

# FINANCIAL STATEMENTS.

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\* For ease of reference, an index of the notes to the financial statements is provided here showing those relevant to the financial statements of the Consolidated entity and those relevant to the financial statements of the Parent.

# NOTES TO THE FINANCIAL STATEMENTS.

## NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Insurance Australia Group Limited (IAG, Parent or Company) 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, Australia. This financial report is for the year ended 30 June 2008 and includes separate financial statements for IAG as an individual entity and consolidated financial statements for the Company and its subsidiaries (referred to as IAG Group, Group or Consolidated entity).

This general purpose financial report was authorised by the board of directors for issue on 22 August 2008.

### A. STATEMENT OF COMPLIANCE

This general purpose financial report for the year ended 30 June 2008 has been prepared in accordance with the Corporations Act 2001, Australian Accounting Standards (AASBs) (including Australian Interpretations) adopted by the Australian Accounting Standards Board, other authoritative pronouncements of the Australian Accounting Standards Board and the Australian Securities Exchange (ASX) Listing Rules.

International Financial Reporting Standards (IFRS) refer to the overall framework of standards and pronouncements approved by the International Accounting Standards Board (IASB). IFRS forms the basis of AASBs. This financial report of the Parent and the Consolidated entity complies with IFRS.

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

### B. BASIS OF PREPARATION OF THE FINANCIAL REPORT

The significant accounting policies adopted in the preparation of this financial report are set out below. The accounting policies adopted in the preparation of this financial report have been applied consistently by all entities in the Consolidated entity and are the same as those of the previous year unless otherwise noted. The financial statements have been prepared on the basis of historical cost principles, as modified by certain exceptions noted in the financial report, with the principal exceptions for the Consolidated entity being the measurement of all investments and derivatives at fair value and the measurement of the outstanding claims liability and related reinsurance and other recoveries at present value.

The presentation currency used for the preparation of this financial report is Australian dollars.

The balance sheet is prepared using the liquidity format in which the assets and liabilities are presented broadly in order of liquidity. The assets and liabilities comprise both current amounts (expected to be recovered or settled within 12 months after the reporting date) and non current amounts (expected to be recovered or settled more than 12 months after the reporting date). For those assets and liabilities that comprise both current and non current amounts, information regarding the amount of the item that is expected to be outstanding longer than 12 months is included within the relevant note to the financial statements.

#### I. Australian Accounting Standards issued but not yet effective

As at the date of this financial report, there are a number of new and revised accounting standards published by the Australian Accounting Standards Board for which the mandatory application dates fall after the end of this current reporting period.

Of these standards the following has been early adopted in the current reporting period:

#### AASB 2008–7 COST OF AN INVESTMENT IN A SUBSIDIARY, JOINTLY CONTROLLED ENTITY OR ASSOCIATE

This standard eliminates the distinction between pre acquisition and post acquisition dividends but establishes a new requirement to immediately assess, based on minimum mandatory checks, whether the payment of a dividend triggers a test for impairment of the investment in the subsidiary from which the dividend was received. The standard also clarifies that when a parent reorganises the structure of its group by establishing a new entity as a parent in a manner that satisfies specified criteria, the new parent measures the cost of its investment in the previous parent at the carrying amount of its share of the equity of the previous parent at the date of the reorganisation. There has been no immediate financial impact from the adoption of this standard.

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

#### a. AASB 3 BUSINESS COMBINATIONS (REVISED MARCH 2008) AND AASB 2008–3

The standards make a number of consequential amendments to other standards arising from the issue of the revised AASB 3. The standards are mandatorily applicable for the first time to the 31 December 2009 financial report and is expected to be applied prospectively from 1 July 2009.

#### b. AASB 101 PRESENTATION OF FINANCIAL STATEMENTS (REVISED SEPTEMBER 2007) AND 2007–8

The standard makes a number of consequential amendments to other standards arising from the issue of the revised AASB 101. The standards are mandatorily applicable for the first time to the 31 December 2009 financial report. The revised standard requires the presentation of a statement of comprehensive income and makes changes to the statement of changes in equity but will not affect any of the amounts recognised in the statements.

#### c. AASB 2008–2 AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS—PUTTABLE FINANCIAL INSTRUMENTS AND OBLIGATIONS ARISING ON LIQUIDATION

The standard is mandatorily applicable for the first time to the 31 December 2009 financial report. This amending standard introduces an exception to the definition of financial liability to classify as equity instruments certain puttable financial instruments and certain instruments that impose on an entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation of the entity. These changes will have no financial impact.

#### d. AASB 2008–1 AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARD AASB 2 SHARE BASED PAYMENTS: VESTING CONDITIONS AND CANCELLATIONS

The standard is mandatorily applicable for the first time to the 31 December 2009 financial report. This amending standard clarifies that only service and performance conditions are vesting conditions (change impacts only those arrangements which include conditions unrelated to service such as including a condition that the employee must hold a number of shares or awards linked to savings plans), and that if a share based payment arrangement is cancelled by a counterparty it is accounted for in the same way as a cancellation by the entity being acceleration of the expense (this change was to deal with companies trying to structure cancellations as if the employee had cancelled trying to avoid acceleration of the expense). These changes will have no financial impact.

#### e. AASB 2008–5 AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS ARISING FROM THE ANNUAL IMPROVEMENTS PROJECT AND THE RELATED 2008–6

The standard makes 24 amendments to 15 standards impacting recognition, measurement or presentation requirements as well as other terminology or editorial amendments. The standards are mandatorily applicable for the first time to the 31 December 2009 financial report with early adoption permitted. These changes are not expected to have a significant, if any, financial impact.

**f. IFRIC 14 AASB 19—THE LIMIT ON A DEFINED BENEFIT ASSET, MINIMUM FUNDING REQUIREMENTS AND THEIR INTERACTION**

The interpretation is mandatorily applicable for the first time to the 31 December 2008 financial report. This interpretation is not expected to have a significant, if any, financial impact.

**g. IFRIC 16 HEDGES OF A NET INVESTMENT IN A FOREIGN OPERATION**

The interpretation clarifies three main areas:

- a parent entity may designate as a hedged risk only the foreign exchange differences arising from a difference between its own functional currency and that of its foreign operation (confirming that the presentation currency does not create an exposure to which an entity may apply hedge accounting);
- which entity within a group can hold a hedging instrument; and
- how an entity should determine the amounts to be reclassified from equity to profit or loss for both the hedging instrument and the hedged item when the entity disposes of the investment. This interpretation is not expected to have a significant, if any, financial impact.

**h. AASB 8 OPERATING SEGMENTS AND AASB 2007–3**

The standards make a number of consequential amendments to other standards arising from the issue of AASB 8. The standards are mandatorily applicable for the first time to the 31 December 2009 financial report. The revised standards will have no financial impact but will impact on financial report disclosures. The revised standards require adoption of a 'management approach' to reporting on the financial performance. The information to be reported will be based on information used internally by key decision makers to evaluate performance. A single set of operating segments will replace the business and geographical segments currently disclosed.

**II. Changes in accounting policies**

There have been no changes in accounting policies which have a material financial impact during the current financial year reporting period.

**III. Reclassifications of comparatives**

Certain items have been reclassified from the Consolidated entity's prior year financial report to conform to the current period's presentation.

**IV. Rounding**

Amounts in this financial report have been rounded to the nearest million dollars, unless otherwise stated. The Company is the kind of company 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.

**C. PRINCIPLES OF CONSOLIDATION**

**I. Subsidiaries**

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

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

Where a subsidiary is less than wholly owned, the equity interests held by external parties are presented separately as minority interests on the consolidated balance sheet, except where the subsidiary is a trust or similar entity for which the core equity is presented as a liability (this is the case with the IAG Asset Management Wholesale Trusts that are subsidiaries, refer note 25) in which case the third party interest is presented separately on the consolidated balance sheet as a liability.

**II. Associates**

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

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

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

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

**SIGNIFICANT ACCOUNTING POLICIES RELATED TO GENERAL INSURANCE CONTRACTS**

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

**D. PREMIUM REVENUE**

Premium revenue comprises amounts charged to policyholders (direct premium) or other insurers (inwards reinsurance premium) for insurance contracts. Premium includes fire service levies, but excludes stamp duties and taxes collected on behalf of third parties, including the goods and services tax. Premium is recognised as earned from the date of attachment of risk (generally the date a contract is agreed to but may be earlier if persuasive evidence of an arrangement exists) over the period of the related insurance contracts in accordance with the pattern of the incidence of risk expected under the contracts. The pattern of the risks underwritten is generally matched by the passing of time. Premium for unclosed business (business written close to reporting date where attachment of risk is prior to reporting date and there is insufficient information to accurately identify the business) is brought to account based on previous years' experience with due allowance for any changes in the pattern of new business and renewals. The unearned portion of premium is recognised as an unearned premium liability on the balance sheet.

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

#### **E. OUTWARDS REINSURANCE**

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

#### **F. CLAIMS**

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

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

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

#### **G. REINSURANCE AND OTHER RECOVERIES**

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

#### **H. ACQUISITION COSTS**

Costs associated with obtaining and recording general insurance contracts are referred to as acquisition costs. These costs include advertising expenses, commissions or brokerage paid to agents or brokers, premium collection costs, risk assessment costs and other administrative costs. Profit commission received from third party names relating to providing managing agency services to Lloyd's syndicates is also included in acquisition costs. Such costs are capitalised where they relate to the acquisition of new business or the renewal of existing business, are presented as deferred acquisition costs, and are amortised on the same basis as the earning pattern of the premium over the period of the related insurance contracts. The balance of the deferred acquisition costs at the reporting date represents the capitalised acquisition costs relating to unearned premium.

#### **I. LIABILITY ADEQUACY TEST**

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

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

#### **J. LEVIES AND CHARGES**

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

### **SIGNIFICANT ACCOUNTING POLICIES APPLICABLE TO OTHER ACTIVITIES**

#### **K. FEE AND OTHER INCOME**

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. Other income is recognised on an accruals basis.

#### **L. LEASES**

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

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

#### **M. TAXATION**

##### **I. Income tax**

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

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

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

- 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 the initial recognition of goodwill.

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

## II. Tax consolidation

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

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

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

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

### NATURE OF TAX FUNDING ARRANGEMENTS AND TAX SHARING ARRANGEMENTS

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

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

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

## III. Goods and services tax

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

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

## N. INVESTMENTS

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

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

For securities traded in an active market, fair value is determined by reference to published bid price quotations. For trust securities this generally means using the redemption price provided by the trustee. For securities not traded, and for securities traded in a market that is not active, fair value is determined using valuation techniques with the most common technique being reference to observable market data by 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 a discounted cash flow methodology.

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

## O. INVESTMENT IN SUBSIDIARIES

Investment in subsidiaries is initially recognised at cost (fair value of consideration provided plus directly attributable costs) and are subsequently carried in the Parent's financial statements at the lower of cost and recoverable amount. Costs incurred in investigating and evaluating an acquisition up to the point of formal commitment to an acquisition are expensed as incurred. Where the carrying value exceeds the recoverable amount, an impairment charge is recognised in profit or loss which can subsequently be reversed in certain conditions.

Income from these investments, comprising dividends and trust distributions, are brought to account on an accruals basis. Dividend revenue is accrued on the date the dividends are declared.

## P. INVESTMENT IN JOINT VENTURES AND ASSOCIATES

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

## Q. DERIVATIVES

A variety of derivatives are used for the sole purpose of managing risk exposures. Derivatives are not held for trading or 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. The fair value is determined by reference to current market

quotes (current bid price for derivatives presented as assets and the current ask price for derivatives presented as liabilities) or generally accepted valuation principles. The derivatives become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market rates relative to their terms. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. Transaction costs for purchases of derivatives are expensed as incurred and presented in the income statement as investment expenses for assets backing insurance liabilities and corporate, administration and other expenses for assets representing equity holders' funds.

#### I. Investment operations

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

#### II. Corporate treasury operations

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

#### III. Hedge accounting

Where derivatives are designated for hedge accounting, they are classified as:

- hedge of the change in fair value of recognised assets or liabilities or firm commitments (fair value hedge);
- hedge of the variability in highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedge); or
- hedge of a net investment in a foreign operation (net investment hedge).

Hedge accounting may be applied to derivatives designated as hedging instruments provided certain criteria are met. Certain transactions have been designated as either a cash flow hedge or a net investment hedge.

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

##### a. CASH FLOW HEDGE

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

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

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

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

##### b. NET INVESTMENT HEDGE

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

#### IV. Embedded derivatives

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 recognised in profit or loss. Where an embedded derivative is required to be separated, it is measured at fair value.

Embedded derivatives are assessed for separation from their host contract when the entity first becomes a party to the contract and are not reassessed unless there is a significant change in the terms of the contract.

#### R. TRADE AND OTHER RECEIVABLES

Trade and other receivables are stated at the amounts to be received in the future and are presented net of any provision for impairment. The amounts are discounted where the effect of the time value of money is 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 profit or loss. Debts which are known to be uncollectible are written off.

#### S. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is initially recorded at cost which is the fair value of consideration provided plus incidental costs directly attributable to the acquisition (for land and buildings held as at 30 June 2004, the fair value at that date has been used as the deemed cost). The cost of plant and equipment that is located on certain leased premises is increased by the present value of the estimated future cost for dismantling and removing the items when the relevant alterations are made to the premises with a corresponding recognition of a lease provision (refer to note 1.Y). All items of property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment charges. Items other than land are depreciated using the straight line method at rates based on the expected useful lives of the assets taking into account estimated residual values. Depreciation rates and residual values are reviewed annually and any changes are accounted for prospectively. The per annum depreciation rates used for each class of asset are as follows:

CLASS OF ASSET	DEPRECIATION RATES
Buildings	2%–5%
Motor vehicles	12.5%–20%
Other plant and equipment	6.67%–40%

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

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

## T. BUSINESS COMBINATIONS

Business combinations are accounted for using the acquisition method. Business combinations occur when control is obtained over an entity or business.

The accounting for an acquisition involves the cost of the business combination being allocated to the individual assets acquired (tangible and intangible) and the individual liabilities assumed (including contingent liabilities) based on their separate fair values determined at the acquisition date. Goodwill represents the excess of the purchase consideration plus incidental costs over the fair value of the net identifiable assets and contingent liabilities acquired. If the cost of acquisition is less than the fair value of the net identifiable assets and contingent liabilities acquired, the difference is recognised immediately in profit.

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

Where the initial accounting for a business combination is determined only provisionally by the first reporting date after acquisition date, the business combination is accounted for using those provisional values. Any subsequent adjustments to those provisional values are recognised within 12 months of the acquisition date and are applied effective from the acquisition date.

Where a business combination is achieved in stages (commonly referred to as a step acquisition), each exchange transaction is treated separately, using the cost of the transaction and the fair value information at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. Before qualifying as a business combination, a transaction may qualify as an investment in an associate (refer note 1.C). With investments in joint ventures and associates, where control is not obtained, the goodwill is included in the carrying amount of the investment in the joint venture and associate, rather than being presented as a separate asset.

Acquisitions and disposals (where control is retained) of minority interests are treated as transactions between equity holders. Therefore, any difference between the acquisition cost of the minority interest and the carrying amount of the minority interest is recognised as an increase or decrease in equity.

## U. 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 and, for assets acquired separately, incidental costs directly attributable to the acquisition. Intangible assets with finite useful lives are amortised on a straight line basis (unless the pattern of usage of the benefits is significantly different) over the estimated useful lives of the assets being the period in which the related benefits are expected to be realised (shorter of legal duration and expected economic life). Amortisation rates and residual values are reviewed annually and any changes are accounted for prospectively. The per annum amortisation rates used for each class of asset are as follows:

CLASS OF ASSET	AMORTISATION RATES
Lloyd's syndicate capacity	n/a
Brands	5%–20%
Distribution channels	8%–14%
Customer relationships	10%–17%
Other contractual arrangements	20%–33%

The carrying amount of intangible assets with finite useful lives is reviewed each reporting date by determining whether there is an indication that the carrying value may be impaired. If any such indication exists, the item is tested for impairment by comparing the recoverable amount of the asset or its cash generating unit to the carrying value. Where the recoverable amount is determined by the value in use, the projected net cash flows are discounted using a pre tax discount rate. For assets with indefinite useful lives, the recoverability of the carrying value of the assets is reviewed for impairment at each reporting date, or more frequently if events or changes in circumstances indicate that it might be impaired. An impairment charge is recognised when the carrying value exceeds the calculated recoverable amount. Impairment charges are recognised in profit or loss and may be reversed where there has been a change in the estimates used to determine the recoverable amount.

### II. Software development expenditure

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

All such capitalised costs are deemed to have an expected useful life of three years unless it can be clearly demonstrated for a specific project that the majority of 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.

## V. GOODWILL

Goodwill acquired in a business combination is initially measured at cost being the excess of the purchase consideration plus incidental costs over the fair value of the net identifiable assets and contingent liabilities acquired and is subsequently presented net of any impairment charges. Goodwill arising on acquisitions prior to 1 July 2004 has been carried forward on the basis of its deemed cost being the net carrying amount as at that date.

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) expected to benefit from the synergies of a business combination for the purpose of impairment testing. Cash generating units are determined based principally on how goodwill is monitored by management. The recoverability of the carrying value of the goodwill allocated to each cash generating unit is tested for impairment at each reporting date, or more frequently if events or changes in circumstances indicate that it might be impaired, by determining the present value (using a pre tax discount rate that reflects the current market assessments of the risks specific to the cash generating unit) of projected net cash flows based on the five year business plans approved by management. Net cash flows beyond the five year period are extrapolated based on growth rates relevant to the asset/business which are consistent with long term industry averages. Where the carrying value exceeds the recoverable amount, an impairment charge is recognised in profit or loss and cannot subsequently be reversed.

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

#### **W. 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 amounts are discounted where the effect of the time value of money is material.

#### **X. 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 valid expectation has been raised in those persons expected to be affected. The provision is based on the direct expenditure to be incurred which is both directly and necessarily caused by the restructuring, including termination benefits, decommissioning of information technology systems and exiting surplus premises, and does not include costs associated with on going activities. The adequacy of the provision is reviewed regularly and adjusted if required. Revisions in the estimated amount of a restructuring provision are reported in the period in which the revision in the estimate occurs. The provision is discounted using a pre tax discount rate where the effect of the time value of money is material. Where discounting is applied, the increase in the provision due to the passage of time is recognised as a finance cost.

#### **Y. LEASE PROVISION**

Certain of the operating leases for property require that the land and/or building be returned to the lessor in its original condition, however, the related operating lease payments do not include an element for the cost this will involve. The present value of the estimated future cost for the plant and equipment to be removed and the premises to be returned to the lessor in its original condition are recognised as a lease provision when the relevant alterations are made to the premises. The costs are capitalised as part of the cost of plant and equipment and then depreciated over the useful lives of the assets (refer note 1.S).

#### **Z. ONEROUS CONTRACTS PROVISION**

A provision is recognised for onerous contracts when the expected benefits to be derived from a contract are lower than the unavoidable cost of meeting the obligations under the contract.

#### **AA. EMPLOYEE BENEFITS**

##### **I. Wages and salaries, annual leave and sick leave**

Liabilities for wages and salaries (including bonuses), annual leave and sick leave are recognised at the nominal amounts unpaid at the reporting date using remuneration rates that are expected to be paid when these liabilities are settled, including on costs. A liability for sick leave is considered to exist only when it is probable that sick leave taken in the future will be greater than entitlements that will accrue in the future.

##### **II. Long service leave**

A liability for long service leave is recognised as the present value of estimated future cash outflows to be made in respect of services provided by employees up to the reporting date. The estimated future cash outflows are discounted using interest rates on national government guaranteed securities which have terms to maturity that match, as closely as possible, the estimated future cash outflows. Factors which affect the estimated future cash outflows such as expected future salary increases, experience of employee departures and period of service, are incorporated in the measurement.

##### **III. Share based incentive arrangements**

Share based remuneration is provided in different forms to eligible employees and IAG directors. All of the arrangements are equity settled share based payments. The fair value at grant date (the date at which the employer and the employee have a shared understanding of the terms and conditions of the arrangement) is determined for each equity settled share based payment using a valuation model which excludes the impact of any non market vesting conditions. This fair value does not change over the life of the instrument. At each reporting date during the vesting period (the period during which related employment services are provided), and upon the final vesting or expiry of the equity instruments, the total accumulated expense is revised based on

the fair value at grant date and the latest estimate of the number of equity instruments that are expected to vest based on non market vesting conditions only, and taking into account the expired portion of the vesting period. Changes in the total accumulated expense from the previous reporting date are recognised in profit or loss with a corresponding movement in an equity reserve. Upon exercise of the relevant instruments, the balance of the share based remuneration reserve relating to those instruments is transferred within equity.

The different treatment of market and non market vesting conditions means that if an equity instrument does not vest because a participant ceases relevant employment then the accumulated expense charged in relation to that participant is reversed, but if an equity instrument does not vest only because a market condition is not met, the expense is not reversed.

To satisfy obligations under the various share based remuneration plans, shares are generally bought on market at or near grant date of the relevant arrangement and held in trust. Shares held in trust that are controlled for accounting purposes are treated as treasury shares held in trust (refer note 1.GG).

#### **IV. Superannuation**

Contributions are made to various superannuation plans, both defined contribution and defined benefit superannuation plans, in accordance with their governing rules and, for defined benefit superannuation plans, recommendations from their respective actuaries, which are designed to ensure that each plan's funding provides sufficient assets to meet its liabilities over the longer term.

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

#### **BB. INTEREST BEARING LIABILITIES AND FINANCE COSTS**

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

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

#### **CC. FOREIGN CURRENCY**

##### **I. Functional and presentation currency**

Items included in the financial records of each of the entities within the Consolidated entity are measured using the currency of the primary economic environment in which the entity operates (the functional currency). For nearly all entities, this is the local currency of the country in which it operates. The financial statements are presented in Australian dollars, which is the functional and presentation currency of the Parent and the presentation currency of the Consolidated entity.

##### **II. Translation of foreign currency transactions**

Foreign currency transactions are translated into the functional currency for each of the entities within the Consolidated entity using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at reporting date are translated to Australian dollars using reporting date exchange rates. Resulting exchange differences are recognised in profit or loss except for those relating to foreign operations and hedging transactions as per sections III and IV below.

### III. Translation of the financial results of foreign operations

The financial position and performance of foreign operations with a functional currency other than Australian dollars are translated into the presentation currency for inclusion in the consolidated financial statements. The assets and liabilities are translated using reporting date exchange rates while equity items are translated using historical rates. Items from the income statement are translated using weighted average rates for the reporting period. Exchange differences arising from the translations are recorded directly in equity in the foreign currency translation reserve. Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated using reporting date exchange rates.

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

### IV. Hedge transactions

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

### V. Principal exchange rates used

The reporting date exchange rates and the annual average daily exchange rates for selected currencies as an indication of the rates used for the current period are provided.

	BALANCE SHEETS		INCOME STATEMENTS AND CASH FLOWS	
	2008	2007	2008	2007
New Zealand dollar	<b>0.79310</b>	0.91060	<b>0.85634</b>	0.87139
British pound	<b>2.07383</b>	2.36486	<b>2.23326</b>	2.45813
Thai baht	<b>0.03117</b>	0.03701	<b>0.03551</b>	0.03587
United States dollar	<b>1.04205</b>	1.17869	<b>1.11508</b>	1.27269

### DD. PROVISION FOR DIVIDENDS

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

### EE. EARNINGS PER SHARE

#### I. Basic earnings per share

Basic earnings per share is determined by dividing the profit or loss attributable to equity holders of the Parent by the weighted average number of shares of the Parent on issue during the reporting period, net of treasury shares held in trust.

#### II. Diluted earnings per share

Diluted earnings per share is determined by dividing the profit or loss attributable to equity holders of the Parent used in the calculation of basic earnings per share, adjusted for relevant costs associated with dilutive potential ordinary shares, by the weighted average number of ordinary shares and dilutive potential ordinary shares.

### FF. SHARE CAPITAL

Shares are classified as equity when there is no obligation to transfer cash or other assets to the holder. Transaction costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

### GG. TREASURY SHARES HELD IN TRUST

Ordinary shares of IAG that are controlled for accounting purposes by share based remuneration trusts that are subsidiaries of the Consolidated entity, are presented on the balance sheet as treasury shares held in trust. The shares are measured at cost (total amount paid to acquire the shares including directly attributable costs), and are presented as a deduction from equity until they are otherwise dealt with. No gain or loss is recognised in profit or loss on the sale, cancellation or reissue of the shares. The shares are derecognised as treasury shares held in trust when the shares vest or are released to the participant.

### HH. RESET EXCHANGEABLE SECURITIES

Reset exchangeable securities (RES) were initially measured at fair value (which was equivalent to the face value) less transaction costs incurred in issuing the securities. On the balance sheet, the RES liability is offset against the investments purchased (Portfolio) from the proceeds of the RES, as there is a legal right of set off and it is the intention that the Portfolio and the RES liability would be settled simultaneously. Transaction costs are capitalised, presented together with interest bearing liabilities, and are amortised using the effective interest method over five years from the date of issue. Interest expense on the RES is brought to account on an accruals basis and payable quarterly subject to the terms of issue. The interest expense on the RES is offset against the interest income generated from the Portfolio in the income statement.

The RES incorporates an embedded derivative which is recognised separately.

### NOTE 2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In the process of applying the significant accounting policies, certain critical accounting estimates and assumptions are used, and certain judgements are made.

The estimates and related assumptions are based on experience and other factors that are considered to be reasonable, the results of which form the basis for judgements about the carrying values of assets and liabilities. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised, and future periods if relevant.

