchange Listing Rules. This general purpose financial report of the IAG Group was authorised by the Board of Directors for issue on 23rd February 2006.

This half year financial report does not include all of the notes normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2005 and any public announcements made by IAG during the half year reporting period in accordance with the continuous disclosure requirements of the Corporations Act 2001.

The half year financial report would normally include only those significant accounting policies that are different to those applied in the preceding annual financial report. To assist readers in understanding the significant accounting policies of the IAG Group under the new Australian equivalents to International Financial Reporting Standards (“AIFRS”), refer below for a complete set of significant accounting policies.

(a) Basis of preparation of half year financial report

For all periods up to and including the year ended 30 June 2005, the IAG Group prepared financial reports in accordance with Australian Generally Accepted Accounting Principles (“Australian GAAP”). From 1 July 2005, the IAG Group is required to prepare financial reports in accordance with AIFRS effective for the half year ended 31 December 2005 and the full year ending 30 June 2006. For the IAG Group, the date of transition to AIFRS was 1 July 2004, which is the start of the comparative period. The principal accounting policies adopted in the preparation of the financial report are set out below. The presentation currency used for the preparation of these financial reports is Australian dollars. The balance sheet is prepared using the liquidity format in which the assets and liabilities are presented broadly in order of liquidity.

Reconciliations and explanations of the impact of the transition from Australian GAAP to AIFRS on the IAG Group’s financial position, financial performance and cash flows are provided in note 2.

The accounting policies adopted in the preparation of this financial report have been consistently applied by all entities in the IAG Group. The policies have been applied consistently to all periods presented in the financial report and in preparing the opening AIFRS balance sheet at 1 July 2004 for the purposes of transition to AIFRS, except for the standards discussed below for which comparatives have not been restated. These financial statements have been prepared on the basis of historical cost principles, as modified by certain exceptions noted in the financial report, with the principal exceptions being the measurement of all investments and derivatives at fair value and the measurement of the outstanding claims liability at present value. Certain items have been reclassified from the prior period’s financial reports to conform to the current period’s presentation; capitalised transaction costs on interest-bearing liabilities previously disclosed as prepayments are now disclosed together with the liabilities (reclassification as at 30 June 2005 of \$16 million), the value of the interest rate swap forming part of the hedge on the US subordinated term notes previously disclosed as a payable is now disclosed together with the liability (reclassification as at 30 June 2005 of \$2 million), the net value of corporate treasury derivatives previously offset against payables is now included in trade and other receivables (reclassification as at 30 June 2005 of \$3 million), and reinsurance premiums payable previously included within trade and other payables is now presented separately on the balance sheet.

Compliance with International Financial Reporting Standards

International Financial Reporting Standards (“IFRS”) refer to the overall framework of standards and pronouncements approved by the International Accounting Standards Board. IFRS forms the basis of Australian Accounting Standards adopted by the Australian Accounting Standards Board, being AIFRS. This half year financial report of the consolidated entity complies with IFRS.

First time adoption of AIFRS

This half year financial report is the first IAG half year financial report to be prepared in accordance with AIFRS. AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* has been applied in preparing these financial statements. There are several recognition and measurement differences between Australian GAAP and AIFRS. Preparation of this AIFRS compliant half year financial report has required amendment of certain accounting policies, changes to certain valuation methodologies, and reporting of certain information in a different manner than was the case under the previous Australian GAAP financial reports. Comparative figures have been restated to reflect these adjustments except for several exceptions noted below. There was also an impact on the cash flow statement with the distributions on the reset preference shares, previously presented as dividends paid, in financing activities, now presented as finance costs paid, in operating activities.

In preparing this half year financial report, the IAG Group has elected to take advantage of certain transitional provisions within AASB 1 which offer exemption from presenting comparative information or applying AIFRS retrospectively. The most significant impact arises from the exemption from presenting comparative information in accordance with AASB 132 *Financial Instruments: Presentation*, AASB 139 *Financial Instruments: Recognition and Measurement* and AASB 1023 *General Insurance Contracts*. Comparative information for financial instruments and insurance contracts has been prepared on the basis of the IAG Group’s previous accounting policies. The differences between the accounting policies applied are provided below in notes 1(h), 1(m), 1(o) and 1(x) with additional information presented in note 2.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(a) Basis of preparation of half year financial report (continued)

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

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

Share based payments – The IAG Group has not retrospectively applied the AIFRS 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 has used the fair value of the property held as at 30 June 2004 as the deemed cost of that property but has continued with original cost for plant and equipment.

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

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

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

Financial instruments options – The IAG Group has used this option to designate financial instruments to the various classifications available under AIFRS as follows:

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

The IAG Group will be required to prepare the first annual financial report prepared in accordance with AIFRS in compliance with each of the standards that are effective at the reporting date, whether mandatorily or by election. Further standards and interpretations may be issued between preparation of this financial report and preparation of the 2006 annual financial report which may impact on the first annual financial report prepared under AIFRS, and so may impact on the financial information presented in this report.

Critical accounting judgements and estimates

In the process of applying the IAG Group's accounting policies, various judgements and estimates are made.

The preparation of the financial statements requires the use of certain critical accounting estimates and assumptions. The areas where assumptions and estimates involve a high degree of judgment or complexity and are considered significant to the financial statements are:

- Outstanding claims liability;
- Reinsurance and other recoveries receivable;
- Goodwill and intangible assets impairment testing;
- Defined benefit post-employment obligations; and
- Share based remuneration expense.

The estimates and related assumptions are based on experience and other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised, and the future periods if relevant. The key changes in accounting estimates for the current half year reporting period are those made in the normal course of reserving for general insurance contracts (refer note 1(e)).

The accounting judgements made during the year that did not involve estimations are considered to have had no significant impact on the amounts recognised in the financial report (2005 – none).

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(a) Basis of preparation of half year financial report (continued)

Australian accounting standards issued but not yet effective

As at the date of this financial report, there are a number of new and revised accounting standards on issue with mandatory application dates after the end of this current reporting period. Many of the standards are permitted to be early adopted. Each of the standards applicable to IAG that were able to be early adopted and applied for the half year financial report have been early adopted and applied. We note the following standards that have only a disclosure impact that will be relevant for the first time to the 2006 annual financial report:

- AASB 7 *Financial Instruments: Disclosures* applicable for the first time to the 30 June 2008 financial report. It is anticipated this standard will be early adopted for the 2006 annual financial report together with AASB 2005-10 which makes a number of consequential amendments to other standards arising from the issue of AASB 7.
- AASB 124 *Related Party Disclosures* issued in December 2005 and the amendments made by AASB 2004-3 *Amendments to Australian Accounting Standards* for which application of the standard is mandatory for the 2006 annual financial report.

Voluntary changes in accounting policies

There have been no voluntary changes in accounting policies made during the current half year period other than those relating to the transition to AIFRS as disclosed in note 2.

(b) Principles of consolidation

Subsidiaries are those entities controlled by IAG. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control is presumed to exist when more than half of the voting power of an entity is owned either directly or indirectly. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The consolidated financial report incorporates the assets and liabilities of all subsidiaries as at the reporting date and the results of all subsidiaries 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.

The financial statements of all subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies. The financial statements of entities operating outside Australia that maintain accounting records in accordance with overseas accounting principles are adjusted to comply with IAG Group accounting policies.

Where a subsidiary is less than wholly-owned, the equity interests held by external parties are disclosed as minority interests and shown separately in the consolidated financial statements.

Significant accounting policies related to general insurance contracts

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

(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 balance sheet.

Premium receivable is stated at the amount due and is normally settled between 30 days and 12 months. The recoverability of premium receivable is assessed and provision is made for doubtful debts based on objective evidence and having regard to past default experience.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(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 disclosed as deferred reinsurance expense in the balance sheet at the reporting date.

(e) Claims

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

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

The estimation of the outstanding claims liability involves a number of key assumptions and 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, IBNR and IBNER, are recognised as revenue. Recoveries receivable are measured as the present value of the expected future receipts calculated on the same basis as the outstanding claims liability, and are disclosed net of any provision for doubtful debts. Provision is made for doubtful debts based on objective evidence for individual receivables.

(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, disclosed as deferred acquisition costs, are amortised on the same basis as the earning pattern of the premium over the period of the related insurance contracts.

(h) Liability adequacy test

The liability adequacy test is an assessment of whether the carrying amount of the unearned premium liability is adequate. If current estimates of the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current general insurance contracts, plus an additional risk margin to reflect the inherent uncertainty in the central estimate, exceed the unearned premium liability less related intangible assets and related deferred acquisition costs, then the unearned premium liability is deemed to be deficient. The test is performed at the level of a portfolio of contracts that are subject to broadly similar risks and that are managed together as a single portfolio. Any deficiency arising from the test is recognised in the income statement. Recognition of a deficiency impacts the balance sheet, 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 balance sheet as an unexpired risk liability.

Prior to 1 July 2005 (refer to note 2 for further details)

Prior to the introduction of the liability adequacy test effective from 1 July 2005, a recoverability test was performed on the carrying amount of deferred acquisition costs. Deferred acquisition costs were measured at the lower of cost and recoverable amount through the conduct of a loss recognition test such that when the sum of the expected future claims and associated settlements costs, in relation to business written to the reporting date, exceeded related unearned premium, the deferred acquisition costs were written down to recoverable amount and the write down was recognised as an expense. This test was conducted at the reporting entity level. The conduct of the test did not result in a write down of deferred acquisition costs for the prior financial years ended 30 June 2004 and 30 June 2005.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(i) 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 disclosed 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 income statement.

Significant accounting policies applicable to other activities

(j) Fee based revenue

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

(k) Leases

All leases entered into by the IAG Group are operating leases, where the lessor effectively retains substantially all the risks and benefits of ownership of the leased items. The lease payments are recognised as an expense on a straight line basis over the term of the lease.

The IAG Group is predominantly the lessee in these arrangements but does act as lessor under certain sub-lease arrangements for which the lease payments are recognised as revenue on a straight line basis over the term of the lease.