The areas where the estimates and assumptions involve a high degree of judgment or complexity and are considered significant to the financial statements, listed together with reference to the notes to the financial statements where more information is provided, are:

- insurance contracts related
  - claims, refer note 11;
  - reinsurance and other recoveries on outstanding claims, refer note 12; and
  - liability adequacy test, refer note 14.B.
- other
  - restructuring provisions, refer note 36;
  - intangible assets and goodwill impairment testing, refer notes 18 and 19;
  - acquired intangible assets initial measurement and determination of useful life, refer notes 18 and 24;
  - provisional accounting of business combinations, refer note 24;
  - share based remuneration, refer note 28;
  - defined benefit superannuation arrangements, refer note 29; and
  - embedded derivatives, refer note 33.

The accounting judgements made during the year that did not involve estimations, including determination of the existence of control when entities are not wholly owned, the recognition of the identifiable intangible assets acquired in a business combination, and the probability of recovering carry forward tax losses, are considered to have had no significant impact on the amounts recognised in the financial report (2007—none).

### NOTE 3. ANALYSIS OF INCOME

	PARENT		CONSOLIDATED	
	2008 \$m	2007 \$m	2008 \$m	2007 \$m
<b>A. GENERAL INSURANCE REVENUE</b>				
Gross written premium	-	-	<b>7,793</b>	7,381
Movement in unearned premium liability	-	-	<b>(28)</b>	(174)
Premium revenue	-	-	<b>7,765</b>	7,207
Direct premium revenue	-	-	<b>7,741</b>	7,192
Inwards reinsurance premium revenue	-	-	<b>24</b>	15
Premium revenue	-	-	<b>7,765</b>	7,207
Reinsurance and other recoveries revenue	-	-	<b>438</b>	871
Total general insurance revenue	-	-	<b>8,203</b>	8,078
<b>B. INVESTMENT INCOME</b>				
Dividend revenue	<b>716</b>	396	<b>49</b>	59
Interest revenue	<b>40</b>	29	<b>531</b>	442
Trust revenue	-	-	<b>55</b>	61
Total investment revenue	<b>756</b>	425	<b>635</b>	562
<b>Net changes in fair values of investments</b>				
Realised net gains and (losses)	<b>10</b>	7	<b>29</b>	(23)
Unrealised net gains and (losses)	<b>(7)</b>	(6)	<b>(209)</b>	185
Total investment income	<b>759</b>	426	<b>455</b>	724
<b>Represented by</b>				
Investment income on assets backing insurance liabilities	-	-	<b>456</b>	381
Investment income on equity holders' funds	<b>759</b>	426	<b>(1)</b>	343
	<b>759</b>	426	<b>455</b>	724
<b>C. FEE AND OTHER INCOME</b>				
Fee based revenue	-	-	<b>320</b>	313
Brokerage and commission	-	-	<b>146</b>	111
Other income	-	-	<b>21</b>	39
Unrealised gains and (losses) on embedded derivatives	<b>69</b>	-	<b>69</b>	-
Total fee and other income	<b>69</b>	-	<b>556</b>	463
<b>D. SHARE OF NET PROFIT/(LOSS) OF ASSOCIATES</b>				
	-	-	<b>(3)</b>	5
Total income	<b>828</b>	426	<b>9,211</b>	9,270

### NOTE 4. ANALYSIS OF EXPENSES

#### A. EXPENSES AS PRESENTED IN THE INCOME STATEMENT

Outwards reinsurance premium expense	-	-	<b>470</b>	464
Claims expense	-	-	<b>5,593</b>	5,345
Acquisition costs	-	-	<b>1,318</b>	1,223
Other underwriting expenses	-	-	<b>590</b>	421
Fire service levies	-	-	<b>216</b>	218
Investment expenses on assets backing insurance liabilities	-	-	<b>24</b>	21
Finance costs	<b>60</b>	77	<b>101</b>	119
Fee based, corporate and other expenses	-	-	<b>1,017</b>	532
Net income attributable to minority interests in unitholders' funds	-	-	<b>18</b>	19
Total expenses	<b>60</b>	77	<b>9,347</b>	8,362

	PARENT		CONSOLIDATED	
	2008 \$m	2007 \$m	2008 \$m	2007 \$m
<b>B. ANALYSIS OF EXPENSES BY FUNCTION</b>				
General insurance business expenses	-	-	<b>8,211</b>	7,692
Fee based business expenses	-	-	<b>438</b>	346
Investment and other expenses	-	-	<b>47</b>	62
Corporate and administration expenses	<b>60</b>	77	<b>651</b>	262
Total expenses	<b>60</b>	77	<b>9,347</b>	8,362
<b>C. OTHER ITEMS</b>				
<b>Disclosure of the following items is considered relevant in explaining the results for the financial year</b>				
Insurance protection tax levied by the NSW State Government	-	-	<b>20</b>	21
<b>Depreciation and amortisation</b>				
Acquired intangible assets	-	-	<b>65</b>	55
Capitalised software development expenditure	-	-	<b>54</b>	18
Property, plant and equipment	-	-	<b>78</b>	61
	-	-	<b>197</b>	134
<b>Impairment charges</b>				
Property, plant and equipment	-	-	<b>9</b>	-
Goodwill	-	-	<b>277</b>	-
Acquired intangibles	-	-	<b>65</b>	-
Trade and other receivables	-	-	<b>3</b>	2
Capitalised software development expenditure	-	-	-	7
	-	-	<b>354</b>	9
<b>Employee benefits</b>				
Defined contribution superannuation plans	-	-	<b>91</b>	70
Defined benefit superannuation plans	-	-	<b>7</b>	10
Share based remuneration	-	-	<b>25</b>	15
Salaries and other employee benefits expense	-	-	<b>1,316</b>	1,126
	-	-	<b>1,439</b>	1,221
<b>Transfers to provisions charged to profit or loss</b>				
Restructuring provision	-	-	<b>60</b>	2
	-	-	<b>60</b>	2
<b>Finance costs</b>				
Reset preference shares distributions paid/payable	<b>28</b>	29	<b>28</b>	29
Subordinated term notes interest paid/payable	<b>30</b>	23	<b>64</b>	76
Loans from related bodies corporate interest paid/payable	-	23	-	-
Amortisation of capitalised transaction costs	<b>2</b>	2	<b>3</b>	4
Other debts of operational nature interest paid/payable	-	-	<b>11</b>	10
Ineffective portion of hedges	-	-	<b>(5)</b>	-
	<b>60</b>	77	<b>101</b>	119
<b>Other</b>				
Net loss on disposal of property, plant and equipment	-	-	-	4
Operating lease payments	-	-	<b>164</b>	184
Software research and development costs expensed	-	-	<b>44</b>	37
Net foreign exchange (gains)/losses	-	-	<b>39</b>	(22)
Liability adequacy test deficiency	-	-	<b>15</b>	-

The IAG Group operated a shared services model throughout the period with the use of dedicated units and entities to provide services throughout the IAG Group. The costs incurred by business units and entities directly, together with internal charges between them, are allocated to the various operating functions and so are included within the various expense classifications in the income statement. For example, the Consolidated entity incurs expense in meeting the superannuation contribution obligations for employees involved in a wide range of functions including sales and marketing, underwriting and claims management. Hence the superannuation expense is allocated across the lines in the income statement based on the areas for which these employees provide services.

## NOTE 5. REMUNERATION OF AUDITORS

	CONSOLIDATED	
	2008 \$000	2007 \$000
<b>A. KPMG AUSTRALIA</b>		
<b>I. Assurance services</b>		
Audit of the financial statements prepared for the Parent and subsidiaries	5,155	4,964
Audit of statutory returns in accordance with regulatory requirements	786	799
Other assurance services	111	453
	<b>6,052</b>	<b>6,216</b>
<b>II. Advisory services</b>		
Taxation services	566	395
Due diligence in relation to potential acquisitions outside Australia	503	1,041
Other attestation and advisory services	1,631	455
	<b>2,700</b>	<b>1,891</b>
<b>B. OVERSEAS RELATED PRACTICES OF KPMG AUSTRALIA</b>		
<b>I. Assurance services</b>		
Audit of the financial statements prepared for subsidiaries	3,186	2,142
Audit of statutory returns in accordance with regulatory requirements	219	38
Other assurance services	179	71
	<b>3,584</b>	<b>2,251</b>
<b>II. Advisory services</b>		
	<b>890</b>	<b>48</b>
<b>C. OTHER AUDITORS</b>		
<b>I. Assurance services</b>		
Audit of the financial statements prepared for subsidiaries	502	1,181
<b>II. Advisory services</b>		
	<b>25</b>	<b>25</b>
Total remuneration of auditors	<b>13,753</b>	<b>11,612</b>

It is IAG Group policy that KPMG may provide assurance and other audit related services that, while outside the scope of the statutory audit, are consistent with the role of auditor. These include regulatory and prudential reviews requested by a regulator such as the Australian Prudential Regulation Authority (APRA). KPMG may not provide services that are perceived to be materially in conflict with the role of auditor. It is IAG Group policy to contract KPMG on assignments additional to their statutory audit and assurance duties where KPMG's expertise and experience with the IAG Group are important. The total fees for such services cannot exceed the audit fees without the approval of the IAG Audit Committee and KPMG can be contracted only in relation to reviewing financial information and not in its preparation. The board is of the opinion that audit independence was not impaired during the current financial year as a result of the provision of these services.

## NOTE 6. INCOME TAX

	PARENT		CONSOLIDATED	
	2008 \$m	2007 \$m	2008 \$m	2007 \$m
<b>A. INCOME TAX EXPENSE</b>				
Current tax	5	(6)	201	359
Deferred tax	(1)	1	(115)	(74)
(Over)/under provided in prior years	-	1	4	(6)
Income tax (credit)/expense	<b>4</b>	<b>(4)</b>	<b>90</b>	<b>279</b>
<b>Deferred income tax expense/(credit) included in income tax comprises</b>				
(Increase)/decrease in deferred tax assets	(1)	1	1	23
Increase/(decrease) in deferred tax liabilities	-	-	(116)	(97)
	<b>(1)</b>	<b>1</b>	<b>(115)</b>	<b>(74)</b>

## B. INCOME TAX RECONCILIATION

The income tax for the financial year differs from the amount calculated on the profit/(loss) before income tax. The differences are reconciled as follows:

	PARENT		CONSOLIDATED	
	2008 \$m	2007 \$m	2008 \$m	2007 \$m
Profit/(loss) for the year before income tax	<b>768</b>	349	<b>(136)</b>	908
Income tax calculated at 30% (2007—30%)	<b>230</b>	105	<b>(41)</b>	272
<b>Tax effect of amounts which are not deductible/(taxable) in calculating taxable income</b>				
Rebateable dividends	<b>(215)</b>	(119)	<b>(9)</b>	(9)
Capital profits/(losses) not subject to income tax	<b>(20)</b>	–	<b>1</b>	6
<b>OTHER NON DEDUCTIBLE ITEMS</b>				
Amortisation and impairment charge on acquired intangible assets and goodwill	–	–	<b>122</b>	15
Interest on reset preference shares	<b>9</b>	9	<b>9</b>	9
Unrealised (gains) and losses on embedded derivatives	–	–	<b>(21)</b>	–
Other	–	–	<b>25</b>	(8)
Income tax (credit)/expense applicable to current year	<b>4</b>	(5)	<b>86</b>	285
Adjustment relating to prior year	–	1	<b>4</b>	(6)
Income tax (credit)/expense attributable to profit/(loss) for the year before impact of tax consolidation	<b>4</b>	(4)	<b>90</b>	279
Income tax (credit)/expense attributable to profit/(loss) for the year after impact of tax consolidation	<b>4</b>	(4)	<b>90</b>	279

## C. TAX CONSOLIDATION

Effective 1 July 2002, the Company became the head entity in a tax-consolidated group comprising the Company and all of its Australian wholly owned subsidiaries and the requirements of the relevant accounting standards have been applied.

### D. DEFERRED TAX ASSETS

#### I. The balance comprises temporary differences attributable to

##### AMOUNTS RECOGNISED IN PROFIT

Property, plant and equipment	–	–	<b>69</b>	80
Employee benefits	–	–	<b>88</b>	68
Insurance provisions	–	–	<b>132</b>	146
Investments	–	–	<b>31</b>	5
Provisions	–	–	<b>15</b>	8
Tax losses	–	–	<b>47</b>	65
Other	<b>1</b>	–	–	4
	<b>1</b>	–	<b>382</b>	376

##### AMOUNTS RECOGNISED DIRECTLY IN EQUITY

Hedges	–	–	–	1
Defined benefit superannuation plans	–	–	<b>(8)</b>	(24)
Share based remuneration	–	–	–	1
Other	<b>6</b>	6	<b>6</b>	6
	<b>7</b>	6	<b>380</b>	360
Set off of deferred tax liabilities	–	–	<b>(92)</b>	(84)
	<b>7</b>	6	<b>288</b>	276

	PARENT		CONSOLIDATED	
	2008 \$m	2007 \$m	2008 \$m	2007 \$m
<b>II. Movements</b>				
Balance at the beginning of the financial year	6	1	360	281
Credited/(charged) to profit or loss	1	(1)	(1)	(23)
Credited/(charged) to equity	-	6	14	(12)
Acquisitions	-	-	-	118
Transfers	-	-	1	(6)
Adjustments relating to prior year	-	-	18	6
Foreign exchange difference	-	-	(12)	(4)
Balance at the end of the financial year	7	6	380	360

### III. Tax losses

The Consolidated entity has not recognised \$25 million of tax losses (2007—\$nil).

#### E. DEFERRED TAX LIABILITIES

##### I. The balance comprises temporary differences attributable to

###### AMOUNTS RECOGNISED IN PROFIT

Investments	-	-	(34)	70
Other provisions	-	-	36	43
	-	-	2	113

###### AMOUNTS RECOGNISED DIRECTLY IN EQUITY

Hedges	-	-	107	27
	-	-	109	140
Set off against deferred tax assets	-	-	(92)	(84)
	-	-	17	56

### II. Movements

Balance at the beginning of the financial year	-	-	140	162
Charged/(credited) to profit or loss	-	-	(116)	(97)
Charged/(credited) to equity	-	-	80	23
Foreign exchange differences	-	-	(3)	1
Transfers	-	-	1	(5)
Acquisition	-	-	-	44
Adjustments relating to prior year	-	-	7	12
Balance at the end of the financial year	-	-	109	140

## NOTE 7. SEGMENT REPORTING

### A. PRIMARY REPORTING—BUSINESS SEGMENTS

The Parent is a non operating holding company operating only in Australia.

The Consolidated entity operated in the general insurance industry throughout the year. Revenue from the general insurance industry is derived from underwriting insurance in Australia, NZ, UK and Asia and these form separate reportable segments. The reportable segments comprise the following businesses (each insurance product is predominantly short-tail in duration except where noted):

#### I. Australia insurance

Comprises the Australia insurance business which distributes a range of direct and intermediated insurance products, under several brands. Direct insurance products are distributed through a network of branches, franchises and country service centres throughout Australia as well as call centres and online facilities using predominantly the NRMA Insurance, SGIO and SGIC brands. Intermediated insurance products are primarily sold under the CGU and Swann Insurance brands through insurance brokers and authorised representatives. This segment includes the operations of an Australian dedicated captive reinsurer.

#### II. New Zealand insurance

Comprises the general insurance business underwritten through subsidiaries in NZ. The insurance products are predominantly sold directly to customers using the State brand, and through intermediaries such as brokers and agents using the NZI brand. Personal and commercial products are also distributed using third party brands by corporate partners such as large financial institutions.

#### III. United Kingdom insurance

Comprises the general insurance underwriting and broker distribution services operating through subsidiaries in the UK. The underwriting businesses include a Lloyd's syndicate and a licensed Gibraltar based underwriter. The broking business includes Equity insurance brokers which is a specialist small businesses insurer offering commercial insurance including haulage and heavy goods vehicles and Hastings which offers motor insurance online. These brands provide a combination of direct and third party multi channel distribution.

#### IV. Asia insurance

Comprises the direct insurance business underwritten through subsidiaries in Asia. The business offers personal and commercial insurance products through local brands in different Asian markets.

#### V. Reinsurance operations

Comprises the inwards reinsurance operation (which is classified as held for sale at current reporting date) and the captive reinsurer for subsidiaries operating outside Australia.

#### VI. Corporate and investments

Comprises other activities, including corporate services, investment management and investment of the equity holders' funds.

The net outstanding claims liability for each segment includes an allocation of the diversification benefit incorporated into the risk margin relating to the combination of the segments at the Consolidated entity level. Depreciation expense is allocated to different business segments as management fees from the corporate segment and so all depreciation relating to property, plant and equipment is treated as part of the corporate segment.

The reported segments have changed from those disclosed in the previous annual report as a result of the continued expansion of the IAG Group and the way the business is managed. The change resulted in the merging of what were previously disclosed as two separate segments, being Australia personal insurance and Australia commercial insurance, to form a single Australia insurance segment. The revised business segments align with the way in which information was viewed by KMP at reporting date for making strategic and operational decisions. The comparative information provided has been reclassified to conform to the current period's presentation.

There are no differences between the recognition and measurement criteria used in the segment disclosures and those used in the financial statements.

	AUSTRALIA INSURANCE \$M	NEW ZEALAND INSURANCE \$M	UNITED KINGDOM INSURANCE \$M	ASIA INSURANCE \$M	RE- INSURANCE OPERATIONS \$M	CORPORATE AND INVESTMENTS \$M	INTER SEGMENT ELIMINATION \$M	TOTAL \$M
<b>2008</b>								
External revenue	<b>6,160</b>	<b>1,026</b>	<b>1,715</b>	<b>203</b>	<b>40</b>	<b>67</b>	<b>-</b>	<b>9,211</b>
Intersegment revenue	<b>-</b>	<b>14</b>	<b>119</b>	<b>4</b>	<b>178</b>	<b>-</b>	<b>(315)</b>	<b>-</b>
Total revenue	<b>6,160</b>	<b>1,040</b>	<b>1,834</b>	<b>207</b>	<b>218</b>	<b>67</b>	<b>(315)</b>	<b>9,211</b>
Underwriting profit/(loss)	<b>139</b>	<b>(39)</b>	<b>(33)</b>	<b>(1)</b>	<b>(50)</b>	<b>-</b>	<b>-</b>	<b>16</b>
Investment income net of investment fees —technical reserves	<b>347</b>	<b>22</b>	<b>61</b>	<b>4</b>	<b>(2)</b>	<b>-</b>	<b>-</b>	<b>432</b>
Insurance profit/(loss)	<b>486</b>	<b>(17)</b>	<b>28</b>	<b>3</b>	<b>(52)</b>	<b>-</b>	<b>-</b>	<b>448</b>
Investment income net of investment fees —equity holders' funds	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>41</b>	<b>-</b>	<b>41</b>
Share of net profit/(loss) of associates	<b>-</b>	<b>-</b>	<b>(3)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(3)</b>
Other net operating result	<b>33</b>	<b>-</b>	<b>(1)</b>	<b>(4)</b>	<b>-</b>	<b>(650)</b>	<b>-</b>	<b>(622)</b>
Profit/(loss) before income tax	<b>519</b>	<b>(17)</b>	<b>24</b>	<b>(1)</b>	<b>(52)</b>	<b>(609)</b>	<b>-</b>	<b>(136)</b>
Income tax expense								<b>(90)</b>
Profit/(loss) for the year								<b>(226)</b>
Segment assets	<b>9,666</b>	<b>629</b>	<b>1,493</b>	<b>124</b>	<b>287</b>	<b>7,456</b>	<b>(275)</b>	<b>19,380</b>
Total assets								<b>19,380</b>
Segment liabilities	<b>9,666</b>	<b>629</b>	<b>1,493</b>	<b>124</b>	<b>287</b>	<b>3,105</b>	<b>(275)</b>	<b>15,029</b>
Total liabilities								<b>15,029</b>
Acquisitions of property, plant and equipment, intangibles and other non current segment assets	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>216</b>	<b>-</b>	<b>216</b>
Depreciation expense	<b>39</b>	<b>5</b>	<b>32</b>	<b>2</b>	<b>-</b>	<b>9</b>	<b>-</b>	<b>87</b>
Amortisation and impairment charges on acquired intangibles and goodwill	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>407</b>	<b>-</b>	<b>407</b>
Total depreciation, amortisation expenses and impairment charges	<b>39</b>	<b>5</b>	<b>32</b>	<b>2</b>	<b>-</b>	<b>416</b>	<b>-</b>	<b>494</b>
Other non cash expenses	<b>62</b>	<b>9</b>	<b>3</b>	<b>-</b>	<b>-</b>	<b>65</b>	<b>-</b>	<b>139</b>

	AUSTRALIA INSURANCE \$M	NEW ZEALAND INSURANCE \$M	UNITED KINGDOM INSURANCE \$M	ASIA INSURANCE \$M	RE- INSURANCE OPERATIONS \$M	CORPORATE AND INVESTMENTS \$M	INTER SEGMENT ELIMINATION \$M	TOTAL \$M
2007								
External revenue	6,796	1,000	912	193	15	354	–	9,270
Intersegment revenue	–	5	27	6	41	–	(79)	–
Total revenue	6,796	1,005	939	199	56	354	(79)	9,270
Underwriting profit/(loss)	375	64	(3)	1	(30)	–	–	407
Investment income net of investment fees— technical reserves	296	22	33	8	1	–	–	360
Insurance profit/(loss)	671	86	30	9	(29)	–	–	767
Investment income net of investment fees— equity holders' funds	–	–	–	–	–	320	–	320
Share of net profit/(loss) of associates	–	–	(2)	7	–	–	–	5
Other net operating result	65	–	18	(9)	–	(258)	–	(184)
Profit/(loss) before income tax	736	86	46	7	(29)	62	–	908
Income tax expense								(279)
Profit/(loss) for the year								629
Segment assets	10,181	674	1,762	131	83	8,862	(56)	21,637
Total assets								21,637
Segment liabilities	10,181	674	1,762	131	83	4,030	(56)	16,805
Total liabilities								16,805
Acquisitions of property, plant and equipment, intangibles and other non current segment assets	–	–	–	–	–	1,746	–	1,746
Depreciation expense	34	4	11	2	–	10	–	61
Amortisation and impairment charges on acquired intangibles and goodwill	–	–	–	–	–	55	–	55
Total depreciation, amortisation expenses and impairment charges	34	4	11	2	–	65	–	116
Other non cash expenses	69	11	7	–	–	6	–	93

## B. SECONDARY REPORTING—GEOGRAPHICAL SEGMENTS

The Consolidated entity operates in the Australia, NZ, UK and Asia (principally Thailand) general insurance industries. Each of these markets forms a separate reportable geographical segment. Australia is the IAG Group's principal market with operations covering all states and territories. The reinsurance operation is a global shared service and there is no sensible transparent manner in which to allocate the results of this operation across the geographic segments.

	AUSTRALIA		NEW ZEALAND		UNITED KINGDOM		ASIA		REINSURANCE		INTER SEGMENT ELIMINATION		TOTAL	
	2008 \$m	2007 \$m	2008 \$m	2007 \$m	2008 \$m	2007 \$m	2008 \$m	2007 \$m	2008 \$m	2007 \$m	2008 \$m	2007 \$m	2008 \$m	2007 \$m
External revenue	<b>6,261</b>	7,106	<b>1,050</b>	1,062	<b>1,660</b>	887	<b>200</b>	196	<b>40</b>	19	–	–	<b>9,211</b>	9,270
Segment assets	<b>16,177</b>	16,685	<b>1,523</b>	1,721	<b>2,931</b>	3,608	<b>272</b>	315	<b>553</b>	228	<b>(2,076)</b>	(920)	<b>19,380</b>	21,637
Acquisitions of property, plant and equipment, intangibles and other non current segment assets	<b>109</b>	57	<b>15</b>	42	<b>83</b>	1,622	<b>3</b>	1	<b>6</b>	24	–	–	<b>216</b>	1,746

## NOTE 8. EARNINGS PER SHARE

	CONSOLIDATED	
	2008 cents	2007 cents
<b>A. REPORTING PERIOD VALUES</b>		
Basic earnings per ordinary share*	<b>(14.29)</b>	32.79
Diluted earnings per ordinary share	<b>(14.18)</b>	32.59

\* The basic earnings per ordinary share excludes the treasury shares held in trust from the denominator of the calculation, but includes earnings attributable to those shares in the numerator, to comply with AASB 133 Earnings per Share. If the amounts relating to those shares are excluded from both the numerator and denominator, the basic earnings per ordinary share for the year ended 30 June 2008 would be reduced to (14.18) cents (2007—32.60 cents).

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>B. RECONCILIATION OF EARNINGS USED IN CALCULATING EARNINGS PER SHARE</b>		
Profit/(loss) for the year	<b>(226)</b>	629
Profit attributable to minority interests	<b>(35)</b>	(77)
Profit/(loss) attributable to equity holders of the Parent which is the earnings used in calculating basic and diluted earnings per share	<b>(261)</b>	552

	CONSOLIDATED	
	2008 Number of shares in millions	2007 Number of shares in millions
<b>C. RECONCILIATION OF WEIGHTED AVERAGE NUMBER OF ORDINARY SHARES USED IN CALCULATING EARNINGS PER SHARE</b>		
Ordinary shares on issue*	<b>1,842</b>	1,691
Treasury shares held in trust	<b>(13)</b>	(10)
Weighted average number of ordinary shares used in the calculation of basic earnings per share	<b>1,829</b>	1,681
<b>Weighted average number of dilutive potential ordinary shares relating to</b>		
Unvested share based remuneration rights supported by treasury shares held in trust	<b>13</b>	10
Weighted average number of ordinary shares used in the calculation of diluted earnings per share	<b>1,842</b>	1,691

\* The 30 June 2007 weighted average number of ordinary shares used to calculate the basic earnings per share includes an additional seven million shares that are deemed to be bonus shares. These deemed bonus shares were issued in response to the \$750 million institutional placement (completed on 12 December 2006) and the \$125 million Share Purchase Plan (completed on 31 January 2007) as these capital raisings were considered to be issued at a discount compared to the relevant market price and accordingly these shares are deemed to contain a bonus element. These deemed bonus shares are considered to have been issued on 1 July 2005 (being at the beginning of the corresponding prior period presented in these financial statements) and thus have a retrospective dilutive effect on the basic earnings per share.