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

(l) Taxation

(i) Income tax

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

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

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

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

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

(ii) Tax consolidation

Insurance Australia Group Limited ("IAG") and its Australian resident wholly-owned subsidiaries adopted the tax consolidation legislation with effect from 1 July 2002 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is IAG.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(l) Taxation (continued)

(ii) Tax consolidation (continued)

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

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

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

Nature of tax funding arrangements and tax sharing arrangements

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

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

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

(iii) Goods and services tax

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

Receivables and payables are stated inclusive of GST. The net amount of GST recoverable from, or payable to, the ATO is included as part of other receivables and payables in the balance sheet. 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.

(m) Investments

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

Investments are initially recorded at fair value (being the cost of acquisition excluding transaction costs) and are subsequently remeasured to fair value at each reporting date. Changes in the fair value from the previous reporting date (or cost of acquisition excluding transaction costs, if acquired during the financial period) are recognised in the income statement as realised or unrealised investment gains or losses. Purchases and sales of investments are recognised on a trade date basis, being the date on which the IAG Group commits to purchase or sell the asset. Transaction costs for purchases of investments are expensed as incurred and disclosed in the income statement as investment expenses on technical reserves and corporate, administration and other expenses. Investments are derecognised when the rights to receive future cash flows from the assets have expired, or have been transferred, and the IAG Group has transferred substantially all the risks and rewards of ownership.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(m) Investments (continued)

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

Investment 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.

Prior to 1 July 2005 (refer to note 2 for further details)

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

(n) Investment in subsidiaries

Investment in subsidiaries are initially recognised at cost and are subsequently 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 its risk exposures. Derivatives are not held for speculative purposes.

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

(i) Investment operations

All of the derivatives managed in conjunction with the investment operations are recognised on the balance sheet (disclosed together with the underlying investments) at fair value with movements in fair value being recorded in the income statement as part of investment revenue. None of the derivatives are designated for hedge accounting. This matches the accounting for the derivatives with the accounting for the underlying investments.

The fair value is determined by reference to current market quotes or generally accepted valuation principles. Derivatives used in investment operations include share price index futures, equity swap agreements, exchange traded options and bank bill and bond futures.

(ii) Corporate treasury operations

There are various derivatives used by the IAG Group to hedge exposure to foreign currency and interest rate movements in relation to corporate treasury transactions, including borrowings. While the IAG Group has a number of economic hedges in place, only a small number of these transactions have been selected for hedge accounting. Those derivatives for which hedge accounting is not applied are recognised on the balance sheet at fair value with movements in fair value being recorded in the income statement. The derivatives are classified as assets and disclosed as receivables when the fair value is positive, or as liabilities and disclosed as payables when the fair value is negative, except for cross currency swaps relating to borrowings, which are disclosed together with the borrowings. The treatments for some of the instruments for which hedge accounting is not applied are as follows:

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 income statement 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 income statement against the revaluation losses and gains of the underlying hedged items.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(o) Derivatives (continued)

(ii) Corporate treasury operations (continued)

Forward foreign exchange contracts – The IAG Group enters into forward foreign exchange contracts to hedge foreign currency exposures recognised on its balance sheet. The forward foreign exchange contracts are recognised in the balance sheet at fair value being the net amounts receivable or payable under the contracts and the associated deferred gains or losses. When recognised, the net receivables or payables are translated using the foreign currency exchange rate current at reporting date.

Anticipated transactions – The IAG Group uses derivatives in relation to anticipated transactions. Transactions are designated as an economic hedge of an anticipated transaction (typically a business combination), 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 derivative arising up to the date of the anticipated transaction, together with any costs arising at the time of entering into the derivative, are deferred and included in the measurement of the transaction. Any gains or losses on the derivative after the transaction date are included in the income statement. If the transaction does not occur as anticipated, the costs are immediately expensed.

(iii) Hedge accounting

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

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

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

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item impacts profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

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

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

Prior to 1 July 2005 (refer to note 2 for further details)

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

(iv) Embedded derivatives (accounting policy applicable from 1 July 2005)

Derivatives embedded in other financial instruments or other non-financial host contracts are 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 the income statement. Where an embedded derivative is required to be separated, it is measured at fair value.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(p) Trade and other receivables

Trade and other receivables are stated at the amounts to be received in the future and are disclosed net of any provision for impairment. The balance is not discounted because the effect of the time value of money is not material. The recoverability of debts is assessed on an ongoing basis and provision for impairment is made based on objective evidence and having regard to past default experience. The impairment charge is recognised in the income statement. Bad debts are written off as incurred.

(q) Property, plant and equipment

Property, plant and equipment is initially recorded at cost which is the fair value of consideration provided plus incidental costs directly attributable to the acquisition (for land and buildings held as at 30 June 2004, the fair value at that date is used as the deemed cost as allowed upon first time adoption of AIFRS). All items of property, plant and equipment are carried at the lower of cost less accumulated depreciation and accumulated impairment losses. Items other than land are depreciated using the straight line method at rates based on the expected useful lives of the assets taking into account estimated residual values. Depreciation rates and residual values are reviewed annually for appropriateness. The depreciation rates used currently for each class of asset are as follows:

Buildings	2% - 5%
Motor vehicles	12.5% - 20%
Office and other plant and equipment	6.67% - 40%

The carrying amount of each class of property, plant and equipment is reviewed each reporting date by determining whether there is an indication that the carrying value of a class may be impaired. If any such indication exists, the item will be tested for impairment by comparing the recoverable amount of the asset or its cash generating unit to the carrying value. An impairment loss is recognised whenever the carrying value exceeds the recoverable amount. Impairment losses are recognised in the income statement and may be reversed where there has been a change in the estimates used to determine the recoverable amount.

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

Lease provision

Certain of the operating leases for property require that the land and/or building be returned to the lessor in its original condition, however, the related operating lease payments do not include an element for the cost this will involve. The present value of the estimated future cost for the plant and equipment to be removed and the premises to be returned to the lessor in its original condition are recognised as a lease provision when the relevant alterations are made to the premises. The costs are capitalised as part of the cost of plant and equipment and then depreciated over the useful lives of the assets.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(r) Intangible assets

(i) Acquired intangible assets

Acquired intangible assets are initially recorded at their cost at the date of acquisition being the fair value of the consideration provided plus incidental costs directly attributable to the acquisition. Intangible assets with finite useful lives are amortised on a straight line basis over the estimated useful lives of the assets being the period in which the related benefits are expected to be realised (shorter of legal duration and expected economic life). The amortisation periods are subject to review annually.

The carrying amount of intangible assets with finite useful lives is assessed each reporting date to determine whether there is any indication that the carrying value of an item may be impaired. If any such indication exists, the recoverable amount of the asset is determined using the present value (using a pre-tax discount rate) of the projected net cash flows. For assets with indefinite useful lives, the recoverability of the carrying value of the assets is reviewed for impairment at each reporting date, or more frequently if events or changes in circumstances indicate that it might be impaired. An impairment loss is recognised whenever the carrying value exceeds the recoverable amount. Impairment losses are recognised in the income statement and may be reversed where there has been a change in the estimates used to determine the recoverable amount.

(ii) Internally generated intangible assets

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

Only software development expenditure incurred after 1 July 2004, the IAG Group's AIFRS transition date, has been considered for capitalisation. All software development expenditure incurred prior to that date was expensed under Australian GAAP.

All such capitalised costs are deemed to have an expected useful life of 3 years unless it can be clearly demonstrated for a specific project that the net benefits are to be generated over a longer period. The capitalised costs are amortised on a straight line basis over the period following completion of a project or implementation of part of a project. The recoverability of the carrying amount of the asset is assessed in the same manner as for acquired intangible assets with finite useful lives.

(s) Goodwill

Acquisitions of a subsidiary or business are accounted for using the acquisition method. Goodwill represents the excess of the purchase consideration plus incidental costs over the fair value of the net identifiable assets and contingent liabilities acquired, irrespective of the extent of any minority interest, and is carried net of any impairment losses. Goodwill arising on acquisitions dated prior to 1 July 2004 has been carried forward on the basis of its deemed cost being the net carrying amount as at 1 July 2004 measured in accordance with the accounting standards relevant at that time (refer to note 2 for further details).

Goodwill is allocated to cash generating units (the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets) for the purpose of impairment testing. The recoverability of the carrying value of the goodwill allocated to each cash generating unit is reviewed for impairment at each reporting date, or more frequently if events or changes in circumstances indicate that it might be impaired, by determining the present value (using a pre-tax discount rate that reflects the current market assessments of the risks specific to the cash generating unit) of projected net cash flows based on the five year business plans approved by management. Net cash flows beyond the five year period are extrapolated based on growth rates which are consistent with long-term industry averages. An impairment loss is recognised whenever the carrying value exceeds the recoverable amount. Impairment losses are recognised in the income statement and cannot be reversed.

At the date of disposal of a business, attributed goodwill is included in IAG's share of net assets in the calculation of the gain or loss on disposal.

With investments in joint ventures and associates, the goodwill is included in the carrying amount of the investment in the joint venture and associate, rather than being disclosed as a separate asset.

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

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(t) Trade and other payables

Trade and other payables are carried at cost, which is the fair value of the consideration to be paid in the future for goods and services received. The balance is not discounted because the effect of the time value of money is not material.

(u) 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 on-going activities of the IAG Group. The adequacy of the provision is reviewed regularly and adjusted if required. Revisions in the estimated amount of a restructuring provision are reported in the period in which the revision in the estimate occurs. The provision is discounted where the effect of the time value of money is material.

(v) 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 expected future salary increases, 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. All of the arrangements are equity settled share based payments. Equity settled share based payments are measured at fair value at grant date (the date at which the IAG Group and the employee have a shared understanding of the terms and conditions of the arrangement) using a valuation model with the total value, adjusted for non-market hurdles, then being expensed through the income statement over the period during which the related employment services are provided. At each reporting date the total accumulated expense is adjusted through the income statement 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 expense is matched by a credit to an equity reserve. Upon exercise of the relevant instrument, the balance of the share based payments reserve relating to those instruments is transferred within equity.

The vesting conditions for the various plans are different with only the Performance Award Rights ("PARs") Plan incorporating a market based vesting condition. If equity instruments 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.

Arrangements granted prior to 7 November 2002 (refer to note 2 for further details)

The IAG Group has not retrospectively applied the AIFRS expense treatment to share based payments granted prior to 7 November 2002 and/or that vested prior to 1 January 2005 as permitted under the transitional provisions for first time adoption of AIFRS. This means that the new requirements have not been applied to the Performance Share Rights Plan or issues under the Employee Share Reward Plan prior to 30 June 2005. The AIFRS expense treatment was applied to all issues under the PARs Plan and issues under the Non-Executive Director Share Plan made after the transitional dates.

To satisfy the 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. Previously under Australian GAAP the cost of acquiring the shares was recorded as a prepayment and then expensed in full, generally over the period during which the employees provided related services.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(v) Employee benefits (continued)

(iv) Superannuation

The IAG Group contributes to various superannuation plans, both defined contribution and defined benefit 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.

For defined contribution plans, obligations for contributions are recognised as an expense in the income statement as they become payable. For defined benefit plans, the net financial position of the plans is recognised in the balance sheet. The movement in the net financial position is recognised in the income statement, except for actuarial gains and losses (experience adjustments and changes in actuarial assumptions), which are recognised directly in retained earnings.

(w) Provision for dividends

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

(x) Interest-bearing liabilities and finance costs

Interest-bearing liabilities are initially recognised at fair value less transaction costs that are directly attributable to the transaction. After initial recognition the liabilities are carried at amortised cost using the effective interest method.

Finance costs include interest, which is accrued at the contracted rate and included in payables, amortisation of transaction costs which are capitalised, disclosed together with the borrowings, and amortised over the life of the borrowings or a shorter period if appropriate, and amortisation of discounts or premiums (the difference between the proceeds, net of transaction costs, and the settlement or redemption of borrowings) over the term of the liabilities. Where interest payments are hedged, they are recognised as finance costs net of any effect of the hedge.

Prior to 1 July 2005 (refer to note 2 for further details)

Prior to 1 July 2005, the reset preference shares, now classified as interest-bearing liabilities, were treated as equity and formed part of the IAG Group's share capital. The transaction costs associated with the capital raising were recognised directly in equity as a reduction in the proceeds of the instruments. The distributions, now treated as interest, were treated as dividends and so recognised only when declared.

(y) Foreign currency

(i) Functional and presentation currency

Items included in the financial records of each of the IAG Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in Australian dollars, which is the Parent's and the IAG Group's functional and presentation currency.

(ii) Foreign currency transactions

Foreign currency transactions are translated into the functional currency for each of the IAG Group's entities using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities recognised in foreign currencies by the IAG Group at reporting date, are translated to Australian dollars at rates of exchange current at reporting date. Resulting exchange differences are brought to account in the income statement except for those relating to controlled foreign operations and hedging transactions as per (iii) and (iv) below.

(iii) Translation of controlled foreign operations

The financial position and performance of controlled foreign operations with a functional currency other than Australian dollars are translated into the IAG Group's presentation 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. Items from the income statement are translated using weighted average rates for the reporting period. Exchange differences arising from the translations are recorded directly in equity in the foreign currency translation reserve. Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the closing rate.

On the disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the foreign currency translation reserve relating to that foreign operation is recognised in the income statement.

(iv) Hedge transactions

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

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 1. Summary of significant accounting policies (continued)

(z) Earnings per share

(i) Basic earnings per share

Basic earnings per share is determined by dividing the earnings attributable to equity holders of the Company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of shares of the Company on issue during the reporting period, excluding treasury shares.

(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) Treasury shares

Ordinary shares of IAG that are controlled for accounting purposes by share based remuneration trusts that are consolidated by the IAG Group, are referred to as treasury shares. They are measured at cost (total amount paid to acquire the shares including directly attributable costs), and are recognised as a deduction from equity until they are otherwise dealt with. No gain or loss is recognised in the income statement on the purchase, sale, issue or cancellation of treasury shares. The balance of treasury shares at a reporting date represents the cumulative cost of acquiring shares that have not yet been distributed to employees as share based remuneration.

Shares held in equity remuneration trusts are derecognised as treasury shares when the shares vest to the participant.

(bb) Reset exchangeable securities

Reset exchangeable securities ("RES") are initially measured at face value less transaction costs incurred in issuing the securities. In the balance sheet, the RES liability is offset against the investments purchased ("Portfolio") from the proceeds of RES, as there is a legal right of set-off and it is the IAG Group's intention that the Portfolio and the RES liability would be settled simultaneously. Transaction costs are capitalised, disclosed together with interest-bearing liabilities, and are amortised over 5 years from the date of issue. Interest expense on the RES is brought to account on an accruals basis and payable quarterly subject to the terms of issue. In the income statement, the interest expense on RES is offset against the interest income generated from the Portfolio.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES
NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 2. Explanation of transition to Australian equivalents to International Financial Reporting Standards

This half year financial report is the first IAG Group financial report to be prepared in accordance with AIFRS. In this note we provide reconciliations and explanations of the differences to Australian GAAP to assist readers in understanding the impact of the transition on the financial position and performance of the IAG Group.

(a) Balance sheet

Provided below are reconciliations of the balance sheets under Australian GAAP (referred to in the tables as AGAAP) and AIFRS together with narrative descriptions explaining the adjustments.

	Notes	AGAAP		AIFRS		AGAAP		AIFRS		AGAAP		AIFRS	
		30 June 2005	Adjustment	30 June 2005	Adjustment	31 Dec 2004	Adjustment	31 Dec 2004	Adjustment	30 June 2004	Adjustment	31 Dec 2004	
		\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Assets													
Cash and cash equivalents		456	n/a	456	n/a	456	465	n/a	465	424	n/a	424	
Investments	(viii)	10,375	n/a	10,375	1	10,376	9,944	n/a	9,944	9,686	n/a	9,686	
Premium receivable		1,710	n/a	1,710	n/a	1,710	1,564	n/a	1,564	1,606	n/a	1,606	
Trade and other receivables		657	n/a	657	1	658	592	n/a	592	742	n/a	742	
Current tax assets		4	-	4	-	4	-	-	-	-	-	-	
Reinsurance and other recoveries receivable		1,053	n/a	1,053	n/a	1,053	916	n/a	916	915	n/a	915	
Inventories		2	n/a	2	n/a	2	2	n/a	2	2	n/a	2	
Prepayments	(iii),(iv)	54	(16)	38	n/a	38	64	(23)	41	56	(14)	42	
Deferred levies and charges		105	n/a	105	n/a	105	105	n/a	105	104	n/a	104	
Deferred reinsurance expense		194	n/a	194	n/a	194	111	n/a	111	184	n/a	184	
Deferred acquisition costs		621	n/a	621	n/a	621	582	n/a	582	558	n/a	558	
Property, plant and equipment	(vi)	258	1	259	n/a	259	246	9	255	231	13	244	
Deferred tax assets	(x)	264	(133)	131	2	133	255	(165)	90	296	(115)	181	
Investment in joint ventures and associates		3	n/a	3	n/a	3	7	n/a	7	7	n/a	7	
Intangible assets	(v)	7	24	31	n/a	31	12	9	21	18	n/a	18	
Goodwill	(i)	1,371	92	1,463	n/a	1,463	1,412	46	1,458	1,455	n/a	1,455	
Total assets		17,134	(32)	17,102	4	17,106	16,277	(124)	16,153	16,284	(116)	16,168	

Certain items have been reclassified from the prior period's financial reports to conform to the current period's presentation (refer to note 1 (a) for further details). These items do not represent a change in recognition and measurement criteria arising from the transition to AIFRS and so have been incorporated into the AGAAP figures rather than being shown as AIFRS adjustments.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES
NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 2. Explanation of transition to Australian equivalents to International Financial Reporting Standards (continued)

(a) Balance sheet (continued)

	Notes	AGAAP 30 June 2005	Adjustment	AIFRS 30 June 2005	Adjustment	AIFRS 1 July 2005	AGAAP 31 Dec 2004	Adjustment	AIFRS 31 Dec 2004	AGAAP 30 June 2004	Adjustment	AIFRS 1 July 2004
		\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Liabilities												
Trade and other payables	(vii)	721	n/a	721	1	722	612	n/a	612	803	n/a	803
Reinsurance premiums payable		195	n/a	195	n/a	195	118	n/a	118	134	n/a	134
Restructuring provision		11	n/a	11	n/a	11	13	n/a	13	29	n/a	29
Current tax liabilities		193	-	193	-	193	63	-	63	222	-	222
Unearned premium liability		3,586	n/a	3,586	n/a	3,586	3,497	n/a	3,497	3,472	n/a	3,472
Lease provision	(vi)	-	21	21	n/a	21	-	21	21	-	21	21
Employee benefits provision	(ii)	206	23	229	n/a	229	157	(8)	149	188	(57)	131
Minority interests in unitholders' funds	(xi)	-	n/a	-	421	421	-	n/a	-	-	n/a	-
Deferred tax liabilities	(x)	163	(139)	24	-	24	176	(163)	13	99	(99)	-
Outstanding claims liability		6,840	n/a	6,840	n/a	6,840	6,548	n/a	6,548	6,327	n/a	6,327
Interest-bearing liabilities	(vii),(ix)	779	n/a	779	553	1,332	788	n/a	788	786	n/a	786
Total liabilities		12,694	(95)	12,599	975	13,574	11,972	(150)	11,822	12,060	(135)	11,925
Net assets		4,440	63	4,503	(971)	3,532	4,305	26	4,331	4,224	19	4,243
Equity												
Share capital	(vii)	3,802	n/a	3,802	(539)	3,263	3,802	n/a	3,802	3,802	n/a	3,802
Treasury shares	(iv)	-	(34)	(34)	n/a	(34)	-	(34)	(34)	-	(21)	(21)
Reserves	(iii),(ix)	(6)	13	7	(5)	2	(4)	9	5	(5)	5	-
Retained earnings		59	83	142	(5)	137	(51)	50	(1)	(259)	32	(227)
Parent interest		3,855	62	3,917	(549)	3,368	3,747	25	3,772	3,538	16	3,554
Minority interests	(xi)	585	1	586	(422)	164	558	1	559	686	3	689
Total equity		4,440	63	4,503	(971)	3,532	4,305	26	4,331	4,224	19	4,243

Certain items have been reclassified from the prior period's financial reports to conform to the current period's presentation (refer to note 1 (a) for further details). These items do not represent a change in recognition and measurement criteria arising from the transition to AIFRS and so have been incorporated into the AGAAP figures rather than being shown as AIFRS adjustments.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 2. Explanation of transition to Australian equivalents to International Financial Reporting Standards (continued)

(b) Total equity

Reconciliation of total equity under Australian GAAP to that under AIFRS. The adjustments shown for each date are cumulative of all adjustments up to and including that date.