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

- the RPS are not included as dilutive potential ordinary shares even though they may convert into ordinary shares because the contingent conversion conditions were not met at the reporting date; and
- the RES (refer note 31.B) are not included as dilutive potential ordinary shares because the contingent conversion conditions were not met at the reporting date.

## NOTE 9. DIVIDENDS

	CENTS PER SHARE	TOTAL AMOUNT \$M	PAYMENT DATE	TAX RATE FOR FRANKING CREDIT	PERCENTAGE FRANKED
<b>A. ORDINARY SHARES</b>					
Recognised in year ended 30 June 2008					
2008 interim dividend	<b>13.5</b>	<b>250</b>	<b>14 April 2008</b>	<b>30%</b>	<b>100%</b>
2007 final dividend	<b>16.0</b>	<b>287</b>	<b>8 October 2007</b>	<b>30%</b>	<b>100%</b>
		<b>537</b>			
Recognised in year ended 30 June 2007					
2007 interim dividend	13.5	237	16 April 2007	30%	100%
2006 final dividend	16.0	255	9 October 2006	30%	100%
		492			

It is standard practice to declare the dividend for a period after the relevant reporting date. In accordance with the relevant accounting policy (refer note 1.DD) 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 dividends recognised in the year ended 30 June 2008 includes \$2 million (2007—\$4 million) paid in relation to treasury shares held in trusts controlled by the Consolidated entity.

#### B. DIVIDEND REINVESTMENT

A Dividend Reinvestment Plan (DRP) operates 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 DRP for the 2008 interim dividend payable on 14 April 2008 was settled with the issuance of 25.2 million fully paid ordinary shares priced at \$3.6443 per share (based on the average market price for the eight trading days from 17 March 2008 to 28 March 2008 inclusive, less a discount of 1.5%) to existing shareholders with dividend entitlements.

#### C. DIVIDEND NOT RECOGNISED AT REPORTING DATE

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

	CENTS PER SHARE	TOTAL AMOUNT \$M	EXPECTED PAYMENT DATE	TAX RATE FOR FRANKING CREDIT	PERCENTAGE FRANKED
2008 final dividend	<b>9.0</b>	<b>169</b>	<b>3 October 2008</b>	<b>30%</b>	<b>100%</b>

The dividend was declared on 22 August 2008. The Company's DRP will operate by issuing new ordinary shares to participants with no discount applied.

The last election notice for participation in the DRP in relation to this final dividend is 3 September 2008.

#### D. RESTRICTIONS THAT MAY LIMIT THE PAYMENT OF DIVIDENDS

There are currently no restrictions on the payment of dividends by the Parent other than:

- the payment of dividends generally being limited to profits subject to ongoing solvency obligations; and
- no dividends can be paid and no returns of capital can be made on ordinary shares, if distributions are not paid on the RPS, unless certain actions are taken by IAG. For further details refer to note 21.

There are currently no restrictions on the payment of dividends from subsidiaries to the Parent other than:

- the payment of dividends generally being limited to profits subject to ongoing solvency obligations of the subsidiary;
- for certain subsidiaries, statutory reserve and regulatory minimum capital requirements (MCR), in particular, APRA has advised Australian general insurers that a general insurer under its supervision must obtain approval from it before declaring a dividend if the general insurer has incurred a loss, or proposes to pay dividends which exceed the level of profits earned in the current period; and
- the Lloyd's syndicate operations being subject to specific solvency calculation restrictions regarding the payment of distributions from Funds at Lloyd's (FAL).

The impact to these requirements caused by the payment of dividends is monitored. Payments of dividends from overseas subsidiaries may attract withholding taxes which have not been provided for in this financial report.

	PARENT		CONSOLIDATED	
	2008 \$m	2007 \$m	2008 \$m	2007 \$m

#### E. DIVIDEND FRANKING AMOUNT

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

Franking account balance at reporting date at 30%	<b>466</b>	538	<b>498</b>	570
Franking credits to arise from payment of income tax payable	<b>49</b>	39	<b>62</b>	51
Franking debits to arise from receipt of income tax refundable	–	(15)	–	(15)
Franking credits to arise from receipt of dividends receivable	<b>1</b>	2	<b>1</b>	2
Franking credits available for future reporting periods	<b>516</b>	564	<b>561</b>	608
Franking account impact of dividends declared before issuance of financial report but not recognised at reporting date	<b>(72)</b>	(123)	<b>(72)</b>	(123)
Franking credits available for subsequent financial years based on a tax rate of 30%	<b>444</b>	441	<b>489</b>	485

The balance of the franking account arises from:

- franked income received or recognised as a receivable at the reporting date;
- income tax paid, after adjusting for any franking credits which will arise from the payment of income tax provided for in the financial statements; and
- franking debits from the payment of dividends recognised as a liability at the reporting date.

In accordance with the tax consolidation legislation, the Parent, as the head entity in the tax-consolidated group, has also assumed the benefit of the franking credits available. The consolidated amounts include franking credits that would be available to the Parent if distributable profits of non wholly owned subsidiaries were paid as dividends.

All of the distributions paid in relation to the RPS and the interest payments in relation to the RES for the financial year were fully franked at 30% (2007—fully franked at 30%).

## NOTE 10. INSURANCE CONTRACTS RISK MANAGEMENT

A key risk from operating in the general insurance industry is the exposure to insurance risk arising from underwriting general insurance contracts. The insurance contracts transfer risk to the insurer by indemnifying the policyholders against adverse effects arising from the occurrence of specified uncertain future events. The risk is that the actual amount of claims to be paid in relation to contracts will be different to the amount estimated at the time a product was designed and priced. The Consolidated entity is exposed to this risk because the price for a contract must be set before the losses relating to the product are known. Hence the insurance business involves inherent uncertainty. The Consolidated entity also faces other risks relating to the conduct of the general insurance business including financial risks (refer principally to note 33) and capital risks (refer principally to note 34).

A fundamental part of the overall risk management strategy is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows arising from insurance contracts.

### A. RISK MANAGEMENT FRAMEWORK

The IAG Group has in place a dedicated risk management function responsible for the development and maintenance of the risk management framework. The risk management framework provides reasonable assurance that the IAG Group's risks are being prudently and soundly managed. The framework includes a written Risk Management Strategy (RMS) which is a high level, strategic document intended to describe key elements of the risk management framework. The RMS:

- describes board and management approved parameters (ie risk appetite) within which key decisions must be made;
- is a key input into how regulators understand and assess the approach to risk management; and
- forms the basis of twice yearly declarations provided by executives and senior management to the board.

The framework also includes clearly defined managerial responsibilities and risk management policies, procedures and controls to identify, assess, monitor, report on and mitigate all material risks, financial and non financial, likely to be faced. A review process is in place to ensure that the risk management framework remains effective. Standard & Poor's (S&P) has rated the IAG Group enterprise risk management program to be 'excellent' which is the highest assessment available under S&P classification system.

The RMS is updated annually and approved by the board and resubmitted to APRA after any material changes are made. A three year rolling business plan is also submitted to APRA after each annual review or whenever material changes are made.

The IAG Group has in place a range of monitoring activities assessing both the financial management and risk management aspects of the business. The appointed actuary for each Australian licensed insurer in the IAG Group is required to prepare a Financial Condition Report (FCR) and an Insurance Liability Valuation Report (ILVR). The ILVR is more quantitative in nature than the FCR. Both documents are required to be submitted to APRA annually.

The FCR includes specific items such as an assessment of asset and liability management, reinsurance arrangements and the risk management framework and incorporates recommendations where issues are noted.

The ILVR advises on the valuation of insurance liabilities including specific details such as assumptions and valuation methods. The ILVR is peer reviewed by another actuary (the reviewing actuary) who must not be an employee of the insurer. The reviewing actuary must provide a review report on the ILVR to the insurer's board and management, the appointed auditor and appointed actuary, but not directly to APRA unless specifically requested to do so.

## B. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING INSURANCE RISK

The insurance activities primarily involve the underwriting of risks and the management of claims. A disciplined approach to risk management is adopted in accordance with IAG Group protocols rather than a premium volume or market share orientated approach. It is believed this approach provides the greatest long term likelihood of being able to meet the objectives of all stakeholders; including policyholders, lenders and equity holders.

The risk management activities can be broadly separated into underwriting (acceptance and pricing of risk), claims management, reserving (including investment in data capabilities), and investment management. The objective of these risk management functions is to enhance the longer term financial performance of the overall insurance operations. The policies for the management of risk are applied consistently across the IAG Group with certain allowances made for non Australian jurisdictions. There is a transition period for newly acquired businesses to comply with these policies.

The key policies in place to mitigate risks arising from underwriting insurance contracts include the following:

### I. Acceptance of risk

The IAG Group Underwriting & Pricing Policy Committee (UPPCo) establishes, reviews and monitors the underwriting and pricing standards and strategies. This committee is supported by regional committees that conduct a similar role but focusing on issues specific to each region. Insurance and reinsurance policies are written in accordance with local management practices and regulations within each geographical region taking into account the Consolidated entity's risk tolerance and underwriting standards.

The underwriting of large numbers of uncorrelated individual risks, across a range of classes of insurance businesses, in different geographical regions reduces the variability in overall claims experience. Maximum limits are set for the acceptance of risk both on an individual contract basis and for classes of business and specific risk groupings. Having limited exposure to long-tail classes of business (where the settlement of claims typically takes longer than one year), currently approximately 20% of the business as measured by GWP, limits risk. Management information systems are maintained that provide up to date, reliable data on the risks to which the business is exposed at any point in time. Efforts are made, including plain language policy terms, to ensure there is no misalignment between what policyholders perceive will be paid when a policy is initially sold and what is actually paid when a claim is made.

The charts in section D provide a dissection of GWP by geography and product for the current and prior financial year demonstrating the limited exposure to the additional risks associated with long-tail classes of business.

### II. Pricing

Statistical models are used which combine historical and projected data to calculate premiums and monitor claims patterns for each class of business. The data used includes historical pricing and claims analysis for each class of business as well as current developments in the respective markets and classes of business. All data used is subject to rigorous verification and reconciliation processes. The models incorporate consideration of market conditions.

### III. Reinsurance

The use of reinsurance to limit exposure to large single claims and accumulation of claims that arise from the same event or the accumulation of similar events. This includes the monitoring of reinsurers' credit risk to control exposure to reinsurance counterparty default (refer note 12).

### IV. Claims management

Initial claim determination is managed by claims officers with the requisite degree of experience and competence with the assistance, where appropriate, of a loss adjustor or other party with specialist knowledge. It is IAG Group policy to respond to and settle all genuine claims quickly whenever possible and to pay claims fairly, based on policyholders full entitlements.

## V. Investment management

Assets and liabilities are managed so as to effectively match the maturity of the assets that are held to back insurance liabilities with the expected pattern of claims payments.

## VI. Risk reduction

Reducing the frequency and severity of a claim in the first place by supporting and assisting the community by engaging in risk reduction activities (such as fire prevention strategies, crime prevention programs and motor vehicle safety initiatives), conducting research to reduce future risk in the community, improving risk management understanding in the community, and reducing the environmental footprint of the IAG Group.

## C. TERMS AND CONDITIONS OF INSURANCE CONTRACTS

The terms and conditions attaching to insurance contracts affect the level of insurance risk accepted. Insurance contracts are generally entered into on an annual basis and at the time of entering into a contract all terms and conditions are negotiable or, in the case of renewals, renegotiable. The majority of direct insurance contracts written are entered on a standard form basis. Non standard and long term policies may only be written if expressly approved by a person with appropriate delegated authority. Risks are only assumed where the IAG Group has the skills to analyse, structure and price the risk appropriately. There are no special terms and conditions in any non standard direct insurance contracts that would have a material impact on the financial report. Insurance contracts written in all geographical regions are subject to substantially the same terms and conditions. There are no embedded derivatives that are separately recognised from a host insurance contract.

Individual reinsurance contracts have a greater potential to have a significant financial impact. Refer to note 12 for more information.

## D. CONCENTRATIONS OF INSURANCE RISK

The exposure to concentrations of insurance risk is mitigated by a portfolio diversified into many classes of business across different countries. A high level indication of the spread of insurance risk may be obtained from the segment reporting note.

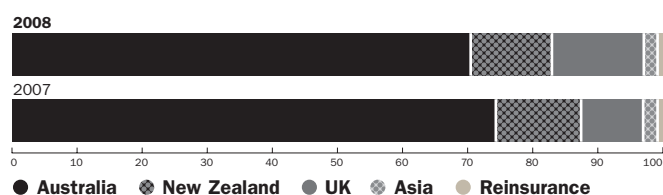
Concentration risk is particularly relevant in the case of natural disasters and other catastrophes which generally result in a concentration of affected policyholders over and above the norm and which constitutes the largest individual potential financial loss. Each year, the Consolidated entity sets its tolerance for concentration risk. Various models are used to estimate the impact of different potential natural disasters and other catastrophes. The tolerance for concentration risk is used to determine the maximum event retention (MER) which is the maximum net exposure to insurance risk determined appropriate for any single event with a given probability. While it is desirable to limit the net exposure, it is reduced to only the maximum event retention limit because the cost of purchasing reinsurance cover to reduce the net exposure further is not considered capital efficient.

The MER limit for a second event during the period of reinsurance cover is generally lower than that for the first event.

The charts below demonstrate the diversity of the IAG Group's operations by both geography (noting that the insurance risks underwritten in Australia are written in all states and territories) and product indicating that the concentration of insurance risk is not significant.

The following bar chart provides a percentage analysis of GWP by region.

### CONSOLIDATED

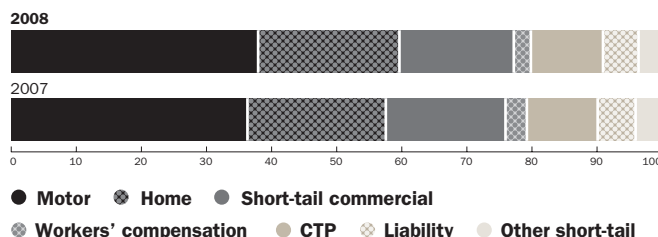


● Australia ● New Zealand ● UK ● Asia ● Reinsurance

The main reason for the increase in relative size of the GWP for the UK is because that operation was acquired during the comparative period and so the comparative figures do not include a full year's premiums.

The following bar chart provides a percentage analysis of GWP by product.

### CONSOLIDATED



Specific processes for monitoring identified key concentrations are set out below:

RISK	SOURCE OF CONCENTRATION	RISK MANAGEMENT MEASURES
An accumulation of risks arising from a natural peril	Insured property concentrations	Accumulation risk modelling, reinsurance protection
A large property loss	Fire or collapse affecting one building or a group of adjacent buildings	Maximum acceptance limits, property risk grading, reinsurance protection
Multiple liability retentions being involved in the same event	Response by a multitude of policies to the one event	Purchase of reinsurance clash protection

As an example of the impact of a potential catastrophe on the Consolidated entity, the exposure to an earthquake in Sydney with associated claims costs of \$4 billion would be limited to an estimated \$118 million (based on the current first event MER limit for natural peril).

For concentrations of risk relating to the reinsurance contracts refer to note 12.

## E. CREDIT RISK

Financial assets or liabilities arising from insurance contracts are presented on the balance sheet at the amount that best represents the maximum credit risk exposure at reporting date.

The credit risk relating to insurance contracts relates primarily to:

- premium receivable which is due from individual policyholders and intermediaries (brokers, agents and business partners). The brokers and agents collect premium from policyholders and remit the monies to the insurer in accordance with contractual arrangements being generally within 90 days for brokers and 30–60 days for agents. Clearly defined credit policies are applied in dealing with these counterparties. The recoverability of premium receivable is assessed and provision is made for impairment based on objective evidence and having regard to past default experience. Concentrations of credit risk are considered low due to the large number of customers/corporate partners comprising the customer base and their dispersion across different industries and geographies. For more detailed credit risk information for the premium receivable balance refer to the receivables note; and
- reinsurance recoveries receivable which are discussed further in note 12.

For information regarding the management of credit risk refer to the financial risk management note.

## F. LIQUIDITY RISK

Underwriting insurance contracts exposes the IAG Group to liquidity risk through the obligation to make payments of unknown amount on unknown dates. Information regarding the maturity of the net discounted outstanding claims liability is provided in note 11.F. For information regarding the management of liquidity risk refer to the financial risk management note.

## G. INTEREST RATE RISK

The underwriting of general insurance contracts creates exposure to the risk that interest rate movements may materially impact the value of the outstanding claims liability. Movements in interest rates impact the determination of the liability through the selection of discount rates. Discounting the liability is in effect allowing for future investment earnings on the assets held to back the insurance liabilities. The funds held to pay outstanding claims are invested principally in fixed interest securities matched to the settlement durations of the outstanding claims. Movements in market interest rates affect the value of the fixed interest securities. Hence movements in interest rates should have minimal impact on the insurance profit for a year due to movements in investment income on assets backing insurance liabilities offsetting the impact of movements in discount rates on the claims liabilities other than the changes in credit spread on fixed interest securities. The fixed interest securities are expected to be held to maturity and so the unrealised losses from the widening credit spread are expected to reverse upon maturity of these securities.

## H. CURRENCY RISK

The IAG Group is an international general insurance group underwriting insurance contracts in Australia, NZ, UK and Asia in operating currencies. The translation of the assets, liabilities, income and expenses of foreign operations with a functional currency other than the Australian dollar exposes the IAG Group to currency risk. This risk is principally managed through the matching of the currency in which assets held to back insurance liabilities are invested to the currency in which the related insurance contracts are written. For additional information regarding the management of currency risk refer to the financial risk management note.

## I. REINSURANCE RISK

For information regarding outwards reinsurance refer to notes 12.E and 12.F.

Inwards reinsurance or retrocession is accepted from various subsidiaries within the IAG Group but these transactions are eliminated upon consolidation. Inwards reinsurance or retrocession from entities not controlled by the IAG Group can only be accepted for exposures that are consistent with the organisation's risk appetite and within limits approved by the board. The Alba group, a subsidiary group of IAG, can only accept inwards reinsurance on a 'single risk' basis (ie it provides facultative reinsurance) and therefore is provided full details of each risk from the cedant.

## J. REGULATORY RISK

The general insurance operations of the IAG Group are subject to regulatory supervision in the jurisdictions in which they operate. The regulatory frameworks continue to develop in a number of those jurisdictions but at a minimum include requirements in relation to reserving, capital and the payment of dividends. The IAG Group works closely with regulators and monitors regulatory

developments across its international operations to assess any potential impact on the ongoing ability to meet the various regulatory requirements.

## K. OPERATIONAL RISK

Operational risk is the risk of financial loss (including lost opportunities) resulting from external events and/or inadequate or failed internal processes, people and systems to perform as required. Operational risk can have overlaps with all of the other risk categories. When controls fail, operational risks can cause damage to reputation, have legal or regulatory implications or can lead to financial loss. The IAG Group cannot expect to eliminate all operational risks, but by initiating a rigorous control framework and by monitoring and responding to potential risks, the IAG Group is able to manage risks.

The IAG Group RMS includes consideration of operational risk. Operational risk is identified and assessed on an ongoing basis and the capital management strategy includes consideration of operational risk. Management and staff are responsible for identifying, assessing and managing operational risks in accordance with their roles and responsibilities. The IAG Group has an internal audit function which monitors processes and procedures surrounding operational risk.

## L. ACQUISITION RISK

The Consolidated entity's strategy of international expansion exposes it to additional risks. Acquisition risks are principally managed by the Consolidated entity's controls over the due diligence and subsequent integration process. The Consolidated entity mitigates this risk as much as possible by performing due diligence appropriate to its risk appetite for each target entity and by using dedicated teams to manage the integration process.

## M. LLOYD'S SYNDICATES

The IAG Group participates in three Lloyd's syndicates being Equity Red Star Motor Syndicate 218 (64%), Syndicate 4455 (100%—classified as held for sale at reporting date) and Syndicate 1208 (100%—in run off).

Every Lloyd's member is required to hold capital at Lloyd's which is held in trust and known as FAL. These funds are intended primarily to cover circumstances where syndicate assets prove insufficient to meet participating members' underwriting liabilities and members fail to meet those liabilities when called upon to do so. The minimum level of FAL is determined by the Individual Capital Assessment (ICA) conducted by each syndicate's managing agency and approved by Lloyd's. The ICA is based on local regulatory requirements and resource criteria and the level of FAL has regard to a number of factors including the nature and amount of risk to be underwritten by the member and the assessment of the insurance, credit, liquidity, market, operation and Group risks in respect of business that has been underwritten as well as the systems and controls that exist both with the syndicate and its managing agency.

In addition, Lloyd's has a Central Fund for which contributions are collected from all members on an annual basis. The purpose of this fund is to pay legitimate claims incurred by syndicates where members are unable to meet their obligations and their FAL have been exhausted. All members at Lloyd's have joint and several liability and, in extreme cases, Lloyd's can also require 'special contributions' from members at the discretion of the Council of Lloyd's to maintain the Central Fund. Lloyd's has an A+ Strong rating issued by S&P.

## NOTE 11. CLAIMS

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>A. CLAIMS EXPENSE, NET</b>		
Direct business	<b>5,149</b>	4,464
Inwards reinsurance business	<b>6</b>	10
<b>Net claims expense</b>	<b>5,155</b>	4,474

### B. CLAIMS DEVELOPMENT

#### I. Net claims expense recognised in the income statement

Given the uncertainty in establishing the outstanding claims liability, it is likely that the final outcome will be different from the original liability established. Claims development refers to the financial adjustment in the current period relating to claims incurred in previous periods because of new and more up to date information that has become available and to reflect changes in inflation and discount assumptions. The information is presented on an accident year basis (claims are related to the period in which the insured event occurred and not the period in which the policy was underwritten).

	CONSOLIDATED					
	2008			2007		
	Current year \$m	Prior years \$m	Total \$m	Current year \$m	Prior years \$m	Total \$m
Gross claims—undiscounted	<b>6,602</b>	<b>(970)</b>	<b>5,632</b>	6,257	(886)	5,371
Discount	<b>(328)</b>	<b>289</b>	<b>(39)</b>	(347)	321	(26)
Gross claims—discounted	<b>6,274</b>	<b>(681)</b>	<b>5,593</b>	5,910	(565)	5,345
Reinsurance and other recoveries—undiscounted	<b>(745)</b>	<b>299</b>	<b>(446)</b>	(1,002)	109	(893)
Discount	<b>32</b>	<b>(24)</b>	<b>8</b>	51	(29)	22
Reinsurance and other recoveries—discounted	<b>(713)</b>	<b>275</b>	<b>(438)</b>	(951)	80	(871)
<b>Net claims expense</b>	<b>5,561</b>	<b>(406)</b>	<b>5,155</b>	4,959	(485)	4,474

Current year claims relate to claim events that occurred in the current financial year. Prior year claims relate to a reassessment of the claim events that occurred in all previous financial periods. A major component of the prior year movement is the release of risk margins in respect of claims payments during the year. In order to maintain strong reserves, much of this release is transferred to current accident year reserves for which the development of claims is less mature and there is much greater uncertainty attaching to the ultimate cost of claims. Another factor contributing to the prior year claims development in the current financial year is releases in liability portfolios.

## II. Net outstanding claims liability recognised on the balance sheet

The following table shows the development of the estimated net undiscounted outstanding claims liability relative to the current estimate of ultimate claims costs for the seven most recent accident years as estimated at each reporting date. The table also shows a reconciliation of the net discounted liability for the seven most recent accident years to the gross outstanding claims liability on the balance sheet.