	Notes	CONSOLIDATED			1 July 2004
		1 July 2005	30 June 2005	31 Dec 2004	
		\$m	\$m	\$m	\$m
Total equity under Australian GAAP as reported in the 2005 half year and annual financial reports		4,440	4,440	4,305	4,224
Adjustments applicable from 1 July 2004					
<i>Adjustments to retained earnings</i>					
Reversal of goodwill amortisation	(i)	92	92	46	n/a
Recognition of defined benefit plans	(ii)	(23)	(23)	8	57
Adjustment to share based remuneration expense	(iii)	5	5	2	2
Capitalisation of software development costs	(v)	24	24	9	n/a
Reversal of market value movement on property	(vi)	(8)	(8)	(2)	n/a
Recognition of depreciation on buildings	(vi)	(1)	(1)	-	n/a
Recognition of lease provision amortisation	(vi)	(11)	(11)	(10)	(8)
Net tax impact of AIFRS adjustments	(x)	6	6	(2)	(16)
Adjustment for minority interests		(1)	(1)	(1)	(3)
		83	83	50	32
<i>Adjustments to reserves</i>					
Recognition of share based payment reserve	(iii)	13	13	9	5
<i>Adjustments to treasury shares</i>					
Consolidation of share based remuneration trusts	(iv)	(34)	(34)	(34)	(21)
<i>Adjustments to minority interests</i>					
Net adjustments impacting minority interests		1	1	1	3
Adjustments applicable from 1 July 2005					
<i>Adjustments to retained earnings</i>					
Adjustment to valuation of investments	(viii)	1	n/a	n/a	n/a
Amortisation of reset preference shares transaction costs	(vii)	(6)	n/a	n/a	n/a
Accrual for distribution on reset preference shares	(vii)	(1)	n/a	n/a	n/a
Net tax impact of AIFRS adjustments	(x)	-	n/a	n/a	n/a
Adjustment for minority interests		1	n/a	n/a	n/a
		(5)	n/a	n/a	n/a
<i>Adjustments to reserves</i>					
Adjustment for cash flow hedge accounting	(ix)	(7)	n/a	n/a	n/a
Net tax impact of AIFRS adjustment	(x)	2	n/a	n/a	n/a
		(5)	n/a	n/a	n/a
<i>Adjustments to share capital</i>					
Reclassification of reset preference shares	(vii)	(550)	n/a	n/a	n/a
Reclassification of reset preference shares transaction costs	(vii)	11	n/a	n/a	n/a
		(539)	n/a	n/a	n/a
<i>Adjustments to minority interests</i>					
Reclassification of minority interests in unitholders' funds	(xi)	(421)	n/a	n/a	n/a
Net other adjustments impacting minority interests		(1)	n/a	n/a	n/a
		(422)	n/a	n/a	n/a
Total equity under AIFRS		3,532	4,503	4,331	4,243

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 2. Explanation of transition to Australian equivalents to International Financial Reporting Standards (continued)

(c) Profit

Reconciliation of profit under Australian GAAP to that under AIFRS for the year ended 30 June 2005 and half year ended 31 December 2004.

	Notes	CONSOLIDATED	
		Year ended 30 June 2005	Half year ended 31 Dec 2004
		\$m	\$m
Profit for the period as reported under Australian GAAP		879	504
Reversal of goodwill amortisation	(i)	92	46
Movement in defined benefit plans	(ii)	(80)	(47)
Adjustment to share based remuneration expense	(iii)	3	2
Capitalisation of software development costs	(v)	24	9
Reversal of market value movement on property	(vi)	(8)	(2)
Recognition of depreciation on buildings	(vi)	(1)	-
Recognition of lease provision amortisation	(vi)	(3)	(2)
Net tax impact of AIFRS adjustments	(x)	22	14
Profit for the period under AIFRS		928	524

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES
NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 2. Explanation of transition to Australian equivalents to International Financial Reporting Standards (continued)

(d) Income statement

Reconciliation of the income statement under Australian GAAP to that under AIFRS for the year ended 30 June 2005 and the half year ended 31 December 2004.

	Notes	AGAAP		AIFRS		AGAAP		AIFRS	
		Year ended 30 Jun 2005	Adjustment	Year ended 30 Jun 2005	Half year ended 31 Dec 2004	Adjustment	Half year ended 31 Dec 2004		
		\$m	\$m	\$m	\$m	\$m	\$m	\$m	
Premium revenue		6,561	n/a	6,561	3,311	n/a	3,311		
Reinsurance expense		(417)	n/a	(417)	(202)	n/a	(202)		
Net premium revenue (i)		6,144	n/a	6,144	3,109	n/a	3,109		
Claims expense	(v)	(4,729)	(21)	(4,750)	(2,349)	(12)	(2,361)		
Reinsurance and other recoveries		660	n/a	660	282	n/a	282		
Net claims expense (ii)		(4,069)	(21)	(4,090)	(2,067)	(12)	(2,079)		
Acquisition costs	(v)	(1,075)	5	(1,070)	(534)	1	(533)		
Other underwriting expenses	(v)	(339)	(38)	(377)	(166)	(25)	(191)		
Fire service levies		(177)	n/a	(177)	(87)	n/a	(87)		
Underwriting expenses (iii)		(1,591)	(33)	(1,624)	(787)	(24)	(811)		
Underwriting profit (i) + (ii) + (iii)		484	(54)	430	255	(36)	219		
Investment income on technical reserves		535	n/a	535	270	n/a	270		
Investment expenses on technical reserves		(19)	n/a	(19)	(7)	n/a	(7)		
Insurance profit		1,000	(54)	946	518	(36)	482		
Investment income on equity holders' funds	(vi)	520	(12)	508	304	(5)	299		
Other income		178	4	182	106	3	109		
Finance costs		(69)	n/a	(69)	(28)	n/a	(28)		
Corporate, administration and other expenses	(i),(v),(vi)	(371)	89	(282)	(177)	44	(133)		
Profit before income tax		1,258	27	1,285	723	6	729		
Income tax expense		(379)	22	(357)	(219)	14	(205)		
Profit for the period		879	49	928	504	20	524		
Profit attributable to minority interests		(119)	2	(117)	(58)	1	(57)		
Profit attributable to equity holders of the Parent		760	51	811	446	21	467		

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 2. Explanation of transition to Australian equivalents to International Financial Reporting Standards (continued)

(e) Notes to the reconciliations for sections (a) to (d) above

(i) Goodwill

The elimination of the requirement to amortise goodwill under AIFRS resulted in the reversal of the goodwill amortisation expense for the half year to 31 December 2004 of \$46 million and for the year to 30 June 2005 of \$92 million. There was a corresponding increase in goodwill of \$46 million as at 31 December 2004 and \$92 million as at 30 June 2005 in the balance sheet.

(ii) Defined benefit plans

Under AIFRS the relevant net position of defined benefit plans is recognised in the balance sheet. The movement in the net position is recognised in the income statement, except for actuarial gains and losses, which are recognised directly in retained earnings. This is the result of an accounting policy selection made by the IAG Group.

The IAG Group has five arrangements that qualify as defined benefit plans under AIFRS. These consist of a defined benefit superannuation plan in Australia, two defined benefit superannuation plans in New Zealand, and two pension schemes, both of which are unfunded. The net position of the three defined benefit superannuation plans was previously not recognised in the IAG Group's balance sheet under Australian GAAP. The present value of each of the two unfunded pension liabilities was previously recognised in the IAG Group's balance sheet, however the measurement and accounting treatment under AIFRS is different.

All cumulative actuarial gains and losses on defined benefit plans have been recognised in equity at the date of transition to AIFRS.

The adjustments required to recognise the defined benefit plans upon transition to AIFRS involved an increase in retained earnings and a reduction in employee benefits provision as at 1 July 2004 of \$57 million. Recognising the movement in the net positions of the plans for the half year to 31 December 2004 involved recognition of an expense through the AIFRS income statement of \$47 million, a reduction in retained earnings directly of \$2 million as at 31 December 2004 and a reduction in employee benefits provision of \$8 million as at 31 December 2004. The adjustments for the year to 30 June 2005 involved recognition of an expense through the AIFRS income statement for the year to 30 June 2005 of \$80 million, with corresponding impact to retained earnings which was rounded to zero as at 30 June 2005 and an increase in employee benefits provision of \$23 million as at 30 June 2005. The net result of all of these changes was a reduction of \$23 million in retained earnings as at 30 June 2005.

(iii) Share based remuneration

The IAG Group acquires IAG shares on-market and holds them in trust to satisfy future obligations for share based remuneration. The shares are purchased on or near grant date at the then market price. Previously under Australian GAAP the cost of acquiring the shares was recorded as a prepayment and then expensed in full, generally over the period during which the employees provided related services.

Under AIFRS the fair value at grant date of the equity instruments granted as share based remuneration is expensed over the relevant period rather than the actual cost of acquiring the shares to support the arrangements. The fair value is expensed over the period from grant date until the equity instruments vest fully to the employee. For equity settled share based payments, an equity reserve is created as the expense is recognised. At each reporting date the total accumulated expense is adjusted through the income statement based on the latest estimate of the number of equity instruments that will vest, considering only employee turnover, and taking into account the expired portion of the vesting period. The AIFRS accounting policy has not been retrospectively applied to share based payments granted prior to 7 November 2002 and/or that vested prior to 1 January 2005 as permitted under the transitional provisions for first time adoption of AIFRS.