	CONSOLIDATED							Total \$m
	Accident year							
	2002 \$m	2003 \$m	2004 \$m	2005 \$m	2006 \$m	2007 \$m	2008 \$m	
<b>NET ULTIMATE CLAIMS COSTS</b>								
Probability of adequacy of outstanding claims liability as at reporting date	<b>90%</b>	<b>90%</b>	<b>90%</b>	<b>93%</b>	<b>90%</b>	<b>90%</b>	<b>90%</b>	
<b>Development</b>								
At end of accident year	<b>2,323</b>	<b>3,696</b>	<b>3,893</b>	<b>4,028</b>	<b>4,389</b>	<b>5,583</b>	<b>5,317</b>	
One year later	<b>2,236</b>	<b>3,387</b>	<b>3,541</b>	<b>3,776</b>	<b>4,117</b>	<b>5,355</b>		
Two years later	<b>2,159</b>	<b>3,276</b>	<b>3,521</b>	<b>3,681</b>	<b>3,996</b>			
Three years later	<b>2,109</b>	<b>3,192</b>	<b>3,451</b>	<b>3,600</b>				
Four years later	<b>2,070</b>	<b>3,090</b>	<b>3,399</b>					
Five years later	<b>2,021</b>	<b>3,079</b>						
Six years later	<b>2,019</b>							
Cumulative development	<b>(304)</b>	<b>(617)</b>	<b>(494)</b>	<b>(428)</b>	<b>(393)</b>	<b>(228)</b>	<b>n/a</b>	
Cumulative development as a percentage of original reserves	<b>(13.1%)</b>	<b>(16.7%)</b>	<b>(12.7%)</b>	<b>(10.6%)</b>	<b>(9.0%)</b>	<b>(4.1%)</b>	<b>n/a</b>	
Current estimate of net ultimate claims cost	<b>2,019</b>	<b>3,079</b>	<b>3,399</b>	<b>3,600</b>	<b>3,996</b>	<b>5,355</b>	<b>5,317</b>	
Cumulative payments	<b>(1,888)</b>	<b>(2,849)</b>	<b>(3,054)</b>	<b>(3,031)</b>	<b>(3,211)</b>	<b>(3,770)</b>	<b>(2,843)</b>	
Net undiscounted outstanding claims liability for the seven most recent accident years	<b>131</b>	<b>230</b>	<b>345</b>	<b>569</b>	<b>785</b>	<b>1,585</b>	<b>2,474</b>	<b>6,119</b>
Discount to present value	<b>(36)</b>	<b>(46)</b>	<b>(54)</b>	<b>(85)</b>	<b>(123)</b>	<b>(214)</b>	<b>(266)</b>	<b>(824)</b>
Net discounted outstanding claims liability for the seven most recent accident years	<b>95</b>	<b>184</b>	<b>291</b>	<b>484</b>	<b>662</b>	<b>1,371</b>	<b>2,208</b>	<b>5,295</b>
<b>Reconciliation</b>								
Claims handling expense (inclusive of risk margin)								<b>394</b>
Net discounted outstanding claims for accident years 2001 and prior								<b>193</b>
Net outstanding claims liability for accident years prior to acquisition year of 2003 for CGU Insurance Group								<b>506</b>
Net outstanding claims liability for inwards reinsurance run off relating to accident years 2002 and prior								<b>28</b>
								<b>6,416</b>
Gross outstanding claims liability on the balance sheet								<b>7,827</b>
Reinsurance and other recoveries on outstanding claims								<b>(1,043)</b>
GST recoverable on net outstanding claims liability								<b>(368)</b>
Net outstanding claims liability								<b>6,416</b>

Favourable development of claims provisions has given rise to the release of risk margins, and in some cases central estimates, as the ultimate claims costs were settled or became more certain.

Conditions and trends that have affected the development of the liabilities in the past may, or may not, occur in the future, and accordingly, conclusion about future results may not necessarily be derived from the information presented in the tables above.

Short-tail claims are normally reported soon after the incident and are generally settled within months following the reported incident. Hence any development on short-tail claims is normally limited to the year the incident occurred and the following year. For long-tail classes of business it can be several years before a claim is reported and settled, hence the original estimation involves greater uncertainty and so inherently there is more likely to be greater disparity between the original and current estimates. It is for these long-tail classes of business that the development of the outstanding claims liability generally occurs over a number of years.

Where an entity or business has been acquired that includes outstanding claims liabilities, the claims costs for the acquired businesses are included in the claims development table from

and including the year of acquisition. Development on the liabilities of such acquired businesses relating to accident years prior to the year of acquisition is included in the table in the year of acquisition (except for CGU Insurance Group, refer to the previous table).

The Consolidated entity conducts general insurance business in local currencies in foreign countries. The gross outstanding claims liability for international operations outside Australia includes contracts written in NZ dollar, British pound and Thai Baht. The translation of the outstanding claims liabilities denominated in foreign currencies into Australian dollars over a number of reporting dates, includes exchange rate movements that have no bearing on the development of the measurement of the underlying claims. All claims liabilities not denominated in Australian dollars have been converted to Australian dollars using constant exchange rates being the rates as at the current reporting date to eliminate this factor and aid comparability.

The claims development table disclosed each period will not be directly reconcilable to the tables presented in previous periods with the key difference being the application of current reporting date exchange rates to the claims liability relating to all accident years.

**C. COMPOSITION OF OUTSTANDING CLAIMS LIABILITY—GROSS, DISCOUNTED**

Expected future payment for claims incurred:

Central estimate	<b>6,194</b>	6,775
Claims handling costs	<b>332</b>	413
Risk margin	<b>1,301</b>	1,374
Outstanding claims liability	<b>7,827</b>	8,562

The outstanding claims liability includes \$4,725 million (2007—\$5,205 million) which is expected to be settled after more than 12 months from reporting date. The gross and net outstanding claims liability at the financial reporting date relating to the inwards reinsurance business was \$285 million (2007—\$384 million) and \$189 million (2007—net \$255 million) respectively.

**D. RECONCILIATION OF MOVEMENTS IN OUTSTANDING CLAIMS LIABILITY**

Outstanding claims liability at the beginning of the financial year—gross, discounted	<b>8,562</b>	6,916
Reinsurance and other recoveries receivable on outstanding claims at the beginning of the financial year (refer note 12.A)	<b>(1,346)</b>	(908)
GST recoverable on net outstanding claims liability at beginning of the financial year	<b>(417)</b>	(278)
Net outstanding claims liability at the beginning of the year	<b>6,799</b>	5,730
Risk margin at the beginning of the year	<b>(1,068)</b>	(1,042)
Net central estimate at the beginning of the year	<b>5,731</b>	4,688
Claims incurred in the current year	<b>6,268</b>	5,811
Reinsurance and other recoveries in the current year	<b>(982)</b>	(924)
Claims costs paid	<b>(6,428)</b>	(5,037)
Reinsurance and other recoveries received	<b>1,000</b>	486
Unwind of the discount	<b>240</b>	222
Development on prior year net central estimate	<b>(284)</b>	(249)
Movement in discounting	<b>(20)</b>	(63)
Net foreign exchange movement	<b>(120)</b>	(23)
Net movement for acquired businesses	<b>—</b>	820
Net central estimate at the end of the year	<b>5,405</b>	5,731
Risk margin at the end of the year	<b>1,011</b>	1,068
Net outstanding claims liability at the end of the year	<b>6,416</b>	6,799
Reinsurance and other recoveries receivable on outstanding claims at the end of the financial year (refer note 12.A)	<b>1,043</b>	1,346
GST recoverable on net outstanding claims liability at end of the financial year	<b>368</b>	417
Outstanding claims liability at the end of the financial year—gross, discounted	<b>7,827</b>	8,562

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>E. DISCOUNTING OF NET OUTSTANDING CLAIMS LIABILITY</b>		
Net outstanding claims liability—undiscounted	<b>7,666</b>	8,250
Discount to present value	<b>(1,250)</b>	(1,451)
Net outstanding claims liability—discounted	<b>6,416</b>	6,799

#### F. MATURITY ANALYSIS

A maturity analysis of the estimated net discounted outstanding claims liability based on the remaining term to payment at reporting date is provided in the table below. This maturity profile is a key tool used in the investment of assets backing insurance liabilities in accordance with the policy of matching the maturity profile of the assets with the estimated pattern of claims payments.

Within 1 year or less	<b>2,245</b>	2,312
Within 1 to 2 years	<b>1,147</b>	1,244
Within 2 to 3 years	<b>853</b>	918
Within 3 to 4 years	<b>597</b>	643
Within 4 to 5 years	<b>393</b>	408
Over 5 years	<b>1,181</b>	1,274
Total	<b>6,416</b>	6,799

#### G. CENTRAL ESTIMATE AND RISK MARGIN

##### I. Reporting date values

The percentage risk margin applied to the present value of expected future payments for claims incurred net of expected recoveries on outstanding claims liability and expected input tax credit

	<b>18.7</b>	18.6
The probability of adequacy of the risk margin	<b>90</b>	90

The high level of professional judgement applied by actuaries in calculating the outstanding claims liability, and hence the probability of adequacy of the liability, means that for a certain probability of adequacy, different risk margins may be applied for similar risks, which is important in considering the overall reserving strength of an insurer.

##### II. Process

The outstanding claims liability is determined based on three building blocks being:

- an estimate of the future cash flows;
- discounting for the effect of the time value of money; and
- adding a risk margin for uncertainty.

##### a. FUTURE CASH FLOWS

The estimation of the outstanding claims liability is based on a variety of actuarial techniques that analyse experience, trends and other relevant factors. The claims estimation process commences with the actuarial projection of the future payments relating to claims incurred at the reporting date. The expected future payments include those in relation to claims reported but not yet paid or not yet paid in full, claims IBNER, claims IBNR and the anticipated direct and indirect claims handling costs.

The estimation process involves using the Consolidated entity's specific data, relevant industry data and more general economic data. Each class of business is usually examined separately and the process involves consideration of a large number of factors including the risks to which the business is exposed at a point in time, claim frequencies and average claim sizes, historical trends in the incidence and development of claims reported and finalised, legal, social and economic factors that may impact upon each class of business as well as the key actuarial assumptions set out in section H, and the impact of reinsurance and other recoveries (refer note 12).

Different actuarial valuation models are used for different claims types with the results then being aggregated. This aggregation of results enhances the valuation process by allowing the use of

the model best suited to particular claims types. The selection of the appropriate model takes into account the characteristics of a class of business and the extent of development of each past accident period.

The different components of the outstanding claims liability are subject to different levels of uncertainty. The estimation of the cost of claims reported but not yet paid or not yet paid in full is made on a case by case basis by claims personnel having regard to the facts and circumstances of the claim as reported, any information available from assessors and information on the cost of settling claims with similar characteristics in previous periods. A further amount, which may be a reduction, is included for IBNER on the basis of past experience with the accuracy of initial claims estimates. With IBNR, the estimation is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified, as no information is currently available about the claim. IBNR claims may often not be apparent to the insured until many years after the events giving rise to the claim have occurred. In calculating the estimated cost of unpaid claims a variety of estimating techniques are used, generally based on statistical analysis of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience. Allowance is made, however, for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims.

Large claims impacting each relevant business class are generally assessed separately, being measured on a case by case basis or projected separately in order to allow for the possible distortive effect of the development and incidence of these large claims. For new products the growing experience with the development of claims is closely monitored.

Reserves are not established for catastrophes in advance of such events and so these events may cause volatility in the results for a period and in the levels of the outstanding claims liability, subject to the effects of reinsurance recoveries.

## b. DISCOUNTING

A projection of future claims payments, both gross and net of reinsurance and other recoveries, is undertaken. Projected future claims payments and associated claims handling costs are discounted to a present value as required using appropriate risk free discount rates.

The valuation of the outstanding claims liability for the major portfolios is primarily performed by actuaries who do not have any direct role in the pricing function so as to ensure that an objective and independent assessment of the outstanding claims liability is maintained on a regular basis.

## c. RISK MARGIN

The central estimate of the outstanding claims liability is an estimate which is intended to contain no deliberate or conscious over or under estimation and is commonly described as providing the mean of the distribution. It is considered appropriate for the measurement of the claims liability to represent a higher degree of certainty regarding the sufficiency of the liability over time, and so a risk margin is added to the central estimate. The risk margin refers to the amount by which the liability recognised in the financial statements is greater than the actuarial central estimate of the liability. The risk margin added to the central estimate increases the probability that the net outstanding claims liability will ultimately prove to be adequate.

Risk margins are held to allow for uncertainty surrounding the outstanding claims liability estimation process. Potential uncertainties include those relating to the actuarial models and assumptions, the quality of the underlying data used in the models, general statistical uncertainty, the general insurance environment, scope for and experience of political intervention (particularly for long-tail classes) and the impact of legislative reform. Uncertainty from the above sources is examined for each class of business and expressed as a volatility of the net central estimate. The volatility for each class is derived after consideration of stochastic modelling and benchmarking to industry analysis. Certain product classes may be subject to the emergence of new types of latent claims and such uncertainties are considered when setting the risk margin appropriate for those classes.

The long-tail classes of business generally have the highest volatilities of the insurance classes as the longer average time for claims to be reported and settled allows more time for sources of uncertainty to emerge. Short-tail classes generally have lower levels of volatility.

The risk margin is set using a probability of adequacy approach. The risk margin required to provide a given probability of adequacy for two or more classes of business or for two or more geographic locations combined is likely to be less than the sum of the risk margins for the individual classes. This reflects the benefit of diversification in general insurance. Two key components of the valuation methodology are the selection of coefficients of variation (CoV) for each class of business and the correlation factors between each pair of classes of business. The CoV is a measure of the volatility of a class of business and is generally greater for long-tail classes when compared to short-tail classes because of the increased uncertainty relating to the longer time until settlement of claims. The correlation factors are a measure of the correlation between pairs of business classes and measure the strength of the relationship of movements in that pair of class liabilities. The higher the correlation between two classes of business, the more likely it is that a negative outcome in one class will correspond to a negative outcome in the other class. The correlations adopted are normally derived from industry analysis, historical experience and the judgement of experienced and qualified actuaries.

The risk margin is set taking into account the correlations assessed between the outstanding claims liabilities arising from the various forms of business underwritten by the different entities within the Consolidated entity. The Group actuary estimates the overall risk margin on a diversified basis, taking into account the diversification benefit arising from combining all classes of business within the Consolidated entity. Allowance is made for diversification between portfolios, between entities and between geographies. The assumptions regarding uncertainty for each class are applied to the net central estimates, and the results are aggregated. The aggregated central estimate plus the risk margin calculated on a diversified basis forms the outstanding claims liability. The policy is for the risk margin to be set so as to provide an overall probability of adequacy for the outstanding claims liability at 90% or greater which has been determined having regard to the inherent uncertainty in the central estimate and the prevailing market environment.

## H. ACTUARIAL ASSUMPTIONS

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

	Australia insurance	New Zealand insurance	United Kingdom insurance	Asia insurance	CONSOLIDATED Reinsurance operations
<b>2008</b>					
Weighted average terms to settlement	<b>4.5 years</b>	<b>0.5 years</b>	<b>1.7 years</b>	<b>1.0 years</b>	<b>1.3 years</b>
Inflation rate	<b>3.0%–4.8%</b>	<b>3.4%</b>	<b>3.0%–4.0%</b>	<b>0.0%</b>	<b>3.5%–4.0%</b>
Superimposed inflation rate	<b>2.5%–5.0%</b>	<b>4.0%</b>	<b>3.5%–4.0%</b>	<b>0.0%</b>	<b>2.0%–3.5%</b>
Discount rate	<b>5.9%–7.1%</b>	<b>8.3%</b>	<b>1.6%–5.4%</b>	<b>0.0%</b>	<b>5.9%–7.1%</b>
Claims handling expense ratio	<b>5.3%</b>	<b>5.0%</b>	<b>3.1%</b>	<b>0.8%</b>	<b>1.9%</b>
<b>2007</b>					
Weighted average terms to settlement	4.1 years	0.4 years	1.7 years	0.4 years	0.6 years
Inflation rate	3.3%–4.5%	3.1%	4.0%	0.0%	0.0%
Superimposed inflation rate	2.5%–8.0%	4.0%	3.0%	0.0%	0.0%
Discount rate	5.7%–6.6%	6.7%–7.9%	4.3%–6.0%	0.0%	0.0%
Claims handling expense ratio	5.9%	5.8%	4.3%	2.7%	1.4%

## **I. PROCESS USED TO DETERMINE ASSUMPTIONS**

The process for establishing the outstanding claims liability involves extensive consultation with internal and external actuaries, claims managers, underwriters and other senior management. One of the key elements of the valuation processes is rigorous data verification and reconciliation.

A description of the key assumptions and the processes used to determine those assumptions is provided below:

### **I. Weighted average term to settlement**

The weighted average term to settlement relates to the expected payment pattern for claims (inflated and undiscounted). The payment pattern is important in considering the timing of future cash outflows and hence discounting and in managing the assets backing insurance liabilities to support the outflows. The future cash flow pattern is estimated separately for each class of business based on historic settlement patterns and estimated future settlement patterns. The weighted average term to settlement, while not itself an assumption, provides a summary indication of the future cash flow pattern.

### **II. Inflation rate**

Insurance costs are subject to inflationary pressures. Economic inflation assumptions are set by reference to current economic indicators. For example, for the motor and property classes, claims costs are related to the inflationary pressures of the materials and goods insured as well as labour costs to effect repairs.

### **III. Superimposed inflation rate**

Superimposed inflation occurs due to non economic effects such as court settlements increasing at a faster rate than wages or CPI inflation and from social and environmental pressures. Where appropriate, the effect of superimposed inflation is made either in the underlying model for the class of business, for example where the past pattern of development in claims cost are used to estimate future claims cost development factors, or by including a specific superimposed inflation rate assumption designed to allow for all other claims inflation not modelled. The level of superimposed inflation is estimated after considering both the superimposed inflation present in the portfolio and industry superimposed inflation trends.

### **IV. Discount rate**

Because the outstanding claims liability represents payments that will be made in the future, they are discounted to reflect the time value of money effectively recognising that the assets held to back insurance liabilities will earn a return during that period. Discount rates represent a risk free rate derived from market yields on government securities.

## **V. Claims handling expense ratio**

In respect of claims incurred up to the reporting date, it is known that costs will be incurred in the management of claims to finalisation. An estimate of these costs is incorporated into the outstanding claims liability using the claims handling expense ratio. The ratio incorporates assumptions about the future costs to be incurred based on past experience of such costs for each class of business.

## **J. THE EFFECT OF CHANGES IN ASSUMPTIONS**

### **I. General impact of changes**

Sensitivity analyses are conducted to quantify the exposure to changes in the key underlying variables. The valuations included in the reported results are calculated using certain assumptions about these variables as disclosed above. The movement in any key variable will impact the financial position and performance for a period. The information below describes how a change in each assumption will affect claims liabilities and provides an analysis of the sensitivity of the net outstanding claims liability to changes in these assumptions.

#### **a. WEIGHTED AVERAGE TERM TO SETTLEMENT**

A decrease in the average term to settlement would reflect claims being paid sooner than anticipated and so increase the claims expense. Note this sensitivity only extends or shortens the term of the payments assumed in the valuation, without changing the total amount of the payments.

#### **b. INFLATION AND SUPERIMPOSED INFLATION RATES**

Expected future payments are inflated to take account of inflationary increases. An increase or decrease in the assumed levels of inflation would have a corresponding impact on claims expense, with particular reference to long-tail business. The inflation rate sensitivity is provided as an indicator of the impact of inflation on the portfolio, whether it be from economic inflation, inflation implied from the use of the past pattern of development in claims cost in the valuation method or inflation related to a specific superimposed inflation rate specified.

#### **c. DISCOUNT RATE**

The outstanding claims liability is calculated by reference to expected future payments. These payments are discounted to adjust for the time value of money. An increase or decrease in the assumed discount rate will have an opposite impact on total claims expense.

#### **d. CLAIMS HANDLING EXPENSE RATIO**

An increase in the ratio reflects an increase in the estimate for the internal costs of administering claims which will increase the outstanding claims liability.

## II. Sensitivity analysis of changes

The impact of changes in key outstanding claims variables is summarised below. Each change has been calculated in isolation of the other changes and each change shows the relevant impact assuming that there is no change to:

- any of the other variables—this is considered unlikely as, for example, an increase in interest rates is normally accompanied by an increase in the rate of inflation; and
- the probability of adequacy—the directors and management have set an internal target for the probability of adequacy for the outstanding claims liability. It is likely that if, for example, the central estimate was to increase by 5%, at least part of the increase would result in a decrease in the probability of adequacy rather than being reflected wholly in the net outstanding claims liability as inferred below.

An economic assumption may be relevant to only a part of a business segment and so a large change in the assumption may have only a small financial impact on the business segment. It is not possible to quantify the sensitivity of certain assumptions such as legislative changes or uncertainty in the estimation process.

The impact on the net outstanding claims liability is disclosed for each of the key assumptions. The movements are stated in absolute terms where the base assumption is a percentage, for example, if the base inflation rate assumption was 3.5%, a 1% increase would mean assuming a 4.5% inflation rate. All movements are recognised directly through profit.

Variable	Movement in variable	CONSOLIDATED				
		Australia insurance \$m	New Zealand insurance \$m	United Kingdom insurance \$m	Asia insurance \$m	Reinsurance operations \$m
<b>2008</b>						
Weighted average term to settlement	<b>+10%</b>	<b>(110)</b>	<b>(1)</b>	<b>(6)</b>	–	<b>(1)</b>
	<b>–10%</b>	<b>113</b>	<b>1</b>	<b>6</b>	–	<b>1</b>
Inflation rate	<b>+1%</b>	<b>149</b>	<b>–*</b>	<b>12</b>	–	<b>1</b>
	<b>–1%</b>	<b>(138)</b>	<b>–*</b>	<b>(12)</b>	–	<b>(1)</b>
Discount rate	<b>+1%</b>	<b>(132)</b>	<b>(1)</b>	<b>(12)</b>	–	<b>–*</b>
	<b>–1%</b>	<b>146</b>	<b>1</b>	<b>12</b>	–	<b>–*</b>
Claims handling expense ratio	<b>+1%</b>	<b>59</b>	<b>2</b>	<b>6</b>	<b>–*</b>	<b>–*</b>
	<b>–1%</b>	<b>(59)</b>	<b>(2)</b>	<b>(6)</b>	<b>–*</b>	<b>–*</b>
<b>2007</b>						
Weighted average term to settlement	+10%	(104)	–	(9)	–*	(1)
	–10%	107	–	9	–*	1
Inflation rate	+1%	148	1	15	–*	–
	–1%	(135)	(1)	(15)	–*	–
Discount rate	+1%	(131)	(1)	(15)	–*	–*
	–1%	147	1	15	–*	–*
Claims handling expense ratio	+1%	67	2	10	1	–*
	–1%	(67)	(2)	(10)	(1)	–*

\* Rounds to zero.

The movements in the net outstanding claims liability would have an opposite net impact on the profit or loss before tax for a year.

## NOTE 12. REINSURANCE AND OTHER RECOVERIES ON OUTSTANDING CLAIMS

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>A. REINSURANCE AND OTHER RECOVERIES RECEIVABLE ON OUTSTANDING CLAIMS</b>		
Reinsurance recoveries receivable on outstanding claims	679	970
Other recoveries receivable on outstanding claims	364	376
<b>Reinsurance and other recoveries receivable on outstanding claims</b>	<b>1,043</b>	<b>1,346</b>

The carrying value of reinsurance and other recoveries receivable on outstanding claims includes \$718 million (2007—\$814 million) which is expected to be settled more than 12 months from reporting date. Reinsurance and other recoveries on paid claims are included in trade and other receivables.

### B. ACTUARIAL ASSUMPTIONS

Reinsurance and other recoveries on outstanding claims are computed using actuarial assumptions and methods similar to that used for outstanding claims (refer note 11.H). The outstanding claims liability is calculated gross of any reinsurance recoveries and a separate estimate is then made of the amounts that are expected to be recoverable from reinsurers based upon the gross provisions. Estimates of potential reinsurance recoveries are made on an individual claim basis for reported claims. The recoverability of these assets is assessed on a periodic basis to ensure that the balance is reflective of the amounts that will ultimately be received.

### C. THE EFFECT OF CHANGES IN ASSUMPTIONS

The effect of changes in assumptions on the net outstanding claims liability, which incorporates the reinsurance and other recoveries receivable on outstanding claims, is disclosed in note 11.J.

### D. SIGNIFICANT RISKS

#### I. Credit risk

Reinsurance arrangements mitigate insurance risk but expose the IAG Group to credit risk. Reinsurance is placed with companies based on an evaluation of the financial strength of the reinsurers, terms of coverage, and price. The IAG Group has clearly defined credit policies for the approval and management of credit risk in relation to reinsurers. The Consolidated entity monitors the financial condition of its reinsurers on an ongoing basis and periodically reviews the reinsurers' ability to fulfil their obligations to the Consolidated entity under respective existing and future reinsurance contracts. Some of the reinsurers are domiciled outside of the jurisdictions in which the Company operates and so there is the potential for additional risk such as country risk and transfer risk.

The level and quality of reinsurance protection is an important element in understanding the financial strength of an insurer. There is limited value in purchasing reinsurance protection from a reinsurer when that reinsurer may be unable to meet its payment obligations upon submission of a claim. The longer the tail of the direct insurance, the more important is the credit rating of the reinsurer.

It is IAG Group policy to only deal with reinsurers with credit ratings of at least S&P BBB+ (or other rating agency equivalent) without collateralisation, with exposure to BBB+ and below limited to 1.5% of the capital base. The principle is that the IAG Group does not trade off price for risk below this minimum acceptable level. For some newly acquired businesses a transition period is used for implementation of this policy. Where the credit rating of a reinsurer falls below the threshold level during the period of risk, there exists a contractual right to replace the counterparty. Some of the reinsurance protection is purchased on a 'collateralised' basis, where reinsurers have deposited funds equivalent to their participation in a trust fund. The counterparty credit profile of the catastrophe reinsurance program currently stands with more than 70% of the limit for the 2008 program with parties rated by S&P as AA- or better. For long-tail reinsurance arrangements more than 94% of the program is placed with parties rated by S&P as AA- or better.

Having reinsurance protection with strong reinsurers also benefits the Consolidated entity in its regulatory capital calculations. The risk charges vary with the grade of the reinsurers such that higher credit quality reinsurance counterparties incur lower APRA regulatory capital charges.

The following table provides information regarding the credit risk relating to the reinsurance and other recoveries on outstanding claims balance based on S&P counterparty credit ratings. These rating allocations relate to balances accumulated from reinsurance programs in place over a number of years and so will not necessarily align with the rating allocations noted above for the current program.

	CONSOLIDATED	
	2008 % of total	2007 % of total
RATING		
AAA	2	5
AA	63	42
A	26	44
BBB and lower/unrated	9	9
	<b>100</b>	<b>100</b>

Because of the nature of the amounts being estimates, the credit risk is incorporated into the estimate rather than being presented separately as a provision for impairment.

## II. Concentrations of credit risk

Reinsurance contracts are entered into with a number of reinsurers from different countries. There is some concentration of credit risk within the reinsurance recoveries receivable balance due to the nature of the reinsurance market and the preference to reinsure with companies that have stronger credit ratings, as well as some counterparties having accumulated balances from reinsurance programs in place over a number of years. The level of reinsurance cover entered into with individual reinsurers is sufficiently diversified so as to avoid a concentration charge in the regulatory capital calculation (refer note 34).

## III. Maturity analysis

Information regarding the maturity of the reinsurance and other recoveries on outstanding claims is incorporated into the maturity analysis in note 11.F which is provided on a net basis.

## IV. Currency risk

The majority of the reinsurance program is denominated in Australian dollars and so there is insignificant currency risk arising from the reinsurance premiums payable or reinsurance recoveries receivable.

## E. RISK MANAGEMENT

The IAG Group has in place a dedicated risk management function responsible for the development and maintenance of the risk management framework. The framework includes a written REMS which sets out key elements of the reinsurance management framework, processes for setting and monitoring the MER, processes for selecting, implementing, monitoring and reviewing reinsurance arrangements and identification, roles and responsibilities of those charged with managerial responsibility for the reinsurance management framework. The REMS is in accordance with the prudential standards issued by APRA. The REMS is updated annually and approved by the board.

The REMS identifies the IAG Group's policies and procedures, processes and controls that comprise its risk management and control systems relating to reinsurance. Annually, the board certifies to APRA that adequate strategies have been put in place to monitor those risks, that systems are in place to ensure compliance with legislative and prudential requirements, and that the board has satisfied itself as to compliance with the REMS.

Following changes in the regulatory framework in 2007, an insurer must have processes in place to achieve legally binding reinsurance arrangements and in addition the insurer must make a declaration annually that the insurer has placed its reinsurance arrangements and that those arrangements are legally binding. Failure to have a legally binding reinsurance arrangement may result in a deduction of the relevant reinsurance recoveries from tier 1 capital. As at the reporting date the transition provisions for these APRA requirements have been complied with.

## F. REINSURANCE PROGRAM

Risks underwritten are reinsured in order to limit exposure to losses, stabilise earnings, protect capital resources and ensure efficient control and spread of the risks underwritten. Each subsidiary that is an insurer has its own reinsurance program and determines its own risk limits. To facilitate the reinsurance process and to create economies of scale, the IAG Group has established a captive reinsurance operation comprising companies located in Australia and Malaysia (liabilities previously held in a captive reinsurer based in Ireland have been transferred to the Australian captive). This operation acts as the reinsurer for the

IAG Group by being the main buyer of the IAG Group's outwards reinsurance program. The reinsurance operation is intended to manage reinsurance and earnings volatility and the IAG Group's exposure to catastrophe risk. The operation retains a portion of the intercompany business it assumes and retrocedes (passes on) the remainder to external reinsurers. The REMS provides that the reinsurance retention is not to exceed 4% of net earned premium.

While a large portion of the business ceded by the Consolidated entity's subsidiaries is reinsured with Group's captive reinsurance operation, individual business units located outside of Australia do purchase additional reinsurance protection outside the IAG Group. This generally relates to facultative reinsurance covers and selected treaty reinsurance arrangements.

## I. Current program

The reinsurance operation purchases reinsurance on behalf of IAG Group entities to cover a return period of at least APRA's minimum of 1:250 year event on a single site basis but is authorised to elect to purchase covers up to 1:250 year event on a whole of portfolio basis. Dynamic financial analysis modelling is used to determine the optimal level to which reinsurance should be purchased for capital efficiency, compared with the cost and benefits of covers available in the market.

The external reinsurance programs consist of a combination of the following reinsurance protection:

- a Group catastrophe cover which is placed in line with the strategy of buying to the level of a 1:250 year event on a modified whole of portfolio basis. The catastrophe program is negotiated on an annual calendar year basis. Covers purchased are dynamic; the MER changes as total requirements change and as the reinsurance purchase strategy evolves;
- an aggregate cover which protects against a frequency of attritional event losses in Australia, NZ, Asia and the UK and operates below the Group catastrophe cover;
- excess of loss and proportional reinsurances which provide 'per risk' protection for retained exposures of the commercial property and engineering businesses in Australia, NZ and Thailand;
- excess of loss reinsurance for all casualty portfolios including CTP, public liability, workers' compensation and home owners warranty products; and
- excess of loss reinsurance for all marine portfolios.

## II. Changes during the year

The catastrophe cover purchased was increased to a limit of \$4.0 billion. The MER for a first event arising from a physical peril was reduced from \$169 million to \$118 million for Australia dropping to a lower amount for a second event. In respect of NZ the MER was reduced to \$102.5 million and for the UK cover was purchased above an MER of \$104 million. These MERs will remain in place for the next three years (increasing by 10% per annum), as purchases were made on a multi year basis. The decision to decrease the retained single event physical peril loss was made as the cost of the coverage available in the reinsurance market was such that the transaction proved to be capital efficient compared with retaining the risk against the Consolidated entity's capital. An aggregate cover, indemnifying Australia, NZ, Asia and the UK was also secured (placed to 92% at reporting date) providing protection against a frequency of attritional physical peril losses.

## NOTE 13. DEFERRED ACQUISITION COSTS

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>RECONCILIATION OF MOVEMENTS FOR THE FINANCIAL YEAR</b>		
Deferred acquisition costs at beginning of the financial year	789	591
Write down for liability adequacy test	(3)	–
Deferred acquisition costs acquired as part of business combination	–	112
Acquisition costs deferred during the year	1,320	1,305
Amortisation charged to profit for the year	(1,315)	(1,223)
Net foreign exchange movement	(33)	4
Deferred acquisition costs at the end of the financial year	758	789

The carrying value of deferred acquisition costs includes \$47 million (2007—\$45 million) which is expected to be amortised more than 12 months from reporting date.

## NOTE 14. UNEARNED PREMIUM LIABILITY

### A. RECONCILIATION OF MOVEMENTS FOR THE FINANCIAL YEAR

Unearned premium liability at beginning of the financial year	4,213	3,503
Unearned premium acquired as part of business combination	–	521
Deferral of premiums on contracts written during the year	4,099	3,531
Earning of premiums written in previous years	(4,071)	(3,357)
Net foreign exchange movement	(144)	15
Unearned premium liability at the end of the financial year	4,097	4,213

The carrying value of unearned premium liability includes \$143 million (2007—\$142 million) which is expected to be earned more than 12 months from reporting date.

### B. LIABILITY ADEQUACY TEST

The liability adequacy test has been conducted using the central estimate of the premium liabilities calculation for reporting to APRA (refer note 34), adjusted as appropriate, together with an appropriate margin for uncertainty for each portfolio of contracts, being Australia insurance operations (including the Australia dedicated captive reinsurer), the NZ insurance operations, the UK insurance operations, the Asia insurance operations, Labuan reinsurance operation, and the Alba inwards reinsurance operation (for the comparative period the Labuan reinsurance operation portfolio and the Alba inwards reinsurance operation portfolio were a single portfolio). The test is based on prospective information and so is heavily dependent on assumptions and judgements.

The liability adequacy test as at reporting date resulted in a surplus for each portfolio of contracts except for the NZ insurance operation and the Labuan reinsurance operation (2007—surplus for each portfolio of contracts). Those amounts were recognised as follows:

- for the NZ insurance operation the deficiency of \$2 million was recognised as an impairment of the deferred acquisition costs. This deficiency represented the amount by which the present value of the net expected future cash flows relating to future claims of \$287 million (which is inclusive of risk margin and is net of related reinsurance recoveries of \$20 million) exceeded the unearned premium liability of \$423 million less the related deferred acquisition costs of \$89 million and deferred reinsurance expense of \$49 million; and
- for the Labuan reinsurance operation the deficiency of \$13 million was recognised partly as an unexpired risk liability of \$12 million and partly as an impairment of the deferred acquisition costs of \$1 million. This deficiency represented the amount by which the present value of the net expected future

cash flows relating to future claims of \$113 million (which is inclusive of risk margin and is net of related reinsurance recoveries of \$52 million) exceeded the unearned premium liability of \$164 million less the related deferred acquisition costs of \$4 million and the related deferred reinsurance expense of \$58 million.

For the purposes of the liability adequacy test, the present value of net expected future cash flows for future claims including the risk margin for the Consolidated entity of \$2,927 million (2007—\$3,134 million) comprises the discounted central estimate of \$2,794 million (2007—\$2,977 million), and a risk margin of \$133 million (2007—\$157 million).

The risk margin included in the Consolidated entity's expected future cash flows for future claims as a percentage of the central estimate is 4.8% (2007—5.3%). The margin used in testing individual portfolios is determined based on an assessment of the recent historical experience in relation to the volatility of the insurance margin for each portfolio of contracts. Where there is insufficient historical experience for a portfolio, such as for a start up business, a probability of adequacy of 75% is used.

The test has not been applied using the statistical concept of probability of adequacy. Hence the risk margin applied for the purposes of the liability adequacy test has been determined using a different methodology to that used for the determination of the risk margin for the outstanding claims liability. The probability of adequacy represented by the liability adequacy test, which for each portfolio fell in the range from 60% to 75%, also differs from the probability of adequacy adopted in determining the outstanding claims liability. The reason for these differences is that the former is in effect an impairment test used only to test the sufficiency of net premium liabilities whereas the latter is a measurement accounting policy used in determining the carrying value of the outstanding claims liability carried on the balance sheet.

## NOTE 15. INVESTMENTS

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>A. COMPOSITION</b>		
<b>I. Money market securities</b>		
LISTED		
Australian government and semi government	1,820	2,227
Australian financial institutions and corporate	259	235
Foreign government	427	449
Foreign financial institutions and corporate	519	888
UNLISTED		
Australian financial institutions and corporate	4,983	4,231
Foreign government and institutions	72	373
	<b>8,080</b>	<b>8,403</b>
<b>II. Equity and trust securities</b>		
LISTED		
Australian	797	1,411
International	314	270
UNLISTED		
Australian	201	186
International	82	612
	<b>1,394</b>	<b>2,479</b>
<b>III. Derivatives</b>		
Exchange traded	4	1
Over the counter	1	1
	<b>5</b>	<b>2</b>
	<b>9,479</b>	<b>10,884</b>

The Parent had an investment of \$1 million being an investment in a former subsidiary which was put into liquidation during the financial year (2007—\$nil).

### B. SIGNIFICANT RISKS

Information is provided here regarding exposures as at reporting date for the significant risks faced in relation to investments. When considering the risks facing the investment balance it is important to note that different objectives and policies are applied in managing assets backing insurance liabilities and shareholders' funds.

The following table provides the composition of the assets backing insurance liabilities and shareholders' funds as at the current reporting date noting that these portfolios include not only investments but also cash.

	CONSOLIDATED			
	Shareholders' funds		Assets backing insurance liabilities	
	\$m	% of total	\$m	% of total
Cash and cash equivalents	439	14.1	795	10.5
Money market securities	1,663	53.5	6,417	84.4
Equity and trust securities/other	1,005	32.4	394	5.1
	<b>3,107</b>	<b>100.0</b>	<b>7,606</b>	<b>100.0</b>

## I. Liquidity risk

Investments are not a source of liquidity risk but are a key part of managing the risk. A maturity analysis of the investments that have a fixed term is provided in the table below. The investments that represent assets held to back insurance liabilities have a maturity matched to the estimated payment pattern of the underlying claims. Some information is also provided in the table regarding the interest rate risk exposure of the securities for key operating environments.

		CONSOLIDATED							
		Floating interest rate	Fixed interest rate securities maturing in						Total
			1 year or less	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	Over 5 years	
<b>2008</b>									
Money market securities	\$m	193	1,813	1,298	2,434	640	948	754	8,080
Weighted average interest rate—Australia	%	n/a	8.11	7.91	7.99	8.36	8.79	7.16	8.05
Weighted average interest rate—New Zealand	%	n/a	8.21	7.53	8.77	8.52	8.70	8.91	8.03
<b>2007</b>									
Money market securities	\$m	389	3,527	1,360	719	718	386	1,304	8,403
Weighted average interest rate—Australia	%	n/a	6.15	6.45	6.71	6.81	6.79	5.66	6.28
Weighted average interest rate—New Zealand	%	n/a	7.44	6.28	7.20	7.34	7.78	8.17	7.02

The breakdowns are provided by contractual maturity. Actual maturities may differ from contractual maturities because certain counterparties have the right to call or prepay certain obligations with or without call or prepayment penalties.

None of the investments has been pledged as collateral at reporting date (2007—none).

For information regarding the management of liquidity risk refer to the financial risk management note.

## II. Credit risk

The IAG Group is exposed to credit risk from investments in third parties where the IAG Group holds debt and similar securities issued by those companies. The credit risk relating to investments is monitored and assessed, and maximum exposures are limited. The maximum exposure to credit risk as at reporting date is the carrying amounts of the investments on balance sheet as they are measured at fair value. The investments comprising assets held to back insurance liabilities are restricted to investment grade securities.

The following table provides information regarding the credit risk relating to the money market securities based on S&P counterparty credit ratings.

RATING	CONSOLIDATED			
	\$m	2008 % of total	\$m	2007 % of total
AAA	4,464	55.3	5,791	68.9
AA	3,485	43.1	2,475	29.5
A	86	1.1	81	0.9
BBB and lower	19	0.2	23	0.3
Unrated	26	0.3	33	0.4
	<b>8,080</b>	<b>100.0</b>	8,403	100.0

For information regarding the management of credit risk refer to the financial risk management note.

## III. Interest rate risk

The IAG Group is exposed to interest rate risk on those investments that are money market securities. Some information regarding the interest rate conditions of these instruments is provided in the maturity analysis table included above. The majority of the money market securities bear a fixed rate of interest. Movements in market interest rates therefore impact the price of the securities (and hence their fair value measurement) but not the contractual cash flows of the securities.

Derivatives are used to manage interest rate risk. For information regarding the notional contract amounts associated with these derivative financial instruments together with a maturity profile and reporting date fair values refer to the financial risk management note.

A key policy used in the management of interest rate risk is the investment of assets held to back insurance liabilities in securities whose interest rate sensitivity matches the related insurance liabilities. For additional information regarding the management of interest rate risk refer to the financial risk management note.

#### IV. Currency risk

The IAG Group's exposure to currency risk from investments arises directly from the investment of shareholders' funds in assets denominated in currencies other than the functional currencies of the IAG Group entities. Assets held to back insurance liabilities are held in the same currency as the related insurance liabilities eliminating any net foreign exchange exposure from foreign operations with the IAG Group exposed only to the residual net investment in these foreign operations.

The following table provides information regarding the composition of the reporting date shareholders' funds balance (including both investments and cash and cash equivalents) by currency.

	CONSOLIDATED			
	\$m	2008 % of total	\$m	2007 % of total
Australian dollar	2,430	78.2	3,186	78.7
New Zealand dollar	101	3.2	70	1.7
British pound	408	13.2	521	12.9
United States dollar	54	1.7	125	3.1
Other	114	3.7	146	3.6
	<b>3,107</b>	<b>100.0</b>	4,048	100.0

Derivatives are not used to manage the currency risk on investments.

For information regarding the management of currency risk refer to the financial risk management note.

#### V. Equity price risk

The Group is exposed to equity price risk through its investment in equities and the use of equity related derivative contracts.

Derivatives are used to manage equity price risk. For information regarding the notional contract amounts associated with these derivative financial instruments together with a maturity profile and reporting date fair values refer to the financial risk management note.

For information regarding the management of equity price risk refer to the financial risk management note.

#### VI. Concentration of risks

While the asset mix for investments is concentrated in money market securities, within this category the investments are diversified by issuer type, industry and specific counterparty. When this is combined with the counterparty credit rating of the investments the concentration risk is considered low.

#### C. FAIR VALUE INFORMATION

All investments are initially recorded at fair value and are then subsequently remeasured to fair value at each reporting date. For those investments traded in an active market this involves applying the published bid price quotations. For trust securities this generally means using the redemption price provided by the trustee.

There is an insignificant portion of investments (less than 1%) for which a valuation methodology is used to determine the fair value. The assets are effectively marked to model rather than marked to market. Reasonable changes in the judgement applied in conducting these valuations would not have a significant impact on the balance sheet.

## NOTE 16. RECEIVABLES

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>A. COMPOSITION</b>		
Premium receivable	2,070	2,072
Provision for impairment	(24)	(27)
	<b>2,046</b>	<b>2,045</b>
Reinsurance and other recoveries on paid claims	217	227
Provision for impairment	(12)	(12)
	<b>205</b>	<b>215</b>
Other trade debtors	60	47
Provision for impairment	(3)	(3)
	<b>57</b>	<b>44</b>
Premium funding loans secured on policies (net of unearned interest)	–	106
Provision for impairment	–	(2)
	–	104
GST recoverable on gross outstanding claims liability	372	434
Investment income receivable	123	124
Investment transactions not yet settled at reporting date	117	50
Corporate treasury derivatives receivable	–	1
Other debtors	333	261
	<b>3,253</b>	<b>3,278</b>

The Parent had a receivable at reporting date of \$69 million being the RES embedded derivative (2007—\$nil). For information regarding the embedded derivative refer to the financial risk management note.

### B. SIGNIFICANT RISKS

Information is provided here regarding exposures as at reporting date for the significant risks faced in relation to receivables.

The receivables are non interest bearing (with the exception of premium funding loans in the comparative) and are normally settled between 30 days and 12 months. The balance has not been discounted because the effect of the time value of money is not material. The net carrying amount of receivables is a reasonable approximation of the fair value of the assets because of the short term nature of the assets.

#### I. Credit risk

The key risk to which the receivables amounts are exposed is credit risk. The maximum exposure to credit risk as at reporting date is the carrying amounts of the receivables on balance sheet. A portion of the trade and other receivables balance is owed by related parties, which are considered to be fully recoverable.

An ageing analysis for certain receivables balances is provided here. The other trade debtors provision of \$3 million (2007—\$3 million) represents specific provisions in an Australian subsidiary that relate to balances overdue more than one year. The other receivables balances have either no overdue amounts or an insignificant portion of overdue amounts. The amounts are aged according to their original due date. Receivables for which repayment terms have been renegotiated represent an insignificant portion of the balances.

	NOT OVERDUE			OVERDUE	TOTAL
	\$m	< 30 days \$m	30–120 days \$m	> 120 days \$m	
Premium receivable	1,655	253	139	23	2,070
Provision for impairment—specific	–	–	–	(3)	(3)
Provision for impairment—collective	–	(12)	(4)	(5)	(21)
Net balance	1,655	241	135	15	2,046
Reinsurance and other recoveries on paid claims	163	10	7	37	217
Provision for impairment—specific	–	–	–	(12)	(12)
Net balance	163	10	7	25	205

The majority of the premium receivable balance relates to policies which are paid on a monthly instalment basis. It is important to note that the late payment of these amounts allows the Group to cancel the related insurance contract eliminating both the credit risk and insurance risk for the unpaid amounts. Upon cancellation of a policy the outstanding premium receivable is reversed.

The total provision for impairment at reporting date for receivables balances totalled \$39 million (2007—\$44 million). The net movement in the aggregated provision for the current period was \$5 million. A reconciliation of the movements during the period has not been provided as the information is not material.

#### II. Concentrations of risk

There are no significant concentrations of risk within receivables as the IAG Group transacts with a large and unrelated customer base in different geographical regions and non customer related receivables are generally with statutory bodies (eg national tax authorities) which are considered fully recoverable.

## NOTE 17. PROPERTY, PLANT AND EQUIPMENT

	CONSOLIDATED			
	Land and buildings \$m	Motor vehicles \$m	Other plant and equipment \$m	Total \$m
<b>2008</b>				
<b>A. COMPOSITION</b>				
At cost	<b>125</b>	<b>86</b>	<b>476</b>	<b>687</b>
Accumulated depreciation	<b>(19)</b>	<b>(40)</b>	<b>(318)</b>	<b>(377)</b>
Impairment charges	<b>(9)</b>	-	-	<b>(9)</b>
Net foreign exchange movements	<b>(5)</b>	-	<b>(5)</b>	<b>(10)</b>
Balance at the end of the financial year	<b>92</b>	<b>46</b>	<b>153</b>	<b>291</b>
<b>2008</b>				
<b>B. RECONCILIATION OF MOVEMENTS FOR THE FINANCIAL YEAR</b>				
Balance at the beginning of the financial year	<b>101</b>	<b>48</b>	<b>148</b>	<b>297</b>
Additions	<b>13</b>	<b>24</b>	<b>65</b>	<b>102</b>
Disposals	<b>(1)</b>	<b>(12)</b>	<b>(2)</b>	<b>(15)</b>
Additions through business combinations	-	<b>1</b>	<b>3</b>	<b>4</b>
Depreciation	<b>(7)</b>	<b>(15)</b>	<b>(56)</b>	<b>(78)</b>
Impairment losses	<b>(9)</b>	-	-	<b>(9)</b>
Net foreign exchange movements	<b>(5)</b>	-	<b>(5)</b>	<b>(10)</b>
Balance at the end of the financial year	<b>92</b>	<b>46</b>	<b>153</b>	<b>291</b>
<b>2007</b>				
<b>C. COMPOSITION OF COMPARATIVES</b>				
Cost	113	73	410	596
Accumulated depreciation	(12)	(25)	(262)	(299)
Balance at the end of the financial year	101	48	148	297

The net carrying amount of all classes of property, plant and equipment is considered a reasonable approximation of the fair value of the assets in the context of the financial statements. There are no items of property, plant and equipment pledged as security for liabilities. The depreciation expense amounts are allocated across various lines in the income statement.

## NOTE 18. INTANGIBLE ASSETS

	CONSOLIDATED						
	Software development expenditure \$m	Lloyd's syndicate capacity \$m	Brands \$m	Other contractual arrangements \$m	Distribution channels \$m	Customer relationships \$m	Total \$m
<b>2008</b>							
<b>A. COMPOSITION</b>							
Cost	241	138	177	24	269	203	1,052
Accumulated amortisation	(149)	-	(33)	(14)	(32)	(41)	(269)
Accumulated impairment charges	(7)	-	(52)	-	-	(13)	(72)
Net foreign exchange movements	(9)	(23)	(26)	(1)	(41)	(26)	(126)
Balance at the end of the financial year	76	115	66	9	196	123	585
<b>2008</b>							
<b>B. RECONCILIATION OF MOVEMENTS FOR THE FINANCIAL YEAR</b>							
Balance at the beginning of the financial year	92	131	154	17	245	142	781
Additions acquired and developed	46	-	-	-	-	-	46
Additions through business combinations	-	-	-	-	-	29	29
Amortisation	(54)	-	(19)	(7)	(21)	(18)	(119)
Impairment losses recognised during the year	-	-	(52)	-	-	(13)	(65)
Net foreign exchange movements	(8)	(16)	(17)	(1)	(28)	(17)	(87)
Balance at the end of the financial year	76	115	66	9	196	123	585
<b>2007</b>							
<b>C. COMPOSITION OF COMPARATIVES</b>							
Cost	195	138	177	24	269	174	977
Accumulated amortisation	(95)	-	(14)	(7)	(11)	(23)	(150)
Accumulated impairment charges	(7)	-	-	-	-	-	(7)
Net foreign exchange movements	(1)	(7)	(9)	-	(13)	(9)	(39)
Balance at the end of the financial year	92	131	154	17	245	142	781

## D. NOTES ON INTANGIBLE ASSETS

### I. Software development expenditure

The software development expenditure asset comprises both internally generated assets and acquired assets. The capitalisation of the software development expenditure involves the exercise of judgement in determining whether the costs incurred will be recovered through the probable generation of future economic benefits from the internal use of the asset. This process is supported by the preparation of detailed business cases and subsequent review processes that are required to approve a greater than \$2 million project including a detailed business case. The asset represents both projects that have been completed and the developed software implemented as well as projects that continue in development. The future economic benefits expected to be realised from the capitalised software development expenditure will benefit various operating functions and so the amortisation of the assets is included in the claims expense, acquisition costs, other underwriting expenses, and corporate, administration and other expenses lines in the income statement.

### II. Acquired intangible assets

All of the intangible assets other than the capitalised software development expenditure intangible asset have been acquired. With the exception of the Lloyd's syndicate capacity, each of the acquired intangible assets has finite useful lives. The amortisation of the acquired intangible assets forms part of corporate, administration and other expenses in the income statement. A broad description of the nature of each of the significant intangible assets is provided here:

#### a. LLOYD'S SYNDICATE CAPACITY

The Lloyd's syndicate capacity relates to the syndicate capacity acquired as part of the acquisition of Equity Insurance Group in 2007 (refer note 24) which at acquisition date held 64.02% of the capacity of Syndicate 218. The value of the syndicate capacity is in the access it gives to the future underwriting profits of the business. The basis of the determination of recoverable amount is a return (profit) to be generated on the expected premiums to be written by the syndicate. The growth assumptions used were 2.5% until 2014 and 2.0% after that. A reduction in growth below these levels is not regarded as reasonably foreseeable. A 1% change in the expected return (to 9% or 11%) would move the value by approximately \$50 million.

#### b. BRANDS

This represents the revenue generating value of acquired brands.

#### c. CUSTOMER RELATIONSHIPS

This is in effect the capitalisation of future profits relating to the insurance contracts in place at acquisition and the expected renewals of those contracts. It represents the amount paid to the vendor for the value of the customer relationships developed prior to acquisition.

#### d. DISTRIBUTION CHANNELS

The value of the distribution channels is in the future revenue expected to be generated as a result of the existing relationships with the broker networks and affinity accounts.