A transitional adjustment for the IAG Group was made to increase retained earnings as at 1 July 2004 by \$2 million representing the accumulated reduction in the expense up to that date. Adjustments for the IAG Group were made to retained earnings for the half year to 31 December 2004 of \$2 million and for the year to 30 June 2005 of \$5 million representing the accumulated reduction in the expense up to those dates. The adjustments involved the recognition of a share based remuneration reserve in equity of \$5 million as at 1 July 2004, \$9 million as at 31 December 2004, and \$13 million as at 30 June 2005.

(iv) Consolidation of share based remuneration trusts

The equity based remuneration trusts used to manage the share based remuneration arrangements are consolidated by the IAG Group under AIFRS. Two trusts are consolidated directly by the Parent while one trust is consolidated directly by a subsidiary. The amount previously recognised as a prepayment in relation to the share based remuneration plans has converted into an investment in subsidiary under AIFRS which eliminates against the unitholders' funds in the trusts upon consolidation. The IAG Group recognises the consolidated IAG shares, the major asset of the trusts, as treasury shares. The treasury shares are measured at cost (total amount paid to acquire the shares), and are shown as a deduction from equity. The shares controlled by the trusts as at 30 June 2005, were acquired on different dates at a total cost of \$34 million for the IAG Group (31 December 2004 - \$34 million, 30 June 2004 - \$21 million). When the relevant rights are exercised, the IAG Group will effectively reissue the shares, which will be recognised as equity measured at the net expense incurred in providing the shares.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 2. Explanation of transition to Australian equivalents to International Financial Reporting Standards (continued)

(e) Notes to the reconciliations for sections (a) to (d) above (continued)

(v) Intangible assets

Certain software development expenditure has been capitalised as an intangible asset under AIFRS that was previously expensed under the application of Australian GAAP. Only software development expenditure incurred after 1 July 2004, the IAG Group's AIFRS transition date, was eligible for capitalisation under AIFRS. The adjustments relating to software development expenditure were a net reduction in the expense for the half year to 31 December 2004 of \$9 million (capitalised expenditure of \$9 million with no amortisation) and for the year to 30 June 2005 of \$24 million (capitalised expenditure of \$24 million less an amount of amortisation which rounded to zero). There was a corresponding increase in intangible assets on the balance sheet for the same amounts.

(vi) Property, plant and equipment

All of the property within the IAG Group is classified as owner occupied property under AIFRS. Prior to transition to AIFRS, all land and buildings were carried at fair value with movements in fair value recognised in the income statement. Under AIFRS, land and buildings are measured at cost with the cost of the buildings being depreciated over their useful life. The carrying value of land and buildings is subject to impairment testing. For land and buildings held as at 30 June 2004, the fair value at that date is used as the deemed cost as allowed upon first time adoption of AIFRS. This required reversal of the movement in the market value of the property recognised in the reported profit for the half year to 31 December 2004 of \$2 million and for the year to 30 June 2005 of \$8 million. There was a corresponding decrease in property, plant and equipment on the balance sheet of the same amount.

Depreciation of the buildings introduced a depreciation expense for the half year to 31 December 2004 which rounded down to zero, and an expense for the year to 30 June 2005 of \$1 million.

Certain of the operating leases for property require that the land and/or building be returned to the lessor in its original condition. This means that at a future date when a lease is exited, costs will be incurred in removing plant and equipment from the premises and returning the property to its original condition. The related operating lease payments do not include an element for the cost this will involve. Under AIFRS, the present value of the estimated future cost for the plant and equipment to be removed and the premises to be returned to the lessor in its original condition are recognised as a lease provision when the relevant alterations are made to the premises, capitalised as part of the cost of plant and equipment, and depreciated over the useful lives of the assets.

Under Australian GAAP, these costs were not recognised until it was probable that the expenditure would be incurred generally referring to when a decision was made to cancel or not renew a lease.

At 1 July 2004, a lease provision of \$21 million was recognised for the IAG Group with a corresponding increase in property, plant and equipment. The net carrying amount of this provision remained the same at 31 December 2004, 30 June 2005 and 1 July 2005. The initial recognition of the addition to property, plant and equipment was accompanied by a depreciation expense of \$8 million up to 1 July 2004 as a reduction to retained earnings. The net balance capitalised as part of property, plant and equipment upon AIFRS transition at 1 July 2004 was \$13 million. The net balance capitalised as part of property, plant and equipment fell to \$11 million as at 31 December 2004 and \$10 million as at 30 June 2005 as a result of additional depreciation expense recognised for the half year to 31 December 2004 of \$2 million and for the year to 30 June 2005 of \$3 million.

(vii) Reset preference shares (applied from 1 July 2005)

The IAG Group's reset preference shares ("RPS") were presented as equity under Australian GAAP as they are not considered a mandatory convertible instrument, are perpetual, and there is no obligation to pay distributions. The RPS are classified as debt under AIFRS because there are circumstances under which the holder can demand conversion of the instruments, and are carried at amortised cost using the effective interest method. This involved a reclassification of \$550 million from share capital to interest-bearing liabilities as at 1 July 2005.

The transaction costs incurred from the issuance of the two tranches of RPS, totalling \$11 million, were recognised directly in equity under Australian GAAP as a reduction in the proceeds of the instruments. With the RPS classified as debt under AIFRS those transaction costs are capitalised, disclosed together with the related liability, and recognised on an effective yield basis (amortised over the period to the first reset date). This required an adjustment as at 1 July 2005 of \$11 million to recognise the capitalisation of the transaction costs, and a reduction in retained earnings of \$6 million representing the portion of the transaction costs that have been effectively amortised up to that date.

Distributions on the instruments made after 1 July 2005 are treated as interest rather than dividends and so have a negative impact on reported profit. With the distributions treated as interest under AIFRS, the distributions are recognised on an accruals basis, which is different to the previous policy of recognising a provision for the distributions only when the distributions were declared. The adjustment to recognise the interest payable as at 1 July 2005 was a decrease in retained earnings of \$1 million.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 2. Explanation of transition to Australian equivalents to International Financial Reporting Standards (continued)

(e) Notes to the reconciliations for sections (a) to (d) above (continued)

(viii) Investments (applied from 1 July 2005)

Upon transition to AIFRS, the IAG Group has continued to measure all investments at market value with movements in market value being reported in the income statement. This is the result of an accounting policy selection made by the IAG Group. This includes all derivatives used in relation to investment activities. This has basically been a continuation of previous practice with small adjustments for disposal costs (Australian GAAP used net market value rather than gross market value) and a change in market price determination (Australian GAAP used last sale price rather than bid/offer price). The net adjustment for the change was a \$1 million increase in investments with a corresponding increase in retained earnings as at 1 July 2005.

(ix) Derivatives (applied from 1 July 2005)

All of the derivative contracts selected for hedge accounting as at 1 July 2005 qualify as a cash flow hedge. The adjustment required to recognise the application of cash flow hedge accounting under AIFRS for these transactions involved an increase in the measurement of the derivatives recognised on the balance sheet of \$7 million (\$8 million increase in interest-bearing liabilities and a \$1 million increase in trade and other receivables) with a corresponding net decrease to an equity reserve.

(x) Taxation

The transition to AIFRS involved two types of tax adjustments. There were adjustments arising from the different methodology used for the determination of tax adjustments discussed here. There were also consequential tax impacts arising from the different recognition treatments of certain assets and liabilities under AIFRS that are discussed below. Income tax is calculated based on the "balance sheet approach" replacing the "income statement approach" previously used. The AIFRS treatment focuses on the closing balances rather than the movements for the period. This method recognises deferred tax balances when there is a difference between the carrying value of an asset or liability, and its tax base (being the amount attributed to an asset or liability for tax purposes) rather than for differences between accounting and taxable profit or loss. Deferred tax assets under AIFRS are recognised based on a 'probable' criterion rather than the 'beyond reasonable doubt' criterion, or 'virtually certain' criterion for unused tax losses, under Australian GAAP. In addition, current and deferred taxes attributable to amounts recognised directly in equity are recognised in equity. Deferred tax balances continue to be undiscounted under AIFRS. This change in methodology had a negligible impact on the recognition of tax related assets and liabilities. However, the tax effect of the AIFRS transition adjustments relating to items that were recognised directly in equity were also recognised in equity which would not have been in accordance with Australian GAAP.

Apart from the change in methodology, the transition to AIFRS also involved consequential tax impacts arising from the different recognition treatments of certain assets and liabilities under AIFRS. These consequential tax impacts involved a net reduction in retained earnings at 1 July 2004 of \$16 million and at 31 December 2004 of \$2 million and a net increase in retained earnings at 30 June 2005 of \$6 million and at 1 July 2005 of \$6 million. There were also some tax amounts recognised directly in equity.

(xi) Minority interests in unitholders' funds (applied from 1 July 2005)

The consolidated IAG Group includes IAG Asset Management Wholesale Trusts in which the IAG Group has a controlling interest for accounting purposes. Previously, when consolidating the trusts, an amount was recognised in equity for the minority interest in the trusts, being the value attributable to unitholders outside the IAG Group. Under AIFRS, the residual interests in the trusts qualify as a liability on the balance sheets of the trusts and is not recognised as equity. Therefore, upon consolidation of the trusts under AIFRS, the value attributable to unitholders outside the IAG Group is recognised as a liability on the balance sheet of the IAG Group and not in equity as a minority interest. The change has also resulted in the distributions from the trusts to those unitholders, previously shown as net profit attributable to outside equity interests, forming part of the profit for the period. The change has no impact on the equity attributable to equity holders of IAG.

These changes required a reclassification of \$421 million as at 1 July 2005 from minority interest presented as equity on the balance sheet to minority interest in unitholders' funds presented as a liability on the balance sheet. The adjustment also impacts on the treatment of net income attributable to minority interests in unitholders' funds in the income statement which is applicable for the first time for the six months ended 31 December 2005 and involves no prior period adjustment.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

	CONSOLIDATED	
	31 Dec 2005	31 Dec 2004
	\$m	\$m
Note 3. Income		
(a) General insurance revenue		
Direct gross written premium	3,206	3,329
Movement in unearned premium reserve	113	(17)
Direct premium revenue	3,319	3,312
Inwards reinsurance premium revenue	1	(1)
Premium revenue	3,320	3,311
Reinsurance and other recoveries	259	282
Total general insurance revenue	3,579	3,593
(b) Investment income		
Dividend revenue	47	48
Interest revenue	192	197
Trust revenue	12	6
	251	251
Changes in fair values of investments		
- realised net gains	44	44
- unrealised net gains	259	274
Total investment income	554	569
Represented by:		
Investment income on technical reserves	202	270
Investment income on equity holders' funds	352	299
	554	569
(c) Other income		
Fee based revenue	101	106
Net gain from disposal of property, plant and equipment*	-	3
Total other income	101	109
Total income	4,234	4,271

* Under AIFRS the definition of income includes both revenue and gains. Gains are determined on a net basis (proceeds less the carrying amount and/or costs of achieving the proceeds). Under Australian GAAP these items were presented on a gross basis.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES
NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

	CONSOLIDATED	
	31 Dec	31 Dec
	2005	2004
	\$m	\$m
Note 4. Analysis of total expenses		
Expenses as disclosed in the income statement:		
Reinsurance expense	209	202
Claims expense	2,245	2,361
Acquisition costs	542	533
Other underwriting expenses	186	191
Fire service levies	123	87
Investment expenses on technical reserves	7	7
Finance costs	45	28
Net income attributable to minority interests in unitholders' funds*	11	-
Corporate, administration and other expenses	133	133
Total expenses	3,501	3,542
Analysis of expenses by function:		
General insurance business expenses	3,305	3,374
Corporate and administration expenses	196	168
Total expenses	3,501	3,542
* This item has been treated differently in the current reporting period following the IAG Group's election to not restate comparatives for certain accounting standards as allowed upon first time adoption of AIFRS. Refer to note 2 for further details.		
Note 5. Profit for the half year		
Profit before income tax includes the following individually significant items disclosure of which is relevant in explaining the results of the IAG Group:		
Expenses:		
Insurance protection tax levied by the NSW State Government	11	10

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES
NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 6. Segment reporting

Primary reporting - business segments

The IAG Group operated in the general insurance industry during the half 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. Other activities, including corporate services, investment management and investment of the IAG Group's equity holders' funds form a separate segment.

	Australian personal insurance 31 Dec 2005	Australian commercial insurance 31 Dec 2005	International insurance 31 Dec 2005	Corporate and investments 31 Dec 2005	Intersegment elimination 31 Dec 2005	Total 31 Dec 2005
	\$m	\$m	\$m	\$m	\$m	\$m
External income	2,238	1,057	558	381	-	4,234
Intersegment income	-	-	124	-	(124)	-
Total income	2,238	1,057	682	381	(124)	4,234
Underwriting profit	115	74	85	-	-	274
Investment income on technical reserves, net of investment expenses	119	59	17	-	-	195
Insurance profit	234	133	102	-	-	469
Investment income on equity holders' funds, net of investment expenses	-	-	-	342	-	342
Other net operating result	-	2	(3)	(77)	-	(78)
Profit before income tax	234	135	99	265	-	733
	31 Dec 2004	31 Dec 2004	31 Dec 2004	31 Dec 2004	31 Dec 2004	31 Dec 2004
	\$m	\$m	\$m	\$m	\$m	\$m
External income	2,302	1,080	542	347	-	4,271
Intersegment income	-	-	139	-	(139)	-
Total income	2,302	1,080	681	347	(139)	4,271
Underwriting profit	167	(30)	82	-	-	219
Investment income on technical reserves, net of investment expenses	158	93	12	-	-	263
Insurance profit	325	63	94	-	-	482
Investment income on equity holders' funds, net of investment expenses	-	-	-	293	-	293
Other net operating result	-	11	(2)	(55)	-	(46)
Profit before income tax	325	74	92	238	-	729

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

	Note	CONSOLIDATED	
		31 Dec 2005 cents	31 Dec 2004 cents
Note 7. Earnings per share			
Basic earnings per ordinary share	(i)	29.06	28.54
Diluted earnings per ordinary share		28.89	28.35

(i) The basic earnings per ordinary share shown above exclude the treasury shares from the denominator of the calculation, but include the earnings attributable to those treasury shares in the numerator, to comply with AASB 133 *Earnings per Share*. If the amounts relating to those treasury shares are excluded from both the numerator and denominator, the basic earnings per ordinary share for the half year period ended 31 December 2005 would be reduced to 28.90 cents (2004 – 28.41 cents).

	31 Dec 2005 \$m	31 Dec 2004 \$m
(a) Reconciliation of earnings used in calculating earnings per share		
Profit for the period	513	524
Profit attributable to minority interests	(52)	(57)
Profit attributable to equity holders of the Parent	461	467
Profit attributable to reset preference shares	*n/a	(15)
Earnings used in calculating basic and diluted earnings per share	461	452

* While for accounting purposes the reset preference shares are classified as debt from 1 July 2005 onwards, they were previously classified as equity under Australian GAAP (refer to note 2 for further details). When classified as equity, a separate earnings per share calculation was conducted for the reset preference shares and the distributions on the shares was deducted from the profit attributable to equity holders of the Parent prior to calculation of the earnings per share for ordinary shares. From 1 July 2005 onwards the distributions are treated as finance costs and in this reconciliation for the half year to 31 December 2005 are included in profit for the period.

(b) Weighted average number of ordinary shares

The weighted average number of ordinary shares outstanding during the financial period used in calculation of the basic earnings per share was 1,585 million (2004 – 1,585 million), being the total number of ordinary shares on issue excluding treasury shares.

The weighted average number of ordinary shares outstanding during the financial period used in calculation of the diluted earnings per share was 1,595 million (2004 – 1,595 million). This amount included the weighted average number of dilutive potential ordinary shares relating to the rights issued under the Performance Share Rights Plan of 0.5 million shares (2004 – 2 million) and other unvested share based remuneration rights supported by treasury shares of 9 million (2004 – 7 million). At 31 December 2005, there remained 0.2 million vested Performance Share Rights on issue.

The following matters are relevant to the determination of the weighted average number of ordinary shares:

- The reset preference shares are not considered to be dilutive potential ordinary shares even though they may convert into ordinary shares because the contingent conversion conditions were not met at the reporting date.
- The reset exchangeable securities (“RES”) on issue by IAG Finance (New Zealand) Limited, a wholly-owned subsidiary of IAG, are not considered to be dilutive potential ordinary shares as at 31 December 2005 (2004 – not applicable) because the contingent conversion conditions were not met at the reporting date.

(c) Reset preference shares

While for accounting purposes the reset preference shares are classified as debt from 1 July 2005 onwards, they were previously classified as equity under Australian GAAP (refer to note 2 for further details). When classified as equity, the reset preference shares had a basic earnings per share for the six months ended 31 December 2004 of 267.27 cents based on distributions paid or payable for the six month period of \$15 million and a weighted average number of reset preference shares outstanding during the period of 5.5 million shares.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

	Cents per share	Total amount \$m	Payment date	Tax rate for franking credit tax rate	Percentage franked
Note 8. Dividends					
(a) Ordinary shares					
Recognised in half year ended 31 December 2005					
2005 final dividend	14.5	231	17 October 2005	30%	100%
Recognised in year ended 30 June 2005					
2005 interim dividend	12.0	191	18 April 2005	30%	100%
2004 final dividend	14.0	222	18 October 2004	30%	100%
		413			

It is standard practice for the IAG Group to declare the dividend for a period after the relevant reporting date. In accordance with the relevant accounting policy (refer note 1(w)) a dividend is not accrued for until it is declared and so the dividends for a period are generally recognised and measured in the financial reporting period following the period to which the dividend relates.

The dividend paid for the half year to 31 December 2005 included \$1 million (year to 30 June 2005 - \$2 million) paid in relation to treasury shares held in trusts controlled by the IAG Group.

(b) Dividend reinvestment

The Company operates a Dividend Reinvestment Plan ("DRP") which allows equity holders to elect to receive their dividend entitlement in the form of IAG shares. The price of DRP shares is the average share market price, less a discount if any (determined by the Directors) calculated over the pricing period (which is at least five trading days) as determined by the Directors for each dividend payment date. The price of DRP shares in 2005 includes no discount (2004 – no discount). The 10.6 million shares allocated to equity holders participating in the DRP for the half year ended 31 December 2005 were purchased on-market (year ended 30 June 2005 – 20.0 million shares).

(c) Dividend not recognised at reporting date

In addition to the above dividends, the following dividend was declared after the reporting date but before finalisation of this half year financial report and has not been recognised in this financial report.

	Cents per share	Total amount \$m	Expected payment date	Tax rate for franking credit	Percentage franked
2006 interim dividend – ordinary shares	13.5	215	10 April 2006	30%	100%

The dividend was declared on 23 February 2006. The last date for the receipt of an election notice for participation in the dividend reinvestment plan in relation to this interim dividend is 8 March 2006. The DRP will operate using shares acquired on-market with no discount applied.

	Distribution percentage per annum	Total amount \$m	Payment date	Percentage franked
(d) Reset preference shares				
Recognised in half year ended 31 December 2005				
	*n/a	*n/a		*n/a
Recognised in year ended 30 June 2005				
First issue June 2002 - IAGPA	5.80%	20	15 June 2005 and 15 December 2004	100%
Second issue June 2003 - IAGPB	4.51%	9	15 June 2005 and 15 December 2004	100%
		29		

* This item has been treated differently in the current reporting period following the IAG Group's election to not restate comparatives for certain accounting standards as allowed upon first time adoption of AIFRS. Refer to note 2 for further details.