#### e. CURRENT YEAR IMPAIRMENT

During the year ended 30 June 2008, the following acquired intangible assets were impaired:

##### i. Hastings insurance brand

This broking brand was originally valued using a royalty relief methodology, based on a royalty rate of 4.38% of premium revenue serviced. However, since then there have been a number internal issues and external market factors which have negatively impacted the strength of the brand. These include both operational issues which led to the panel of underwriters used by the broker being seriously curtailed from August 2007 and reduced call volumes and conversion as the UK private motor market increasingly relies on purely price led offerings through the internet. Marketing expenditure in the market has also increased substantially. The royalty rate adopted to value this brand at the current reporting date was 0.875%. Applying this rate to the lower premium revenue expected to be generated by Hastings resulted in a recoverable value for this brand which was \$50 million lower than its carrying value, and an impairment loss of this amount was recognised in the income statement.

##### ii. Equity insurance broking distribution brand

A management decision to discontinue use of this brand led to a full write down of the carrying value of \$2 million.

##### iii. Equity insurance direct channel customer relationships

The Equity insurance direct channel intangible asset reflects the anticipated profits from a mix of over the phone and internet insurance broking. Internet sourced business is growing as a proportion of this channel. It carries higher acquisition costs and lower customer retention rates which reduce the value of this channel. This migration of the business to the internet accelerated during the period and applying these updated assumptions resulted in an estimated recoverable value which was \$13 million lower than the carrying value and an impairment loss of this amount was recognised in the income statement.

### III. Other intangible assets

There are a number of other intangible assets that are controlled but which are not presented on the balance sheet because they do not meet the recognition criteria. These are both acquired and internally generated intangible assets. These include brands, information technology systems and distribution channels.

## NOTE 19. GOODWILL

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>A. COMPOSITION</b>		
Goodwill	<b>2,313</b>	2,282
Net foreign exchange movements	<b>(161)</b>	(26)
Accumulated impairment charges	<b>(277)</b>	–
	<b>1,875</b>	2,256
<b>B. RECONCILIATION OF MOVEMENT FOR THE FINANCIAL YEAR</b>		
Goodwill at beginning of the financial year	<b>2,256</b>	1,486
Additional goodwill amounts arising from business combinations	<b>33</b>	777
Disposal goodwill amounts arising from business disposals	<b>(2)</b>	–
Net foreign exchange movements during the year	<b>(135)</b>	(7)
Impairment charge for the year	<b>(277)</b>	–
Goodwill at the end of the financial year	<b>1,875</b>	2,256
<b>C. ALLOCATION TO CASH GENERATING UNITS</b>		
Australia insurance operations <sup>(i)</sup>	<b>1,156</b>	1,148
New Zealand insurance operations	<b>281</b>	319
Asia insurance operations	<b>45</b>	53
United Kingdom insurance operations	<b>393</b>	715
Alba inwards reinsurance operation <sup>(ii)</sup>	<b>–</b>	21
	<b>1,875</b>	2,256

(i) In previous periods this goodwill amount was tested on the basis of two cash generating units. The cash generating units changed following a restructuring of the operation of the IAG Group. These cash generating units align with the way goodwill was monitored for internal management purposes at the current reporting date.

(ii) This cash generating unit previously consisted of all non Australia reinsurance operations but changed following the classification of the Alba inwards reinsurance operation as held for sale.

As the IAG Group continues to incorporate businesses into the IAG Group and/or reorganises the way businesses are managed, reporting structures may change requiring a reconsideration of the identification of the cash generating units.

The goodwill relating to certain acquisitions outside Australia is denominated in currencies other than Australian dollars and so is subject to foreign exchange rate movements.

The impairment testing of the goodwill involves the use of accounting estimates and assumptions. The recoverable amount of each cash generating unit is determined on the basis of value in use calculations. The value in use is calculated using a discounted cash flow methodology covering a five or 10 year period with an appropriate terminal value at the end of year five or 10, less net assets, for each of the key business units within a cash generating unit.

The following describes the key assumptions on which management has based its cash flow projections to undertake impairment testing of goodwill:

- cash flow forecasts are based on five year business plans;
- terminal value is calculated using a perpetuity growth formula based on the cash flow forecast for year five or 10, the discount rate (after tax), terminal growth rate in profit or premium and, where appropriate, terminal insurance margin;
- terminal growth rates and insurance margins are based on past performance and management's expectations for future performance in each segment and country; and
- discount rates used reflect the risk free rate, an appropriate beta and equity risk premium (after tax) in each segment and country, risk adjusted where applicable. Discount rates used are pre tax.

The carrying value of identified intangible assets is deducted from the values generated from the cash flow projections to arrive at a recoverable value for goodwill which is then compared with the carrying value of goodwill.

### I. Cash generating units with current year impairment charges

Goodwill impairment charges have been recognised in the current period relating to the UK cash generating unit and the Alba inwards reinsurance operation cash generating unit as the cash flow projections derived values that were lower than the carrying value of goodwill.

While the UK operation as a whole forms a cash generating unit, the sub component that is the key driver for the current impairment is the combined Hastings insurance broking operation and Advantage underwriting operation purchased together effective 29 September 2006. The events and conditions giving rise to the impairment of the value of these businesses are, in summary:

- reduced volumes of business and income generated by the Hastings and Equity retail broking operations. This reflected both operational issues which led to the Hastings panel of underwriters used by the broker being seriously curtailed from August 2007 and reduced call volumes and conversion as the UK private motor market increasingly relies on purely price led offerings through the internet. Marketing expenditure in the market has also increased substantially. Consideration of these conditions, and the likely prospects of the business, led to reductions in both the forecast volume of business and profitability of this operation;
- continued losses from the Advantage underwriting operation, which operates primarily in the UK private motor market. This business is highly dependent on Hastings for distribution. The combination of significant price increases implemented to restore profitability and the challenges faced by Hastings meant this business has continued to report losses and the decision has been taken to either sell the insurance licence or put the business into run off and the cash flow projections used reflect a run off assumption; and
- the gross discount rate used to value the UK cash generating unit as at 30 June 2008 was 13.8% (10.4% net of tax). This compares with 14.1% (10.7% net of tax) used for the previous assessment as at 31 December 2007. The change in discount rate resulted from a change in the Group's estimate of its WACC.

There are a number of key sensitivities within the valuation and these are noted below. They are stated in isolation although they are not wholly independent—for example, changes in interest rates leading to a change in discount rate could also lead to a change in profitability as the investment income would change.

- An increase/decrease of 1% in the discount rate used would have increased/decreased the impairment loss by approximately \$136 million.
- An increase/decrease of 3% in the year on year premium growth over the valuation period would have decreased/increased the impairment loss by approximately \$102 million.
- An increase/decrease of 1% in the terminal growth rate used would have decreased/increased the impairment loss by approximately \$72 million.
- An increase/decrease of 1% in the terminal insurance margin used would have decreased/increased the impairment loss by approximately \$60 million.

The Alba inwards reinsurance operation was acquired as a start up operation on 3 July 2006. The operation has since that time failed to perform as originally expected and the operation no longer fits within the Group's altered plans in Asia. Thus, the decision was taken to dispose of this operation which consists of an Asian based Lloyd's syndicate and a UK based managing agent. The operation was classified as held for sale at the current reporting date. The recoverable value is based on the carrying value of the tangible assets and liabilities. The realisable value on sale (including allowance for selling costs), is unclear at this time and an impairment loss for the full carrying value of \$25 million was recognised in the income statement.

#### II. Cash generating units with no impairment

The cash flow projections derived values for each of the other cash generating units that were in excess of the carrying value of goodwill. Reasonably foreseeable changes in the key assumptions on which the recoverable amounts are based would not be expected to cause the respective recoverable amounts to fall short of the carrying amounts at reporting date.

## NOTE 20. TRADE AND OTHER PAYABLES

	CONSOLIDATED	
	2008	2007
	\$m	\$m
<b>A. COMPOSITION</b>		
<b>Trade creditors</b>		
Commissions payable	122	112
Stamp duty payable	65	60
GST payable on premium receivable	76	75
Other	207	267
	<b>470</b>	514
Loan from former related party <sup>(i)</sup>	–	79
Deferred payable under acquisition agreement <sup>(ii)</sup>	30	21
<b>Other payables</b>		
Other creditors and accruals	262	306
Investment creditors	121	193
Interest payable on interest bearing liabilities	23	26
	<b>906</b>	1,139

The Parent had interest payable on interest bearing liabilities of \$16 million at reporting date (2007—\$20 million).

- (i) The loan from former related party related to an entity that was previously a subsidiary, but which was placed in liquidation. The loan was settled upon the completion of its liquidation process.
- (ii) Cash flow hedge accounting is applied in relation to this payable.

#### B. SIGNIFICANT RISKS

Information is provided here regarding exposures as at reporting date for the significant risks faced by the Group in relation to trade and other payables.

Trade and other payables are unsecured, non interest bearing and are normally settled within 30 days with the exception of the deferred payable under acquisition agreement which is expected to be settled in 2009 (the expected settlement was previously 2011 but this changed with the classification of the Alba operation as held for sale) and the loan from former related party. Amounts have not been discounted because the effect of the time value of money is not material (the deferred payable under acquisition agreement was discounted in the comparative period). The carrying amount of payables is a reasonable approximation of the fair value of the liabilities because of the short term nature of the liabilities.

## NOTE 21. INTEREST BEARING LIABILITIES

	SECTIONS	PARENT		CONSOLIDATED	
		2008 \$m	2007 \$m	2008 \$m	2007 \$m
<b>A. COMPOSITION</b>					
<b>I. Capital nature</b>					
TIER 1 REGULATORY CAPITAL					
AUD reset preference shares	C.I	350	550	350	550
TIER 2 REGULATORY CAPITAL					
USD subordinated term notes	C.II	-	-	250	283
Derivatives for USD subordinated term notes*	C.II	-	-	151	125
GBP subordinated term notes	C.III	519	591	519	591
AUD subordinated term notes	C.IV	-	-	-	299
NZD subordinated term notes	C.X	-	-	79	-
<b>II. Operational nature</b>					
NZD senior term notes	C.V	-	-	40	45
GBP unsecured notes	C.VI	-	-	4	89
Euro floating rate notes	C.VII	-	-	20	37
USD floating rate notes	C.VIII	-	-	-	9
GBP receivables refinancing debt	C.IX	-	-	-	6
GBP secured mortgage		-	-	-	2
Less: capitalised transaction costs		(9)	(11)	(12)	(19)
		<b>860</b>	<b>1,130</b>	<b>1,401</b>	<b>2,017</b>
<b>B. RECONCILIATION OF MOVEMENTS FOR THE FINANCIAL YEAR</b>					
Balance at the beginning of the financial year		<b>1,130</b>	547	<b>2,017</b>	1,296
<b>Debts taken on through acquisitions of subsidiaries</b>					
Secured variable rate bank loan		-	-	-	556
15.6% deep discounted bonds		-	-	-	348
Secured mortgage		-	-	-	2
Unsecured notes issued to vendor (Equity Insurance Group)		-	-	-	93
Euro/USD floating rate notes and GBP receivables refinancing		-	-	-	71
<b>New issues</b>					
GBP short term notes issued for acquisition of subsidiaries		-	350	-	350
Issue of NZD subordinated term notes		-	-	87	-
Issue of GBP subordinated term notes		-	625	-	625
<b>Repayments</b>					
Repayment of AUD reset preference shares		(200)	-	(200)	-
Repayment of AUD subordinated term notes		-	-	(300)	-
Repayment of GBP short term notes		-	(350)	-	(350)
Repayment of secured variable rate bank loan		-	-	-	(556)
Repayment of 15.6% deep discounted bonds		-	-	-	(348)
Repayment of GBP unsecured notes		-	-	(80)	-
Other repayments		-	-	(32)	(17)
<b>Other movements</b>					
Foreign exchange movement on notes		(72)	-	(125)	(40)
Foreign exchange movement on cash flow hedge		-	-	33	40
Other fair value movement on cash flow hedge		-	-	(8)	(10)
Other foreign exchange movements		1	(33)	5	(38)
Discount on GBP subordinated term notes		-	(6)	-	(6)
Transaction costs capitalised during the financial year		-	(6)	-	(6)
Amortisation of capitalised transaction costs		1	3	4	7
		<b>860</b>	<b>1,130</b>	<b>1,401</b>	<b>2,017</b>

\* The derivatives related to the USD subordinated term notes are disclosed together with the notes but do not form part of tier 2 regulatory capital.

## C. SIGNIFICANT TERMS AND CONDITIONS

### I. AUD reset preference shares

The RPS are a hybrid security with characteristics of both debt and equity. The securities were issued in two tranches referred to as RPS1 (face value of \$350 million issued June 2002, ASX code IAGPA) and RPS2 (face value of \$200 million issued June 2003, ASX code IAGPB). The RPS2 were bought back on 16 June 2008 for an amount of \$100 per RPS2.

The RPS entitle the holder to a preferred, but not cumulative, distribution of 5.63% per annum for RPS1 and prior to the buy-back on 16 June 2008, 4.51% per annum for RPS2. The distributions are payable semi annually in arrears on 15 December and 15 June and are able to be franked. The distributions are expected to be fully franked and if a distribution is unfranked or partially franked, the distribution will be increased to compensate for the unfranked component. Because of the hybrid nature of the securities, distributions on the RPS are not the same as interest payments and may not always be paid, as there are a number of conditions that must be met before a distribution can be paid. If distributions are not paid on the RPS, no dividends can be paid and no returns of capital can be made on ordinary shares unless IAG takes certain actions.

The RPS may be exchanged by IAG or the holder on a reset date, by the holder upon a specified trigger event (such as change in control of IAG by a takeover bid), or by IAG on a tax event (such as a more than insignificant increase in taxation costs), regulatory event (such as not all of the RPS being entitled to be treated as tier 1 capital for regulatory reporting purposes) or following certain takeovers or schemes of arrangements. While the holder may initiate an exchange, IAG is able to select the method of exchange being either conversion into ordinary shares, arranging for a third party to acquire the RPS for their face value, or to redeem, buy-back or cancel the RPS (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. The next reset date for RPS1 is 15 June 2012.

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 would rank equally with RES if the RES are exchanged into preference shares. Except in limited circumstances, the RPS do not carry voting rights at general meetings.

### II. USD subordinated term notes

The USD 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 (IAL)). They are fixed rate notes (5.19% payable semi annually), with the principal and interest flows denominated in US dollar, which are hedged with cross currency swaps and interest rate swaps. Cash flow hedge accounting is applied for this hedge arrangement (refer note 33 for further information). The notes mature in April 2015, however, they may be redeemed at par at the issuer's option from April 2010 onwards, subject to the approval of APRA. If the notes are not redeemed in April 2010, all notes become floating rate notes with an interest rate of the three month Libor plus a margin of 2.04% per annum. The notes qualify as lower tier 2 capital for the purposes of IAL's APRA regulatory capital position.

### III. GBP subordinated term notes

The GBP subordinated term notes were issued with face value of £250 million (equivalent to \$625 million at date of issue) by the Company and were issued at a discount. They are fixed rate notes (5.625% payable annually) listed on the London Stock Exchange with the principal and interest flows denominated in GBP. Amounts are translated into the equivalent Australian dollar using the reporting date exchange rate. The primary difference between the Australian dollar equivalent of the face value of the notes at inception and the carrying value is due to foreign exchange rate movements. The notes mature on 21 December 2026

(non callable for the first 10 years). If the notes are not redeemed by 21 December 2016, all notes become floating rate notes with an interest rate of the three month GBP Libor plus 1.62%. The notes qualify as lower tier 2 capital for the purpose of the APRA's regulatory capital position.

The notes were issued to UK institutional investors as part of the funding of the acquisition of Equity Insurance Group and repayment of the short term notes of £140 million (equivalent to \$350 million) which was raised to fund the earlier acquisition of the Hastings and Advantage insurance operations.

### IV. AUD subordinated term notes

The AUD subordinated term notes had a face value of \$300 million and were issued through IAL's debt issuance program. The notes were redeemed for face value on 27 November 2007. Of the notes, \$250 million carried a fixed rate of 6.35% and were issued at a discount whilst \$50 million carried a floating interest rate equal to the prevailing bank bill swap rate plus a margin of 1.08%. The notes qualified as lower tier 2 capital for the purposes of IAL's APRA regulatory capital position.

### V. NZD senior term notes

The NZ\$50 million senior term notes were issued through IAG (NZ) Holdings Limited's medium term note program. The notes were issued at a discount and mature in August 2008. They are fixed rate notes (7.25% payable semi annually) with the principal and interest flows denominated in NZ dollars. Amounts are translated into the equivalent Australian dollars using the reporting date exchange rate. The primary difference between the Australian dollar equivalent of the face value of the notes at inception and the carrying value is due to foreign exchange rate movements.

### VI. GBP unsecured notes

Unsecured notes with a face value of £38 million were issued to the management of Equity Insurance Group by IAG UK Holdings Ltd on 8 January 2007. Amounts are translated into the equivalent Australian dollar 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 movements. The obligations under the notes are guaranteed by IAG. The notes were issued in three tranches. The first tranche has a face value of £33 million with an interest rate of GBP six month Libor per annum. The notes mature in January 2009 and are redeemable at the option of the holder on a six monthly basis from July 2007 onwards. The second tranche has a face value of £2 million, with an interest rate of GBP 12 month Libor per annum and is due to be redeemed in January 2010. The third tranche has a face value of £3 million, with an interest rate of GBP six month Libor per annum. The notes are redeemable at the option of the holder in July 2008 and January 2009.

At reporting date, only £2 million (2007—£38 million) remains outstanding after £36 million was redeemed or placed in trust during the current period (2007—£nil).

### VII. Euro floating rate notes

The Euro floating rate notes comprise two issues:

- notes with a face value of €12 million issued by Empire Equity Limited. They are senior variable rate notes with an interest rate of the three month Euribor plus 4.25%. The notes mature on 7 September 2025 but are redeemable at the option of the issuer from 7 September 2010. In July 2008, IAG was substituted as the issuer of these notes; and
- notes with a face value of €12 million issued by Advantage were redeemed during the current year. They were subordinated variable rate notes with an interest rate of the three month Euribor plus 3.95%.

Cross currency swaps are used to convert the currency exposure of these liabilities to GBP. Hedge accounting is not applied for this arrangement. For information regarding the notional principal or contractual amounts associated with these derivative financial instruments together with a maturity profile and reporting date fair values refer to the financial risk management note.

### VIII. USD floating rate notes

The USD floating rate notes with a face value of US\$8 million issued by Advantage were redeemed during the current year. They were subordinated variable rate notes with an interest rate of the three month US dollar Libor plus 3.95%.

Cross currency swaps were used to convert the currency exposure of this liability to GBP. Hedge accounting was not applied for this arrangement.

### IX. GBP receivables refinancing debt

Hastings Insurance Services Limited has entered into a receivables financing agreement for a minimum period of three years commencing 10 January 2006. The facility under the agreement is £15 million with an interest rate of the published base rate of Barclays Bank PLC plus 1.25%.

### X. NZD subordinated term notes

The NZD subordinated term notes have a face value of NZ\$100 million, and were issued at par by Insurance Australia Funding 2007 Limited (a wholly owned subsidiary of IAL). They are fixed rate notes with an interest rate of 9.105% per annum, payable semi annually. The notes mature in November 2017, however, they may be redeemed at par at the issuer's option from November 2012 onwards, subject to the approval of APRA. If the notes are not redeemed in November 2012, all notes become floating notes with an interest rate of the three month NZ Bank Bill Swap Rate plus a margin of 1.5% per annum. The notes qualify for lower tier 2 capital for the purpose of IAL's APRA regulatory capital position.

### D. LIQUIDITY RISK

The following table provides information about the maturity periods of the interest bearing liabilities based on the contractual maturity dates of undiscounted cash flows. Some of the liabilities have call or reset dates which may result in the actual maturities being different to the contractual maturities.

	CARRYING VALUE \$m	MATURITY DATES OF CONTRACTUAL UNDISCOUNTED CASH FLOWS					TOTAL \$m
		Within 1 year \$m	1 to 2 years \$m	2 to 5 years \$m	Over 5 years \$m	Perpetual \$m	
<b>2008</b>							
<b>Capital nature</b>							
<b>TIER 1 REGULATORY CAPITAL</b>							
AUD reset preference shares <sup>(i), (iii)</sup>	350	-	-	-	-	350	350
<b>TIER 2 REGULATORY CAPITAL</b>							
USD subordinated term notes <sup>(i)</sup>	250	-	-	-	250	-	250
GBP subordinated term notes <sup>(i), (iii)</sup>	519	-	-	-	519	-	519
NZD subordinated term notes <sup>(i)</sup>	79	-	-	-	79	-	79
<b>Operational nature</b>							
Various instruments	64	44	-	-	20	-	64
Total contractual undiscounted principal payments		44	-	-	868	350	1,262
Contractual undiscounted interest payments <sup>(ii)</sup>		88	86	192	n/a	-	366
Total contractual undiscounted payments		132	86	192	868	350	1,628
<b>2007</b>							
<b>Capital nature</b>							
<b>TIER 1 REGULATORY CAPITAL</b>							
AUD reset preference shares <sup>(i), (iii)</sup>	550	-	-	-	-	550	550
<b>TIER 2 REGULATORY CAPITAL</b>							
USD subordinated term notes <sup>(i)</sup>	283	-	-	-	283	-	283
GBP subordinated term notes <sup>(i), (iii)</sup>	591	-	-	-	591	-	591
AUD subordinated term notes <sup>(i)</sup>	299	-	-	-	300	-	300
<b>Operational nature</b>							
Various instruments	188	-	130	11	47	-	188
Total contractual undiscounted principal payments		-	130	11	1,221	550	1,912
Contractual undiscounted interest payments <sup>(ii)</sup>		91	83	215	n/a	-	389
Total contractual undiscounted payments		91	213	226	1,221	550	2,301

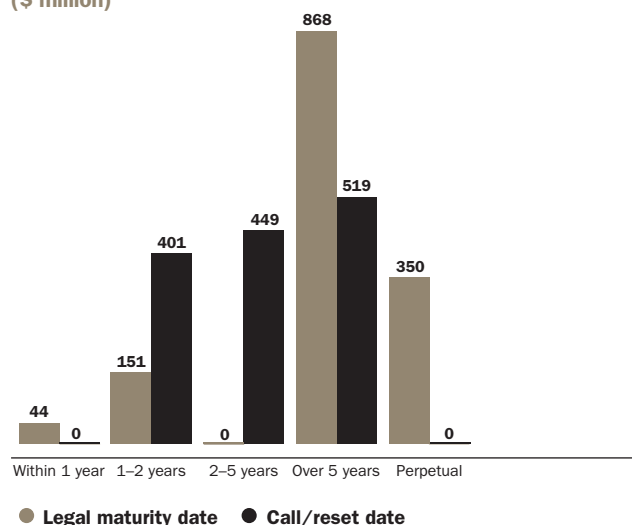
(i) These liabilities have call or reset dates upon which certain terms, including the distribution rate, can be changed. For further information refer to the chart below and the detailed descriptions of the instruments provided in section C.

(ii) Contractual undiscounted interest payments are calculated based on underlying fixed interest rates or prevailing market floating rates as applicable. Interest payments have not been included beyond five years. Reporting date exchange rates have been used for interest projections for liabilities in foreign currencies.

(iii) These liabilities are liabilities of the Parent entity.

The following chart presents the same information as the table above (together with the derivatives related to the USD subordinated term notes) for the current period together with information regarding the call or reset dates. The chart demonstrates that there are limited facilities that need to be refinanced in the near term though some liabilities have call or reset dates.

#### GROUP DEBT PROFILE (\$ million)



The IAG Group also has the RES which are set off on the balance sheet which are perpetual with reset dates and which are convertible at any time into preference shares.

#### E. INTEREST RATE RISK

Details about the exposure to interest rate risk as at reporting date for interest bearing liabilities is provided in the tables and detailed instrument descriptions provided elsewhere in this note.

The IAG Group is exposed to interest rate risk directly from the unhedged interest bearing liabilities that bear a variable interest rate but this is only a small portion of the liabilities. The interest bearing liabilities bearing a fixed interest rate are measured at amortised cost and so the IAG Group is not exposed at a particular reporting date to changes in the fair value of the liabilities relating to interest rate movements or to changes in the related cash flow obligations. The IAG Group will however be exposed on a call or reset or maturity date when the terms of a liability, including the interest rate, may need to be reset to market rates.

#### F. CURRENCY RISK

Details about the exposure to currency risk as at reporting date for interest bearing liabilities is provided in the tables and detailed instrument descriptions provided elsewhere in this note.

The foreign currency risk exposure from interest bearing liabilities arises primarily from the IAG Group long term borrowings denominated in USD, NZD and GBP. There is no significant impact on profit from foreign currency movements associated with these borrowings as the USD subordinated term notes are specifically hedged with cross currency swaps and interest rate swaps for which hedge accounting is applied (refer section C.II) and the NZD and GBP subordinated term notes are effectively hedging a portion of the net investment in the NZ and UK operations respectively for which hedge accounting is applied (refer section C.III).

For information regarding the management of currency risk refer to the financial risk management note.

#### G. USE OF DERIVATIVES

The IAG Group uses derivatives to manage the exposure to risks relating to the interest bearing liabilities. Hedge accounting is applied to only a limited number of these arrangements. In each case where hedge accounting is applied the arrangements are designated as cash flow hedges. Additional information is provided below for those related derivative positions. For information regarding the notional contract amounts associated with these derivative financial instruments together with a maturity profile and reporting date fair values refer to the financial risk management note.

It is important to note that some of the interest bearing liabilities themselves are used to hedge currency risk relating to the net investment in foreign operations by forming part of arrangements for which hedge accounting is applied, refer to the financial risk management note. Cross currency swaps are also used to convert the currency exposure on the Euro floating rate notes (and previously the USD floating rate notes) into British pound but hedge accounting is not applied for these economic hedges.

#### I. Cross currency swaps on USD subordinated term notes

IAL has entered into cross currency swaps to fully hedge the Australian dollar value of principal and interest flows on the Consolidated entity's USD subordinated term notes. The swaps mature in 2010. Over the term of the swaps, the Consolidated entity will receive US dollar payments equal to the interest payable on the notes and will pay interest at either a fixed rate or variable rate of the three month bank bill swap rate plus a margin on a principal amount of \$401 million. On maturity of the swap, the IAG Group will repay the principal amount of \$401 million and receive US\$240 million based on the original spot exchange rate at inception. This has the economic effect of converting the USD borrowing into an Australian dollar borrowing. Hedge accounting is applied in relation to these swap agreements.

#### II. Interest rate swap agreements on USD subordinated term notes

IAL has entered into interest rate swap agreements to manage the interest rate exposure on the Consolidated entity's USD subordinated term notes (previously swaps were also used in relation to a portion of the now redeemed AUD subordinated term notes). IAL pays a fixed rate of interest under the swap agreements and receives a variable rate of interest equal to the amount payable on the underlying hedged borrowings. The interest income and expense associated with the swap agreements are recognised in profit or loss on a daily basis over the term for which the swap is effective as a hedge of the underlying borrowing. As at reporting date, the weighted average fixed interest rate payable under the swap agreements was 6.92% per annum (2007—6.77% per annum) and the weighted average floating rate receivable was 9.36% per annum (2007—7.88% per annum) for the Consolidated entity.

#### H. COMPLIANCE RISK

Throughout the current reporting period the IAG Group has conformed with the requirements of its debt agreements, including all financial and non financial covenants.

## I. FAIR VALUE INFORMATION

The interest bearing liabilities are initially measured at fair value (net of transaction costs) but are subsequently measured at amortised cost. Based on market conditions at any point in time, the carrying value of the liabilities may not be representative of the fair value of the liabilities. A comparison of the carrying amount and fair value for the liabilities is provided in the table below.

	2008		2007	
	Carrying value \$m	Fair value \$m	Carrying value \$m	Fair value \$m
<b>Capital nature</b>				
TIER 1 REGULATORY CAPITAL				
AUD reset preference shares*	350	298	550	548
TIER 2 REGULATORY CAPITAL				
USD subordinated term notes	250	249	283	279
Derivatives for USD subordinated term notes	151	151	125	125
GBP subordinated term notes*	519	433	591	548
AUD subordinated term notes	–	–	299	300
NZD subordinated term notes	79	78	–	–
<b>Operational nature</b>				
Various instruments	64	65	188	190
Total	1,413		2,036	
Less: capitalised transaction costs	(12)		(19)	
	1,401		2,017	

\* These instruments are liabilities of the Parent entity.

## METHODOLOGY

The individual interest bearing liabilities are not standardised market instruments and so it is not possible for the fair value to be determined by mark to market with the exception of the AUD RPS for which the fair value is determined using the reporting date offer price per the ASX. Hence the fair values have been determined by mark to model applying valuation techniques using objective market inputs sourced from third parties wherever possible. The inputs are based on known similar financial instruments in the market around reporting date noting that some of the liabilities are not as directly comparable to other market instruments as some liabilities in which case a greater level of judgement has been applied in determining the inputs.

The differences between the carrying value of the liabilities and the fair value has been driven predominantly by widening in credit spreads in the current period. Under the IAG Group's current accounting policy of measuring the interest bearing liabilities at amortised cost in line with the purpose and nature of the instruments to the IAG Group the differences in value will not be realised by the IAG Group as the liabilities are not transferable.

## J. FINANCING ARRANGEMENTS

	Notes	Facilities drawn at reporting date		CONSOLIDATED Facilities available	
		2008 \$m	2007 \$m	2008 \$m	2007 \$m
Standby letter of credit facilities	A	52	59	53	65
Standby facility	B	–	–	–	30
Debt issuance program	C	–	299	750	750
New Zealand medium term note program	D	40	45	40	45
Receivables refinancing debt		–	6	31	35

Various entities within the Consolidated entity have facilities outstanding with external service providers, mostly banks, providing short term financing arrangements for specific situations not significant to the Consolidated entity including standby letters of credit, and guarantees for lease guarantees and performance bonds.

- A The standby letter of credit facilities are denominated in US dollars and are translated into equivalent Australian dollars using the reporting date exchange rate. The majority of the amount shown relates to a standby letter of credit issued in support of the Consolidated entity's participation in Lloyd's of London.
- B The standby facility was for liquidity support in the event that IAL was unable to refinance maturing obligations under the debt issuance program due to a market disturbance. The facility was not renewed during the current financial year.
- C IAL has a \$750 million debt issuance program. S&P has assigned its AA– long term and A–1+ short term ratings to the program's senior obligations and A+ to its subordinated notes. IAL is rated AA– for its insurer financial strength and counterparty credit ratings.
- D IAG (NZ) Holdings Limited has a NZ\$50 million medium term note program. S&P has assigned a AA– long term rating to the guaranteed and unsubordinated series of wholesale notes issued under the program. The program is guaranteed by IAL. This program is denominated in NZ dollars and is translated into equivalent Australian dollars using the reporting date exchange rate. Exchange rate movements are recognised in the foreign currency translation reserve.

## NOTE 22. RECONCILIATION OF TOTAL EQUITY

	PARENT/CONSOLIDATED			
	2008 Number of shares in millions	2007 Number of shares in millions	2008 \$m	2007 \$m
<b>SHARE CAPITAL</b>				
<b>Ordinary shares</b>				
Balance at the beginning of the financial year	1,794	1,595	4,361	3,263
Shares issued under institutional placement	–	136	–	750
Institutional placement share issue costs, net of tax	–	–	–	(13)
Shares issued under Share Purchase Plan	–	23	–	125
Share Purchase Plan issue costs, net of tax	–	–	–	(1)
Shares issued for the fully underwritten dividend	59	40	287	237
Shares issued under Dividend Reinvestment Plan	25	–	92	–
Balance at the end of the financial year	1,878	1,794	4,740	4,361
	PARENT		CONSOLIDATED	
	2008 \$m	2007 \$m	2008 \$m	2007 \$m
<b>A. SHARE CAPITAL (REFER ABOVE)</b>	4,740	4,361	4,740	4,361
<b>B. TREASURY SHARES HELD IN TRUST</b>				
Balance at the beginning of the financial year	–	–	(69)	(40)
Acquisition of shares	–	–	(4)	(30)
Shares vested and/or released to participants	–	–	2	1
Balance at the end of the financial year	–	–	(71)	(69)
<b>C. RESERVES</b>				
<b>Foreign currency translation reserve</b>				
Balance at the beginning of the financial year	–	–	(34)	(15)
Net exchange difference on translation of foreign operations	–	–	(214)	(73)
Hedge of net investment in a subsidiary	–	–	183	54
Balance at the end of the financial year	–	–	(65)	(34)
<b>Share based remuneration reserve</b>				
Balance at the beginning of the financial year	–	–	33	19
Charged to profit for the year	–	–	25	15
Transfers from the reserve upon vesting of rights/shares	–	–	(2)	(1)
Balance at the end of the financial year	–	–	56	33
<b>Hedging reserve</b>				
Balance at the beginning of the financial year	–	–	(3)	(10)
NET MOVEMENTS IN FAIR VALUE OF DERIVATIVES FORMING HEDGE				
Cash flow hedges	–	–	(26)	(30)
NET MOVEMENTS IN FAIR VALUE RECOGNISED IN PROFIT				
Cash flow hedges	–	–	33	40
Net tax impact on movements	–	–	(2)	(3)
Balance at the end of the financial year	–	–	2	(3)
Total reserves	–	–	(7)	(4)
<b>D. RETAINED EARNINGS/(ACCUMULATED LOSSES)</b>				
Balance at the beginning of the financial year	547	686	372	274
Profit/(loss) attributable to equity holders of the Parent	764	353	(261)	552
Actuarial gains and (losses) on defined benefit superannuation plans, net of tax	–	–	(34)	39
Dividends declared and paid	(537)	(492)	(537)	(492)
Acquisition of minority interest in subsidiaries	–	–	–	(5)
Dividends on treasury shares held in trust	–	–	2	4
Balance at the end of the financial year	774	547	(458)	372
Parent interest	5,514	4,908	4,204	4,660

	PARENT		CONSOLIDATED	
	2008 \$m	2007 \$m	2008 \$m	2007 \$m
<b>E. MINORITY INTERESTS</b>				
Balance at the beginning of the financial year	–	–	<b>172</b>	180
Profit attributable to minority interests	–	–	<b>35</b>	77
Actuarial gains and (losses) on defined benefit superannuation plans, net of tax, attributable to minority interests	–	–	<b>(3)</b>	1
Distributions to minority interests	–	–	<b>(57)</b>	(86)
<b>Balance at the end of the financial year</b>	<b>–</b>	<b>–</b>	<b>147</b>	172
<b>Minority interests comprising</b>				
Share capital	–	–	<b>126</b>	126
Retained earnings	–	–	<b>21</b>	46
Minority interests	–	–	<b>147</b>	172
<b>Total equity</b>	<b>5,514</b>	4,908	<b>4,351</b>	4,832

## F. NOTES TO SECTIONS A–E ABOVE

### I. Share capital

All ordinary shares on issue are fully paid. Ordinary shares entitle the holder to a vote at a general meeting of the Company and to participate in the dividends and the proceeds on winding up the Company in proportion to the number of, and amounts paid on, the shares held. Dividends, if declared, are subject to there being distributable profits available and not breaching APRA capital adequacy requirements.

During the year ended 30 June 2008, the Company made the following two issues of ordinary shares to fund dividend payments:

- 2007 final dividend—\$287 million issued through a fully underwritten arrangement; and
- 2008 interim dividend—\$92 million issued to the DRP participants.

During the year ended 30 June 2007, the Company made the following two issues of ordinary shares to fund the acquisition of Equity Insurance Group:

- \$750 million issued through an institutional placement at \$5.50 per ordinary share (completed 12 December 2006); and
- \$125 million issued through a Share Purchase Plan at \$5.50 per ordinary share (completed 31 January 2007).

During the year ended 30 June 2007, the Company settled its interim dividend payable on 16 April 2007 with the issuance of 40.5 million fully paid ordinary shares priced at \$5.8507 per share.

### II. Treasury shares held in trust

Share based remuneration is provided in different forms to eligible employees and non-executive directors. To satisfy obligations under the various share based remuneration plans, shares are generally bought on market at or near grant date of the relevant arrangement and held in trust. Upon consolidation of the trusts, the shares held that are controlled for accounting purposes are recognised as treasury shares held in trust, as described

in note 1.GG. The balance of treasury shares held in trust at a reporting date represents the cumulative cost of acquiring IAG shares that have not yet been distributed to employees as share based remuneration.

### III. Nature and purpose of reserves

#### a. FOREIGN CURRENCY TRANSLATION RESERVE

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

#### b. SHARE BASED REMUNERATION RESERVE

The share based remuneration reserve is used to recognise the fair value at grant date of equity settled share based remuneration provided to employees and non-executive directors over the vesting period, as described in note 1.AA.

#### c. HEDGING RESERVE

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

### IV. Minority interests

Minority interests represent the proportion of equity holders' equity that is attributable to minority shareholders. Minority interests relates to Insurance Manufacturers of Australia Pty Limited (Australia), World Class Accident Repairs (Cheltenham North) Pty Limited (Australia), Mutual Community General Insurance Proprietary Limited (Australia), NHCT Limited (Thailand), and Safety Insurance Public Company Limited (Thailand). During the financial year ended 30 June 2007, the Consolidated entity acquired the minority interests in Mike Henry Travel Insurance Limited (New Zealand) and DriveRight Limited (New Zealand).

## NOTE 23. NOTES TO THE CASH FLOW STATEMENTS

	PARENT		CONSOLIDATED	
	2008 \$m	2007 \$m	2008 \$m	2007 \$m
<b>A. COMPOSITION</b>				
Cash and cash equivalents	–	–	<b>1,234</b>	1,163
	–	–	<b>1,234</b>	1,163

Cash and cash equivalents represent cash on hand and held with banks, deposits at call and money market securities readily convertible to cash within two working days, net of any bank overdraft. There are no cash balances held that are not available for use in normal operations. The carrying amount of the cash and cash equivalents presented on the balance sheets is the same as that used for the purposes of the cash flow statements as there are no bank overdrafts used which are repayable upon demand.

### B. SIGNIFICANT RISKS

The net carrying amount of cash and cash equivalents represents the maximum exposure to credit risk relevant to cash and cash equivalents at reporting date and is equivalent to the fair value of the assets because of the negligible credit risk and frequent repricing.

A portion of the cash balances are held in currencies other than Australian dollar. For information regarding the management of currency risk by the Group refer to the financial risk management note.

The majority of the amounts bear variable rates of interest. Those balances bearing a fixed rate of interest mature in less than one year. A small portion of the amounts bear no interest.

### C. RECONCILIATION OF PROFIT/(LOSS) FOR THE YEAR TO NET CASH FLOWS FROM OPERATING ACTIVITIES

Profit/(loss) for the year	<b>764</b>	353	<b>(226)</b>	629
Depreciation and impairment of property, plant and equipment	–	–	<b>87</b>	61
Amortisation and impairment of intangible assets and goodwill	–	–	<b>461</b>	80
Net realised (gains) and losses on disposal of investments	<b>(10)</b>	–	<b>(29)</b>	23
Net unrealised (gains) and losses on revaluation of investments	<b>7</b>	–	<b>209</b>	(184)
Net (gains) and losses on disposal of property, plant and equipment	–	–	–	4
Provision for doubtful debts and impairment	–	–	<b>3</b>	2
Retained earnings adjustment for actuarial gains and (losses) on defined benefit superannuation plans	–	–	<b>(37)</b>	40
Retained earnings adjustment for share based remuneration	–	–	<b>25</b>	15
Unrealised (gains) and losses on embedded derivatives	<b>(69)</b>	–	<b>(69)</b>	–
Other	<b>2</b>	2	<b>(14)</b>	(16)
<b>Decrease/(increase) in operating assets</b>				
Premium and other receivables	<b>37</b>	5	<b>372</b>	(652)
Prepayments and deferred levies and expenses	–	–	<b>(42)</b>	(73)
Deferred tax assets	<b>(2)</b>	(5)	<b>(12)</b>	(36)
Current tax assets	–	–	<b>1</b>	(18)
Inventories	–	–	–	(1)
Defined benefit superannuation asset	–	–	<b>59</b>	(62)
<b>Increase/(decrease) in operating liabilities</b>				
Trade and other payables	<b>(65)</b>	43	<b>36</b>	(51)
Provisions	–	–	<b>57</b>	8
Current tax liabilities	<b>14</b>	(36)	<b>2</b>	(32)
Deferred tax liabilities	–	–	<b>(39)</b>	16
Outstanding claims liability	–	–	<b>(735)</b>	470
Unearned premium liability	–	–	<b>(116)</b>	189
Unexpired risk liability	–	–	<b>12</b>	(11)
Net cash flows from operating activities	<b>678</b>	362	<b>5</b>	401

### D. SIGNIFICANT NON CASH TRANSACTIONS RELATING TO FINANCING AND INVESTING TRANSACTIONS

There were no financing or investing transactions during the year which have had a material effect on the assets and liabilities that did not involve cash flows.

## NOTE 24. ACQUISITIONS AND DISPOSALS OF BUSINESSES

There were no acquisitions or disposals of businesses by the Parent during the year (2007—none). The following acquisitions and disposals of businesses relate to the Consolidated entity.

### A. ACQUISITION OF SUBSIDIARIES

#### I. For the financial year ended 30 June 2008

##### a. ACQUISITION OF REGIONAL BROKING BUSINESSES IN THE UNITED KINGDOM

The IAG Group continued with its strategy in the UK of acquiring smaller regional brokers. There were several businesses acquired during the year with total consideration paid of \$45 million. The largest three acquisitions during the year were the purchase of Barnett & Barnett effective 10 March 2008 for a total acquisition cost (including transaction costs) of \$26 million, the purchase of Just Idol Limited (trading as Diamond Insurance Services) effective 2 November 2007 for a total acquisition cost (including transaction costs) of \$5 million and purchase of Bryan & Knott Holdings Limited effective 4 April 2008 for a total acquisition cost (including transaction costs) of \$5 million. The additional

information regarding these three largest acquisitions provided below is disclosed on an aggregated basis as the individual acquisitions were not significant to the IAG Group. The acquired businesses form part of the UK cash generating unit.

##### b. ACQUISITION OF NEW ZEALAND BASED GENERAL INSURANCE BUSINESS

The IAG Group acquired the renewal business of Anthony Runacres and Associates Limited effective 30 November 2007 for a total acquisition cost of \$7 million including transaction costs and the estimated present value of deferred consideration. The business consists of insurance and risk professionals who specialise in fire and general insurance broking in the commercial sector. This business forms part of the NZ cash generating unit.

##### c. ACQUISITION OF SPECIALIST UNDERWRITER IN THE AUSTRALIA COMMERCIAL INSURANCE MARKET

The IAG Group acquired Strata Unit Underwriting Agency Pty Ltd effective from 18 April 2008. The business consists of an underwriting operation specialising in strata insurance. This business forms part of the Australia cash generating unit.

	UK BRANCH ACQUISITIONS \$M
<b>2008</b>	
Purchase price	
Cash paid	<b>33</b>
Present value of deferred payments	<b>1</b>
Present value of contingent payments	<b>1</b>
Costs directly associated with acquisitions	<b>1</b>
<b>Total purchase consideration</b>	<b>36</b>
Fair value of net identifiable assets acquired recognised by acquiree	
Cash and cash equivalents	<b>10</b>
Receivables	<b>11</b>
Payables	<b>(14)</b>
Current tax liabilities	<b>(1)</b>
<b>Net identifiable assets acquired</b>	<b>6</b>
Intangible assets recognised upon acquisition	
Customer relationships	<b>14</b>
Goodwill	<b>16</b>
	<b>30</b>

The fair value of assets and liabilities are based on discounted cash flow models or the book values have been used as a proxy for fair value. In addition to the intangible assets recognised and disclosed above, there are other intangible benefits that have been acquired. These benefits have not been recognised separately from goodwill because they were not separately recognisable and/or were not able to be reliably measured. These assets are principally the value of the workforce acquired and the value of cost and revenue synergies relating largely to an ability to provide improved products and services to customers.

The measurement of identifiable intangible assets acquired in a business combination is highly subjective and there are a range of possible values that could be attributed for initial recognition. The IAG Group uses the skills and experience of valuation specialists in establishing an initial range within which the fair value is to be recognised. Judgement is then applied in selecting the value to be recognised on the balance sheet. Judgement is also applied in determining the useful life of the intangible assets which impacts directly on the amortisation charges to be incurred following an acquisition.

<b>2008</b>	
Cash consideration paid	<b>33</b>
Cash balance acquired	<b>(10)</b>
<b>Net outflow of cash</b>	<b>23</b>
Contribution from the acquired businesses (from date of acquisition)	
Income	<b>5</b>
<b>Profit/(loss) before income tax</b>	<b>1</b>

## II. For the financial year ended 30 June 2007

### a. ACQUISITION OF A UNITED KINGDOM BASED

#### GENERAL INSURANCE BUSINESS AND INSURANCE BROKER

On 4 December 2006, the Consolidated entity announced that it would acquire EIG (Investments) Limited the holding company of the Equity Insurance Group. Equity Insurance Group is the UK's fifth largest motor underwriter, the eighth largest motor insurance broker and the largest motorcycle insurer. It operates through two key businesses—Equity Insurance Brokers and Equity Red Star, Lloyd's largest motor insurance syndicate.

The acquisition was completed on 8 January 2007 upon receipt of regulatory approval. The IAG Group consolidated Equity Insurance Group from and including 1 January 2007.

The total consideration for the acquisition was \$1,425 million (including transaction costs) and was funded by the issue of ordinary shares, raising of long term debt and use of existing internal funds.

The key changes made to bring the financial position of the acquired entities prepared in accordance with UK GAAP in line with the significant accounting policies of the Consolidated entity related to alignment of outstanding claims liability reserving policies. After those adjustments were made there were no significant fair value adjustments acquired.

### b. ACQUISITION OF A UNITED KINGDOM BASED

#### INSURANCE BROKER AND GENERAL INSURANCE BUSINESS

The Consolidated entity, effective 29 September 2006, acquired 100% of the share capital of Hastings Insurance Services Limited (Hastings) and Advantage Insurance Company Limited (Advantage) which are involved in general insurance broking and underwriting in the UK, for total acquisition cost (including transaction costs) of \$349 million.

The key changes made to bring the financial position of the acquired entities prepared in accordance with UK GAAP in line with the significant accounting policies of the Consolidated entity related to alignment of outstanding claims liability reserving policies. After those adjustments were made, there was only one significant fair value adjustment that revalued a property upwards from its historical cost.

### c. ACQUISITIONS OF A LLOYD'S MANAGING AGENCY AND SPECIALIST ASIAN SYNDICATE

Effective from 3 July 2006 the Consolidated entity acquired a newly formed Lloyd's managing agency and specialist Asian syndicate to support the development and management of its expanding Asia business for a total acquisition cost of \$23 million. The businesses operate as Alba Group Pte Limited (Alba). The syndicate has access to all markets in which Lloyd's is licensed.

### d. ACQUISITION OF A NORTHERN IRELAND BASED INSURANCE BROKER BUSINESS

The Consolidated entity acquired Open & Direct Insurance Services Limited (Open & Direct) and its subsidiaries effective 17 January 2007 for a total acquisition cost (including transaction costs) of \$57 million.

### CHANGES DURING 2008 ON 2007 ACQUISITIONS

The Consolidated entity, effective 29 September 2006, acquired 100% of the share capital of Hastings and Advantage which are involved in general insurance broking and underwriting in the UK. The fair value of the net assets and acquired intangible assets were reported in the 30 June 2007 financial report on a provisional basis. The table below shows the final amounts used in accounting for the transaction together with adjustments made to the provisional amounts.

	CONSOLIDATED		
	Provisional \$m	Adjustment \$m	Final \$m
Purchase consideration (including transaction costs) <sup>(i)</sup>	349	(28)	321
Total assets	447	–	447
Total liabilities <sup>(i)</sup>	(422)	(28)	(450)
Fair value of net identifiable assets acquired	25	(28)	(3)
Customer relationships <sup>(ii)</sup>	52	(36)	16
Brands	96	–	96
Other contractual arrangements—software	20	–	20
Fair value of identifiable intangible assets acquired	168	(36)	132
Goodwill <sup>(ii)</sup>	156	36	192
	324	–	324

(i) This adjustment to the acquired tax liabilities reflects a final assessment received from the UK tax authority of tax liabilities relating to Hastings for tax periods prior to the date when the company was acquired by the IAG Group. The change has been reflected as an adjustment to the consideration paid as the amount is being recovered from the retention account with a portion of the original consideration paid having being retained to settle this known liability. This adjustment has therefore had no impact on the goodwill recognised.

(ii) Detailed work completed in the first half year of the current reporting period resulted in the identification of errors with certain inputs used in the provisional acquisition date valuation of one of the acquired intangible assets. The correction of these inputs resulted in a reallocation of value between the acquired intangible asset and goodwill.

	CONSOLIDATED			
	Open & Direct \$m	Alba \$m	Hastings and Advantage \$m	Equity Insurance Group \$m
2007				
Purchase price				
Cash paid	55	–	318	1,323
Present value of deferred payments*	–	23	–	93
Costs directly associated with acquisitions	2	–	3	9
<b>Total purchase consideration</b>	<b>57</b>	<b>23</b>	<b>321</b>	<b>1,425</b>
Fair value of net identifiable assets acquired recognised by acquiree				
Cash and cash equivalents	9	–	81	1,202
Investments	–	–	187	889
Receivables	6	–	114	463
Deferred acquisition costs	–	–	8	104
Property, plant and equipment	1	–	34	51
Deferred tax assets	–	–	–	81
Capitalised software development expenditure	–	–	–	31
Payables	(16)	–	(97)	(91)
Current tax liabilities	(1)	–	(12)	–
Unearned premium liability	–	–	(138)	(383)
Outstanding claims liability	–	–	(132)	(1,044)
Interest bearing liabilities	–	–	(71)	(906)
Other	(1)	–	23	(115)
<b>Net identifiable assets acquired</b>	<b>(2)</b>	<b>–</b>	<b>(3)</b>	<b>282</b>
Intangible assets recognised upon acquisition				
Distribution channels	–	–	–	269
Customer relationships	44	–	16	112
Brands	1	–	96	79
Other contractual arrangements	–	–	20	–
Lloyd's syndicate capacity	–	–	–	138
Goodwill	14	23	192	545
	<b>59</b>	<b>23</b>	<b>324</b>	<b>1,143</b>

\* Deferred settlement on Equity Insurance Group comprised of unsecured notes (face value of £38 million) and DARs (2,141,470 rights with a grant date fair value of \$12 million).

The fair value of assets and liabilities are based on discounted cash flow models or the book values have been used as a proxy for fair value. In addition to the intangible assets recognised and disclosed above, there are other intangible benefits that have been acquired. These benefits have not been recognised separately from goodwill because they were not separately recognisable and/or were not able to be reliably measured. These assets are principally the value of the workforce acquired and the value of cost and revenue synergies relating largely to an ability to provide improved products and services to customers.