All of the distributions paid in relation to the reset preference shares for the current half year reporting period and the previous annual reporting period were fully franked at 30%.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

	Notes	CONSOLIDATED	
		31 Dec	30 Jun
		2005	2005
		\$m	\$m
Note 9. Interest-bearing liabilities			
<i>Unsecured</i>			
NZ senior term notes	(i)	46	91
Subordinated term notes	(ii)	299	299
US subordinated term notes	(iii)	327	315
Derivatives related to US subordinated term notes	(iii)	89	88
Reset preference shares	(iv)	550	-
Perpetual subordinated loan	(v)	2	2
Less: capitalised transaction costs		(18)	(16)
		1,295	779
		Half year ended 31 Dec 2005	Year ended 30 Jun 2005
		\$m	\$m
(a) Reconciliation of movements			
Balance at the end of the previous financial period		779	786
AIFRS transition adjustments			
- Reclassification of reset preference shares *	(iv)	550	-
- Reclassification of capitalised transaction costs *		(11)	-
- Cumulative amortisation of capitalised transaction costs *		6	-
- Fair value transition adjustment for cash flow hedge *		7	-
Balance at the beginning of the financial period		1,331	786
Foreign exchange movement on US subordinated term notes		12	(30)
Foreign exchange movement on cash flow hedge		(12)	32
Other fair value movement on cash flow hedge		6	-
Repayment of tranche of NZ senior term notes	(i)	(46)	-
Foreign exchange movement on NZ senior term notes		1	-
Transaction costs capitalised during the period		-	(12)
Amortisation of capitalised transaction costs		3	3
Balance at the end of the financial period		1,295	779

* These reconciliation adjustments arose from the IAG Group's election to not restate comparatives for certain accounting standards as allowed upon first time adoption of AIFRS. Refer to note 2 for further details.

The transaction costs capitalised during the year to 30 June 2005 of \$12 million relate to the issuance of the reset exchangeable securities which are held off balance sheet and so not included in interest-bearing liabilities (refer note 1(bb) for further details).

(b) Significant terms and conditions

(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 at a discount, with NZ\$50 million that matured and was fully repaid in August 2005 and NZ\$50 million to mature in August 2008. This programme is denominated in New Zealand dollars and translated into the equivalent Australian dollars using the reporting date exchange rate. The primary difference between the Australian dollar equivalent of the face value of the notes at inception and the carrying value is due to foreign exchange rate movements.

(ii) The subordinated term notes have a face value of \$300 million and were issued at a discount through Insurance Australia Limited's debt issuance programme with \$250 million at a fixed rate and \$50 million at a floating rate. The notes mature in November 2012, however, they may be redeemed at par at the issuer's option from November 2007 onwards, subject to the approval of the Australian Regulation Prudential Authority ("APRA"). If the notes are not redeemed in November 2007, all notes become floating rate notes with an interest rate of the three month Bank Bill Swap Rate plus a margin of 1.58% per annum. The notes qualify as Lower Tier 2 capital for the purposes of Insurance Australia Limited's APRA regulatory capital position.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 9. Interest-bearing liabilities (continued)

(b) Significant terms and conditions (continued)

(iii) The US subordinated term notes have a face value of US\$240 million and were issued at par by NRMA Insurance Funding 2003 Limited (a wholly-owned subsidiary of Insurance Australia Limited). They are fixed rate notes with the principal and interest flows denominated in US dollars, which are hedged with cross currency swaps and an interest rate swap. Cash flow hedge accounting is applied for this hedge arrangement. The notes mature in April 2015, however, they may be redeemed at par at the issuer's option from April 2010 onwards, subject to the approval of APRA. If the notes are not redeemed in April 2010, all notes become floating rate notes with an interest rate of the three month London Inter-Bank Offer Rate plus a margin of 2.04% per annum. The notes qualify as Lower Tier 2 capital for the purposes of Insurance Australia Limited's APRA regulatory capital position.

(iv) The reset preference shares ("RPS") are a hybrid security with characteristics of both debt and equity. The securities were issued in two tranches referred to as IAGPA (issued June 2002) and IAGPB (issued June 2003) with the first reset date for each tranche being 15 June 2007 and 15 June 2008 respectively. The Company may, prior to any reset date, make changes to certain terms (such as the next reset date, the market rate, the margin and the frequency and timing of the dividend payment dates) which will apply from the day after the relevant reset date. The RPS rank in priority to ordinary shares for the payment of dividends and in the event of a winding up. In a winding up, all RPS will rank equally for return of capital behind all other creditors of IAG, and ahead of ordinary shares. The RPS do not carry voting rights at general meetings, except in limited circumstances.

The RPS entitle the holder to a preferred, but not cumulative, distribution (currently 5.8% per annum for IAGPA and 4.51% per annum for IAGPB). The distributions are payable semi-annually in arrears on 15 December and 15 June and are able to be franked. IAG expects the distributions to be fully franked and if a distribution is unfranked or partially franked, the distribution will be increased to compensate for the unfranked component. Because of the hybrid nature of the securities, distributions on the RPS are not the same as interest payments and may not always be paid, as there are a number of conditions that must be met before a distribution can be paid. If distributions are not paid on the RPS, no dividends can be paid and no returns of capital can be made on ordinary shares unless IAG takes certain actions.

The RPS may be exchanged by IAG or the holder on a reset date, by the holder upon a specified trigger event (such as change in control of IAG by a takeover bid), or by IAG on a tax event (such as a more than insignificant increase in taxation costs), regulatory event (such as not all of the RPS being entitled to be treated as Tier 1 capital for regulatory reporting purposes) or following certain takeovers or schemes of arrangements. While the holder may initiate an exchange, IAG is able to select the method of exchange being either conversion into ordinary shares, arranging for a third party to acquire the shares for their face value, or to redeem, buy-back or cancel the shares (subject to APRA approval). The RPS convert into ordinary shares that would rank equally in all respects with all other ordinary shares. All conversions into ordinary shares, other than a holder requesting conversion on a reset date, will receive a discount of 2.5% of the ordinary share price used in calculating the number of ordinary shares to be issued on conversion.

(v) The perpetual subordinated loan is between Mutual Community General Insurance Proprietary Limited, a non-wholly owned subsidiary of the IAG Group, and the minority interest equity holder in that company. The loan is interest bearing.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

	CONSOLIDATED		CONSOLIDATED	
	Half year ended 31 Dec 2005	Year ended 30 Jun 2005	Half year ended 31 Dec 2005	Year ended 30 Jun 2005
	Number of shares million	Number of shares million	\$m	\$m
Note 10. Reconciliation of total equity				
(a) Share capital				
<i>Ordinary shares</i>				
Balance at the beginning of the financial period	1,594	1,591	3,263	3,263
Shares issued under Performance Share Rights Plan	1	3	-	-
Balance at the end of the financial period	1,595	1,594	3,263	3,263
<i>Reset preference shares</i>				
Balance at the end of the previous financial period	6	6	539	539
AIFRS transition adjustments				
- Reclassification of reset preference shares ⁽ⁱ⁾	(6)	-	(550)	-
- Reclassification of capitalised transaction costs ⁽ⁱ⁾	-	-	11	-
Balance at the beginning and end of the financial period	-	6	-	539
Total share capital at the end of the financial period	1,595	1,600	3,263	3,802
(b) Treasury shares				
Balance at the beginning of the financial period	(8)	(6)	(34)	(21)
Acquisition of shares	(4)	(2)	(20)	(13)
Distribution of shares	2	-*	9	-*
Balance at the end of the financial period	(10)	(8)	(45)	(34)
(c) Reserves				
<i>Foreign currency translation reserve</i>				
Balance at the beginning of the financial period			(6)	(5)
Net exchange difference on translation of foreign operations			2	(1)
Hedge of net investment in a subsidiary			1	-
Balance at the end of the financial period			(3)	(6)
<i>Share based remuneration reserve</i>				
Balance at the beginning of the financial period			13	5
Recognition of equity settled share based remuneration			13	8
Transfers from the reserve upon vesting of rights/shares			(10)	-
Balance at the end of the financial period			16	13
<i>Hedging reserve</i>				
Balance at the end of the previous financial period			-	-
AIFRS transition adjustments				
- Recognition of cash flow hedges, net of tax ⁽ⁱ⁾			(5)	-
Balance at the beginning of the financial period			(5)	-
Movements in fair value of derivatives forming hedge			(4)	-
Balance at the end of the financial period			(9)	-
Total reserves			4	7

* The amount was less than 0.5 million and thus rounded down to zero.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

	CONSOLIDATED	
	Half year ended 31 Dec 2005	Year ended 30 Jun 2005
	\$m	\$m
Note 10. Reconciliation of total equity (continued)		
(d) Retained earnings		
Balance at the end of previous financial period	142	(259)
Net total AIFRS transition adjustments (refer to note 2 for reconciliation)	(5)	32
Balance at the beginning of the financial period	137	(227)
Profit attributable to equity holders of the Parent	461	811
Actuarial gains / (losses) on defined benefit plans, net of tax	8	-
Dividends declared and paid ⁽ⁱⁱⁱ⁾	(231)	(442)
Balance at the end of the financial period	375	142
Parent interest	3,597	3,917
(e) Minority interests		
Balance at the end of previous financial period	586	686
AIFRS transition adjustments		
- Reclassification of minority interests in unitholders' funds ⁽ⁱ⁾	(421)	-
- Net impact of other AIFRS transition adjustments	(1)	3
Balance at the beginning of the financial period	164	689
Profit attributable to minority interests	52	117
Distributions to minority interests	(44)	(120)
Other movements in unitholders' funds	-	(100)
Balance at the end of the financial period	172	586
Comprising:		
- Share capital	124	124
- Retained profits	48	41
- Unitholders' funds	-	421
Balance at the end of the financial period	172	586
Total equity	3,769	4,503

⁽ⁱ⁾ These reconciliation adjustments arose from the IAG Group's election to not restate comparatives for certain accounting standards as allowed upon first time adoption of AIFRS. Refer to note 2 for further details regarding the transition adjustments. Refer to note 9 for further details regarding the instruments.

⁽ⁱⁱⁱ⁾ Prior to 1 July 2005 the distributions on reset preference shares were included as dividends. From 1 July 2005 onwards the distributions are treated as finance costs and in this reconciliation are included in profit attributable to equity holders of the Parent. Refer to note 2 for further details.

(f) Notes to sections (a) to (e) above

(i) Share capital

All ordinary shares on issue are fully paid and have no par value. 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. Reset preference shares rank before ordinary shares in the event of the Parent being wound up and distributions on reset preference shares are paid in priority to any dividends on ordinary shares.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 10. Reconciliation of total equity (continued)

(f) Notes to sections (a) to (e) above (continued)

(ii) Treasury shares

The IAG Group provides share based remuneration in different forms to eligible employees and directors. To satisfy the 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. Upon consolidation of the trusts, the shares held are recognised as treasury shares, as described in note 1(aa).

Shares purchased in relation to the dividend reinvestment plan are purchased on behalf of the equity holders using the equity holders' dividend income and so at no time do the ordinary shares used as part of the dividend reinvestment plan qualify as treasury shares.

(iii) Nature and purpose of reserves

Foreign currency translation reserve

The foreign currency translation reserve records the foreign currency differences arising from the translation of the financial position and performance of entities in the IAG Group that have a functional currency other than Australian dollars.

Hedging reserve

The hedging reserve is used to record gains or losses on derivatives that form part of hedging relationships which have been designated as cash flows hedges or net investment hedges, as described in note 1(o).

Share based remuneration reserve

The share based remuneration reserve is used to recognise the fair value at grant date of equity-settled share based remuneration over the vesting period, as described in note 1(v).

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 11. Changes in composition of the IAG Group

31 December 2005

During the half year ended 31 December 2005, the IAG Group acquired ordinary shares in IAG Insurance (Thailand) Ltd (formerly Royal and Sun Insurance Alliance (Thailand) Ltd) effective 4 July 2005. The entity is a subsidiary for accounting purposes. At the date of acquisition, the acquired entity was involved in general insurance underwriting in Thailand.

31 December 2004

During the half year ended 31 December 2004 the consolidated entity acquired 50.1% of Mike Henry Travel Insurance Limited on 6 July 2004 with a contractual obligation to purchase the remaining equity on or before 1 July 2006. As this acquisition was not material, no further information was provided.

Details of the 2005 acquisition are as follows:

	CONSOLIDATED
	31 Dec
	2005
	\$m
Purchase price:	
Cash paid	34
Direct costs associated with acquisition	1
Total purchase consideration	35
Fair value of net identifiable assets acquired:	
Cash and cash equivalents	6
Investments	18
Receivables	22
Deferred acquisition costs	1
Property, plant and equipment	1
Payables	(18)
Current tax liabilities	(1)
Unearned premium liability	(5)
Outstanding claims liability	(14)
Net identifiable assets acquired	10
Goodwill	20
Intangible	5
	25

The goodwill is attributable to the synergies expected to arise after the acquisition. The fair value of assets and liabilities are based on discounted cash flow models. No restructuring provisions were created.

While there are other intangible benefits that have been acquired as part of the transaction, these benefits have not been recognised separately from goodwill because they were not separately recognisable and/or were not able to be reliably measured.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 11. Changes in composition of the IAG Group (continued)

The net cash flow in relation to the acquisition is as follows:

	CONSOLIDATED
	31 Dec
	2005
	\$m
Cash consideration paid	35
Cash balance acquired	(6)
Net outflow of cash	29
Contribution from the acquired business:	
Income	37
Profit before income tax	1

The contribution from the acquired business is recognised for the period from 4 July 2005 (date of acquisition) to 31 December 2005.

Note 12. Contingent liabilities and contingent assets

There have been no material changes in contingent liabilities or contingent assets since 30 June 2005.

		CONSOLIDATED	
	Notes	31 Dec	30 Jun
		2005	2005
		\$	\$

Note 13. Net tangible assets

Net tangible assets per ordinary share	(i)	1.29	1.18
Net tangible assets per reset preference share	(ii)	n/a	100.00

(i) Net tangible assets per ordinary share has been determined after adjusting for minority interests, goodwill and other intangible assets and the value of reset preference shares on issue (only for reporting date at 30 June 2005, refer (ii) below for further details).

(ii) While for accounting purposes the reset preference shares were previously classified as equity under Australian GAAP, they are classified as debt from 1 July 2005 onwards (refer to note 2 for further details) and hence the net tangible assets disclosure is not relevant. When classified as equity, the net tangible assets per reset preference share were reflected at the face value of \$100, as the entitlement to the net assets in all circumstances is limited to the face value of the reset preference shares.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

NOTES TO THE FINANCIAL STATEMENTS FOR THE HALF YEAR ENDED 31 DECEMBER 2005

Note 14. Events subsequent to reporting date

As these 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 half year ended 31 December 2005.

(a) Interim dividend

On 23 February 2006 an interim dividend of 13.5 cents per share, 100% franked, was declared by the Company. The Dividend Reinvestment Plan will operate using shares acquired on-market with no discount applied. The dividend is to be paid on 10 April 2006.

(b) Acquisition of a Malaysian based composite insurance business

On 9 December 2005, the IAG Group announced that it had agreed to acquire a 30% interest in a general insurer in Malaysia, AmAssurance Berhad ("AmAssurance"). AmAssurance underwrites both general and life insurance business and generates approximately A\$350 million in annual gross written premium (based on unaudited management accounts prepared in accordance with Malaysian generally accepted accounting principles). The final regulatory approval required in Malaysia has been received and completion is expected in March 2006.

(c) Memorandum of understanding with a China based general insurance business

On 7 February 2006, the IAG Group announced it had signed an exclusive memorandum of understanding regarding a proposed investment in China Pacific Property Insurance Co, Ltd (CPIC Property). The IAG Group will negotiate with CPIC Property to purchase an initial 24.9% interest, as well as an option to increase its ownership to 40% subject to certain regulatory approvals. CPIC Property is part of the China Pacific Group and is the second largest general insurer in China. CPIC Property generated gross written premium of approximately A\$2.2 billion in the period from January to October 2005 (based on unaudited management accounts prepared in accordance with Chinese generally accepted accounting principles).

(d) Increasing interest in Thailand's Safety Insurance Public Company Limited

On 10 February 2006, the IAG Group acquired an additional 16.7% interest in Safety Insurance Public Company Limited ("Safety Insurance"), taking its existing 21.6% shareholding to 38.3%. The IAG Group announced on 13 February 2006 that it intends to further increase its interest in Safety Insurance through a general tender offer to all Safety Insurance shareholders.

Safety Insurance is Thailand's 7th largest general insurer and 5th largest motor insurer, and has been listed on the Stock Exchange of Thailand since 1977 and currently generates approximately A\$100 million gross written premium per annum.

(e) Return of capital

On 23 February 2006, IAG announced it would return \$200 million to shareholders by 30 June 2006. The form of the return will be determined in due course with a buy-back or special dividend being considered.

INSURANCE AUSTRALIA GROUP LIMITED AND CONTROLLED ENTITIES

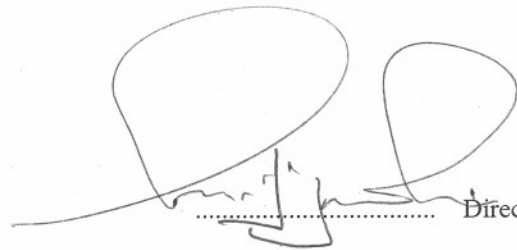
DIRECTORS' DECLARATION

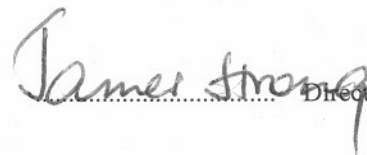
In the opinion of the Directors of Insurance Australia Group Limited:

- (a) the financial statements and notes, set out on pages 4 to 43, are in accordance with the Corporations Act 2001, including:
- (i) giving a true and fair view of the financial position of the IAG Group as at 31 December 2005 and of its performance, as represented by the results of its operations and its cash flows, for the half year ended on that date; and
 - (ii) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and
- (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

This declaration has been made after receiving the declarations required to be made to the Directors in accordance with section 295A of the Corporations Act 2001 for the half year ended 31 December 2005.

Signed at Sydney this 23rd day of February 2006 in accordance with a resolution of the Directors.


..... Director


..... Director

Independent Review Report to the shareholders of Insurance Australia Group Limited

Scope

The financial report and directors' responsibility

The financial report comprises the consolidated interim income statement, balance sheet, statement of recognised income and expense, cash flows statement, accompanying notes 1 to 14 to the financial statements, and the directors' declaration for the Insurance Australia Group Limited Consolidated Entity ("the Consolidated Entity"), for the half-year ended 31 December 2005. The Consolidated Entity comprises Insurance Australia Group Limited ("the Company") and the entities it controlled during that half-year.

The directors of the Company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report. The directors are also responsible for preparing the relevant reconciling information regarding adjustments required under the Australian Accounting Standard AASB 1 *First-Time Adoption of Australian equivalents to International Financial Reporting Standards*.

Review approach

We conducted an independent review in order for the Company to lodge the financial report with the Australian Securities and Investments Commission. Our review was conducted in accordance with Australian Auditing Standards applicable to review engagements.

We performed procedures in order to state whether on the basis of the procedures described anything has come to our attention that would indicate the financial report does not present fairly, in accordance with the Corporations Act 2001, Australian Accounting Standard AASB 134 *Interim Financial Reporting* and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Consolidated Entity's financial position, and of its performance as represented by the results of its operations and cash flows.

We formed our statement on the basis of the review procedures performed, which were limited primarily to:

- enquiries of company personnel; and
- analytical procedures applied to the financial data.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our review was not designed to provide assurance on internal controls.

The procedures do not provide all the evidence that would be required in an audit, thus the level of assurance is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

A review cannot guarantee that all material misstatements have been detected.

Statement

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe the half-year financial report of Insurance Australia Group Limited is not in accordance with:

- a) the Corporations Act 2001, including:
 - i. giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2005 and of its performance for the half-year ended on that date; and
 - ii. complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and
- b) other mandatory financial reporting requirements in Australia.

KPMG

KPMG

Dr Andries B Terblanché

Dr Andries B Terblanché
Partner

Sydney
23rd February 2006