The measurement of identifiable intangible assets acquired in a business combination is highly subjective and there are a range of possible values that could be attributed for initial recognition. The IAG Group uses the skills and experience of valuation specialists in establishing an initial range within which the fair value is to be recognised. Judgement is then applied in selecting the value to be recognised on the balance sheet. Judgement is also applied in determining the useful life of the intangible assets which impacts directly on the amortisation charges to be incurred following an acquisition.

	CONSOLIDATED			
	Open & Direct \$m	Alba \$m	Hastings and Advantage \$m	Equity Insurance Group \$m
2007				
Cash consideration paid	57	–	321	1,332
Cash balance acquired	(9)	–	(81)	(1,202)
Net outflow of cash	48	–	240	130
Contribution from the acquired businesses (from date of acquisition)				
Income	n/a*	12	329	557
Profit/(loss) before income tax	n/a*	(13)	(21)	2

\* Amounts for Open & Direct are included in the disclosure for Equity Insurance Group for these items.

The income, GWP and profit of the Consolidated entity for the year ended 30 June 2007 would have increased by \$408 million and \$43 million respectively, had the subsidiaries acquired during the financial year been consolidated from the beginning of the financial year.

This information is at least in part based on the acquiree's unaudited management accounts prepared in accordance with the acquiree's accounting policies and does not include fair value adjustments. This information is not necessarily indicative of the operating results that would have occurred if the acquisition had been completed at the beginning of the financial year or of the operating results in future years at least in part because the information does not include expenses relating to integration of the businesses or the operating synergies to be realised.

## B. OTHER ACQUISITIONS

### I. For the financial year ended 30 June 2008

There were no other acquisitions.

### II. For the financial year ended 30 June 2007

#### a. MIKE HENRY TRAVEL INSURANCE LIMITED

On 7 July 2006 the remaining 49.9% share of Mike Henry Travel Insurance Limited, a specialist travel underwriter in NZ, was acquired for a purchase consideration of \$4 million.

#### b. DRIVERIGHT LIMITED

On 20 October 2006 the remaining 49% share of DriveRight Limited, a specialist underwriter of mechanical breakdown insurance in NZ, was acquired for a purchase consideration of \$2 million.

## C. DISPOSAL OF SUBSIDIARIES

### I. For the financial year ended 30 June 2008

#### a. DISPOSAL OF CGU PREMIUM FUNDING LOAN BUSINESS

Effective 17 August 2007, the IAG Group disposed of the existing and ongoing loan business of CGU Premium Funding Pty Limited. A net profit of \$9 million was recognised from the sale of the business.

#### b. HELD FOR SALE—ALBA GROUP

The Alba inwards reinsurance operation which consists of an Asian based Lloyd's syndicate and a UK based managing agent was classified as held for sale at the current reporting date. The disposal of this business is expected to complete in the coming financial year.

### II. For the financial year ended 30 June 2007

There were no disposals of subsidiaries by the Consolidated entity.

## NOTE 25. DETAILS OF SUBSIDIARIES

The following entities constitute the Consolidated entity:

	NOTES	COUNTRY OF INCORPORATION/FORMATION	EXTENT OF BENEFICIAL INTEREST IF NOT 100%	
			2008 %	2007 %
<b>ULTIMATE PARENT</b>				
Insurance Australia Group Limited		Australia		
<b>SUBSIDIARIES</b>				
<b>Australian general insurance operations</b>				
Insurance Australia Limited		Australia		
NRMA Personal Lines Holdings Pty Limited		Australia		
Insurance Manufacturers of Australia Pty Limited		Australia	<b>70.00</b>	70.00
World Class Accident Repairs (Cheltenham North) Pty Limited		Australia	<b>70.00</b>	70.00
CGU Insurance Australia Limited		Australia		
CGU Insurance Limited		Australia		
Swann Insurance (Aust) Pty Ltd		Australia		
Mutual Community General Insurance Proprietary Limited		Australia	<b>51.00</b>	51.00
IAG Re Australia Limited (formerly NZI Insurance Australia Limited)		Australia		
Sitrof Australia Limited		Australia		
CGU-VACC Insurance Limited		Australia		
CGU Workers Compensation (NSW) Limited		Australia		
CGU Workers Compensation (VIC) Limited		Australia		
CGU Workers Compensation (SA) Limited		Australia		
CGU Premium Funding Pty Ltd		Australia		
Strata Unit Underwriting Agency Pty Limited		Australia		–
<b>New Zealand operations</b>				
IAG (NZ) Holdings Limited	C	New Zealand		
IAG New Zealand Limited	C, E	New Zealand		
Mike Henry Travel Insurance Limited	C	New Zealand		
National Auto Club Underwriters Agency (NZ) Limited	C	New Zealand		
Clipper Club Underwriters Limited	C	New Zealand		
DriveRight Limited	B	New Zealand		
New Zealand Insurance Limited	C	New Zealand		
State Insurance Limited	C	New Zealand		
Direct Insurance Services Limited	C	New Zealand		
Swann Insurance (NZ) Limited	C	New Zealand		
IAG (NZ) Share Plan Nominee Limited	C	New Zealand		
The IAG New Zealand Limited Employee Share Plan	C	New Zealand		
The IAG Performance Awards Rights Plan for Executives in New Zealand	C	New Zealand		
NZI Staff Superannuation Fund Nominees Limited	C	New Zealand		
Belves Investments Limited	C	New Zealand		
Anthony Runacres and Associates Limited	C	New Zealand		

	NOTES	COUNTRY OF INCORPORATION/FORMATION	EXTENT OF BENEFICIAL INTEREST IF NOT 100%	
			2008 %	2007 %
<b>United Kingdom operations</b>				
IAG UK Holdings Limited	C	United Kingdom		
EIG (Investments) Limited	C	United Kingdom		
Equity Insurance Group Limited	C	United Kingdom		
Equity Insurance Holdings Ltd	C	United Kingdom		
Equity Red Star Limited	C	United Kingdom		
Equity Syndicate Management Limited	C	United Kingdom		
Equity Red Star Services Limited	C	United Kingdom		
Equity Group 2005 Limited	C	United Kingdom		
Equity Insurance Management Limited	C	United Kingdom		
Equity Red Star Holdings Limited	C	United Kingdom		
Equity Insurance Properties Limited	C	United Kingdom		
Can Do Finance Limited	C	United Kingdom		
Equity Nominee Services Limited	C	United Kingdom		
ERSH Limited	C	United Kingdom		
Cox Managing Agency Limited	C	United Kingdom		
Equity Shared Services Limited	C	United Kingdom		
Cox Commercial Limited	C	United Kingdom		
CDCM (No2) Limited	C	United Kingdom		
CDCM Limited	C	United Kingdom		
Equity Broking Management Limited	C	United Kingdom		
Equity Red Star (accident & health) Limited	C	United Kingdom		
Argent Insurance Practice Limited	C	United Kingdom		
Bennetts UK Limited	C	United Kingdom		
J McWhirter (Insurance Brokers) Limited	C	United Kingdom		
M K Lyle (Life & Pensions) Limited	C	United Kingdom		
HML Marketing Limited	C	United Kingdom		
Brokersure.co.uk Limited	C	United Kingdom		
Equity Claims Limited	C	United Kingdom		
Equity Insurance Brokers Limited	C	United Kingdom		
Anthony Kidd Agencies Limited	C	United Kingdom		
Direct Insurance Services Limited	C	United Kingdom		
Open & Direct Insurance Services Limited	C	United Kingdom		
Open & Direct Insurance Services (Newtownards) Limited	C	United Kingdom		
Open & Direct Insurance Services (Dungiven) Limited	C	United Kingdom		
W.G. O'Kane Life & Pensions Ltd	C	United Kingdom		
Advantage Insurance Company Limited	C	Gibraltar		
Hastings Insurance Services Limited	C	United Kingdom		
IAG Conquest House Limited	C	United Kingdom		
Empire Equity Limited	C	Gibraltar		
Logan Consultants Limited	C	Gibraltar		
EIG (Finance) Limited	C	United Kingdom		
Wedring Limited	C	United Kingdom		
Barnett & Barnett Holdings Limited	C	United Kingdom		
Barnett & Barnett Ltd	C	United Kingdom		–
Barnett & Barnett Financial Services Ltd	C	United Kingdom		–
Bryan & Knott Insurance Services Ltd	C	United Kingdom		–
Just Idol Limited	C	United Kingdom		–
<b>Other International operations</b>				
IAG Re Labuan (L) Berhad	C	Malaysia		
IAG (Asia) General Pte Ltd	C	Singapore		
NHCT Limited	C, F	Thailand	49.10	49.00
IAG Insurance (Thailand) Ltd	D	Thailand		
Safety Insurance Public Company Limited	D	Thailand	96.09	96.09
Beijing Continental Automobile Association Limited	C, D	China		
IAG India (Mauritius) (formerly IAG China (Mauritius))	C	Mauritius		
IAG Investments Management Services (Shanghai) Company Limited	B, D	China		–

	NOTES	COUNTRY OF INCORPORATION/FORMATION	EXTENT OF BENEFICIAL INTEREST IF NOT 100%	
			2008 %	2007 %
<b>Investment operations</b>				
IAG Asset Management Limited		Australia		
IAG Nominees Pty Limited		Australia		
IAG Portfolio Limited		Australia		
IAG Asset Management Cash Management Trust		Australia	<b>94.21</b>	73.22
IAG Asset Management Private Equity Trust		Australia	<b>83.21</b>	83.20
IAG Asset Management Fund of Hedge Funds		Australia		
Merrill Lynch Market Neutral Trust		Australia		
Perpetual Market Neutral Trust		Australia	<b>97.11</b>	
GMO Market Neutral Trust		Australia	<b>85.20</b>	78.23
ACA Acadian Market Neutral Trust		Australia		
IAGAM Arrowstreet Macquarie Market Neutral Trust		Australia		–
IAGAM Sustainable Investment Trust		Australia	<b>50.00</b>	–
<b>Corporate operations</b>				
IAG International Pty Limited		Australia		
NRMA Information Services Pty Limited		Australia		
NRMA Insurance Funding 2003 Limited		Australia		
IAG Finance (New Zealand) Limited		Australia		
Insurance Australia Group Services Pty Limited		Australia		
IAG & NRMA Superannuation Pty Limited	A	Australia		
IAG Share Plan Nominee Pty Limited	A	Australia		
The IAG Share and Performance Award Rights Plan Trust		Australia		
The IAG Deferred Awards Rights Plan		Australia		
The IAG Executive Performance Rights Plan		Australia		
ACN 007 078 140 Pty Limited	A	Australia		
Insurance Australia Funding 2007 Limited		Australia		–
Micro Wind Turbines Australia Pty Limited	A	Australia	<b>50.00</b>	–
<b>Subsidiaries that commenced deregistration after 30 June 2008</b>				
China Investments (Mauritius)	C	Mauritius		
<b>Subsidiaries held for sale as at 30 June 2008</b>				
Alba Group Pte Ltd	C	Singapore		
Alba Pte Ltd	C	Singapore		
Alba Underwriting Ltd	C	United Kingdom		
Diagonal Underwriting Agency Limited	C	United Kingdom		
<b>Entities deregistered during the year ended 30 June 2008</b>				
EIG (Acquisitions) Limited	C	United Kingdom	–	
<b>Entities put into liquidation during the year ended 30 June 2008</b>				
IAG Re Limited	C	Ireland	–	

#### General notes relating to a number of subsidiaries

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

B Audited by accounting firms not affiliated with KPMG.

C Audited by overseas KPMG firms.

D All subsidiaries have a 30 June financial year end, except these companies which have a 31 December year end. These entities have been consolidated using financial information as at 30 June.

E All subsidiaries have only ordinary shares on issue except this entity also has perpetual preference shares on issue.

F The following special conditions exist with respect to the IAG Group's Thailand subsidiaries:

- IAG International Pty Limited owns 49% of the share capital of NHCT Limited and has a majority voting right and the right to appoint the board of directors of NHCT Limited. Therefore, NHCT Limited is considered a subsidiary of IAG International Pty Limited. The remaining 51% is held by Allessi Capital Co., Ltd, a company registered in Thailand; and
- IAG International Pty Limited owns 25% directly in IAG Insurance (Thailand) Ltd and is able to govern the financial and operating policies of the company through a further 75% interest held indirectly through its holding in NHCT Limited.

## NOTE 26. INVESTMENT IN JOINT VENTURES AND ASSOCIATES

	NOTES	REPORTING DATE	COUNTRY OF FORMATION	CARRYING VALUE	PRINCIPAL ACTIVITY	OWNERSHIP INTEREST	
				2008 \$m		2008 %	2007 %
<b>A. INTERESTS IN JOINT VENTURES AND ASSOCIATES</b>							
<b>Joint venture</b>							
NTI Limited	A, C, D	30 June	Australia	2	Managing co insurance arrangement	50.00	50.00
Assetinsure Financial Risk Products Pty Limited	A	30 June	Australia	–	Risk insurance products	50.00	–
<b>Associates</b>							
AmAssurance Berhad	C	31 March	Malaysia	68	Insurance underwriting	30.00	30.00
First Rescue and Emergency (NZ) Limited	A, C	31 March	New Zealand	–*	Roadside assistance	50.00	50.00
Loyalty New Zealand Limited	A, C	31 March	New Zealand	–*	Loyalty program	25.00	25.00
Sureplan NZ Limited	A, C	31 March	New Zealand	–*	Fleet risk management	30.00	30.00
AR Hub Pty Ltd	A, B	30 June	Australia	–*	Software development	33.33	33.33
Arista Insurance Limited		31 December	United Kingdom	–*	Wholesale broker	25.60	25.60
InsuranceWide.com Services Limited		31 December	United Kingdom	–*	Online aggregator	26.70	26.70
AmG Insurance Berhad		31 March	Malaysia	–*	Holding company	30.00	–
				<b>70</b>			

\* Amounts round to zero.

### General notes relating to a number of joint ventures and associates

A Investment is measured at cost in the Consolidated entity due to materiality.

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

C Audited by accounting firms not affiliated with KPMG.

D The following special condition exists with respect to the NTI Limited joint venture:

- CGU Insurance Limited, a subsidiary of the Consolidated entity, has a 50% interest in NTI Limited, the principal activity of which is to facilitate a co insurance arrangement of commercial motor vehicle business. The Consolidated entity's portion of the results of the co insurance arrangement is recorded directly in its accounting records.

None of the associates is listed on a stock exchange. Those entities that are equity accounted and that do not have a 30 June financial year end are equity accounted for using financial information for the year to 30 June which includes, at least in part, unaudited management results.

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>B. RECONCILIATION OF MOVEMENTS IN INVESTMENT IN JOINT VENTURES AND ASSOCIATES FOR THE FINANCIAL YEAR</b>		
Balance at the beginning of the financial year	75	74
Investment in associate acquired during the financial year	–	3
Share of associate's net profit/(loss)	(3)	5
Net foreign exchange movements	(1)	(6)
Dividends received	(1)	(1)
Balance at the end of the financial year	70	75

### C. SUMMARISED FINANCIAL INFORMATION OF ASSOCIATE

These disclosures relate only to the investment in AmAssurance Berhad (AmAssurance), as all other investments in joint ventures and associates are not significant.

Assets	803	731
Liabilities	173	657
Revenue	340	343
Profit*	13	18

\* These amounts are for the year ended 31 March, being the financial year of AmAssurance, and have been extracted from the audited financial report of AmAssurance.

### D. COMMITMENTS AND CONTINGENT LIABILITIES

There are no capital or other commitments or contingent liabilities arising from the investment in AmAssurance that are significant to the Consolidated entity.

## NOTE 27. EMPLOYEE BENEFITS

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>A. EMPLOYEE BENEFITS PROVISION</b>		
Annual leave	82	82
Long service leave	61	59
Cash based incentive arrangements	86	76
Defined benefit pensions*	9	10
Defined benefit superannuation plans liabilities	5	15
	<b>243</b>	<b>242</b>

\* There is one defined benefit pension arrangement in Australia with a discounted liability of \$7 million as at 30 June 2008 (2007—\$7 million) involving 78 participants (2007—82) and one defined benefit pension arrangement in NZ with a discounted liability of \$2 million as at 30 June 2008 (2007—\$3 million) involving 48 participants (2007—51). These liabilities are met from the general assets of the relevant subsidiary rather than assets being set aside in trust.

The employee benefits provision includes \$50 million (2007—\$59 million) which is expected to be settled after more than 12 months from reporting date.

### B. EMPLOYEE NUMBERS

The Consolidated entity had 14,626 employees on a full time equivalent basis as at 30 June 2008 (2007—15,445).

### C. CASH BASED INCENTIVE ARRANGEMENTS

#### I. STI Plan

The STI Plan continued in operation during the year ended 30 June 2008. Eligible employees have the capacity to earn a proportion of their base pay as a cash incentive annually. The incentive opportunity is set depending on an employee's role and responsibilities. The majority of employees are on a 10%, 15% or 20% plan. The incentive payments are determined based on an assessment of individual performance and achievement of a range of business unit and individual goals.

#### II. IMA LTI scheme

A LTI is provided to senior employees of IMA. This is a cash based incentive arrangement involving hurdles relating to compound growth in the IMA underwriting result and growth of risks in force.

#### III. Employee share plans

The following two employee share plans do not represent a remuneration benefit and so are not treated as share based remuneration but rather provide access for employees to available tax concessions.

##### a. EXEMPT PURCHASE OFFER—AUSTRALIA ONLY

The Exempt Purchase Offer (EPO) allows Australian employees to voluntarily elect to receive up to \$1,000 of their salary in the form of IAG shares, free of income tax, provided certain conditions are met. The plan is designed to utilise a tax concession known as the tax exemption concession. Employees set aside funds for the purchase through a salary sacrifice arrangement. Brokerage is subsidised by the IAG Group. There is no vesting period. The shares are purchased on market and are subject to a three year restriction period during which the shares cannot be sold or dealt with. The employee is entitled to dividends and voting rights from the date of allocation. There are no circumstances under which the shares can be forfeited.

##### b. DEFERRED PURCHASE OFFER—AUSTRALIA ONLY

The Deferred Purchase Offer (DPO) allows all full and part time Australian employees of the IAG Group to voluntarily elect to receive a minimum of \$1,500 of their salary, up to a maximum 30% of salary, in the form of IAG shares. The plan is designed to utilise a tax concession known as the tax deferral concession. Employees set aside funds for the purchase through a salary sacrifice arrangement. Brokerage is subsidised by the IAG Group. There is no vesting period. The shares are purchased on market and held in trust subject to a restriction period for tax purposes of up to 10 years. The employee is entitled to receive dividend distributions and can vote (by providing voting instructions to the trustee) from the date of allocation. The only circumstance under which the shares can be forfeited is in the case of serious misconduct.

## NOTE 28. SHARE BASED REMUNERATION

The provision of share based remuneration creates a link between shareholder value creation and rewarding employees. Share based remuneration encourages employee share ownership, links employee reward to the performance of the IAG Group and assists with retention of key personnel. This type of remuneration encourages employees to focus on creating shareholder value over the longer term.

The obligations under share based payment arrangements are covered by the on market purchase of IAG ordinary shares which are held in trust. The shares are purchased on or near grant date at the prevailing market price. The arrangements are managed using in house trusts, one for Australia and two for NZ, which are controlled for accounting purposes and so are subsidiaries of the Consolidated entity. The trustee for each trust is a subsidiary of the Consolidated entity. The trusts are administered by an external company.

The number of shares purchased to cover each tranche is determined by the trustee based on independent actuarial advice. The trusts allow for excess shares purchased in relation to one plan to be used to meet obligations of the other plans at the trustee's discretion. The trusts held 14,640,418 shares as at 30 June 2008 (2007—13,863,210 shares) representing 0.78% (2007—0.77%) of the share capital. This includes shares that are not controlled for accounting purposes and so not recognised as treasury shares.

Trading in IAG shares that are awarded under the share based remuneration arrangements is covered by the same restrictions that apply to all forms of share ownership by employees. These restrictions limit an employee trading in IAG shares where they are in a position to be aware, or are aware, of price sensitive information.

Share based remuneration is provided through a range of different plans each of which has different purposes and different rules. The share based remuneration expense amounts are included in the claims expense, other underwriting expenses, and corporate, administration and other expenses lines in the income statement.

### A. NON-EXECUTIVE DIRECTORS' SHARE PLAN

The Non-Executive Director's Share Plan continued in operation during the year ended 30 June 2008. Non-executive directors are required to receive at least 20%, but not in excess of 90%, of their annual IAG Board fee (at the time shares are allocated) in IAG shares, rather than in cash. Annual share allocations are generally made effective from 1 December each year. The shares vest on a pro rata daily basis with limited forfeiture conditions and the participant is entitled to dividends and other shareholder rights during the vesting period. The on market share price at grant date is used as the fair value of the equity instruments granted which for those granted during the current reporting period was \$4.44. The shares are purchased on market and held in trust subject to a restriction period, for tax purposes, of between one and 10 years. The number of shares purchased is determined by the amount of the base fee each director is to receive in IAG shares, the weighted average market price of the shares at the date of allocation, and the trustee's discretion to use excess shares from another plan.

## B. SENIOR MANAGEMENT AND EXECUTIVE SHARE PLANS

The senior management and executive share plan arrangements consist of two separate arrangements working together. These two arrangements are the EPRs Plan and the DARs Plan which are detailed below. The IAG NRSC approve the participation of each individual in the plans. There remain in place share plan arrangements that are now closed to new offers but within which there remain outstanding rights to be settled with the most significant being the PARs Plan.

### I. DARs Plan

The DARs Plan continued in operation during the year ended 30 June 2008 having been implemented in November 2006. The structure and operation of the plan is the same for employees in each geographical region. The rights are granted for nil consideration, are non transferable, and can be settled only with existing IAG shares. Where the rights vest (the holder becomes entitled to exercise the right), the plan entitles participating employees to acquire one IAG ordinary share for each right.

The exercise price for all rights is a nominal value of \$1 per tranche of rights exercised. Holders do not receive dividends and do not have voting rights until the rights are exercised. IAG shares are bought on market and held in trust to satisfy future exercise of the rights.

The rights vest after a period (current maximum is three years) as determined by the board subject to the participants continuing in relevant employment for the full period. When a participant ceases employment in special circumstances such as redundancy, rights may vest on cessation of employment. If there is a change of control of IAG, the board has discretion to determine if and when rights should vest.

If the vesting condition is not met then the rights lapse. The rights also lapse where the holder chooses to forego the rights, and all rights expire 10 years from grant date where they have not previously lapsed or been exercised. The following information relates to the rights issued under the DARs Plan:

GRANT DATE	FAIR VALUE AT GRANT DATE	RIGHTS ON ISSUE AT BEGINNING OF YEAR	RIGHTS GRANTED DURING YEAR	RIGHTS EXERCISED DURING YEAR	RIGHTS LAPSED DURING YEAR	NUMBER OF RIGHTS AT END OF YEAR	
						On issue	Exercisable
<b>2008</b>							
GRANT DATE							
19/12/2006	\$5.354	2,310,480	-	(133,063)	(153,408)	2,024,009	8,905
13/03/2007	\$5.156	217,312	-	-	(8,250)	209,062	-
27/09/2007	\$4.820	-	4,868,200	(66,550)	(227,200)	4,574,450	3,350
11/02/2008	\$2.810	-	26,345	-	-	26,345	-
14/04/2008	\$3.330	-	55,370	-	-	55,370	-
		<b>2,527,792</b>	<b>4,949,915</b>	<b>(199,613)</b>	<b>(388,858)</b>	<b>6,889,236</b>	<b>12,255</b>
<b>2007</b>							
GRANT DATE							
19/12/2006	\$5.354	-	2,370,852	(21,937)	(38,435)	2,310,480	30,598
13/03/2007	\$5.156	-	219,562	-	(2,250)	217,312	-
		-	2,590,414	(21,937)	(40,685)	2,527,792	30,598

In addition to the grant of DARs shown above, an additional 2,141,470 DARs were issued from 8 January 2007 as part of the consideration for the acquisition of the Equity Insurance Group (refer notes 24.A and 32.C.III).

The fair value of the rights is calculated as at the grant date using a Black Scholes valuation.

	SIGNIFICANT FACTORS AND ASSUMPTIONS USED		
	27/09/2007	11/02/2008	14/04/2008
<b>2008</b>			
Grant date			
Share price on grant date (\$)	\$5.24	\$3.57	\$3.86
Exercise price (\$)	\$1 per tranche exercised	\$1 per tranche exercised	\$1 per tranche exercised
Risk free interest rate (%)	6.94%	7.61%	7.32%
Expected dividend yield (%)	5.73%	8.26%	7.64%
Expected life of rights (years)	2 years	3 years	2 years
<b>2007</b>			
Grant date		19/12/2006	13/03/2007
Share price on grant date (\$)		\$6.16	\$5.96
Exercise price (\$)		\$1 per tranche exercised	\$1 per tranche exercised
Risk free interest rate (%)		6.39%	6.34%
Expected dividend yield (%)		4.79%	4.95%
Expected life of rights (years)		3 years	3 years

Some of the assumptions are based on historical data which is not necessarily indicative of future trends. Reasonable changes in these assumptions would not have a material impact on the amounts recognised in the financial statements.

## II. EPRs Plan

The EPRs Plan was implemented in October 2007. The structure and operation of the plan is the same for employees in each geographical region. The rights are granted for nil consideration, are non transferable, and can be settled only with existing IAG shares. Where the rights vest (the holder becomes entitled to exercise the right), the plan entitles participating employees to acquire one IAG ordinary share for each right. There is no exercise price. Holders do not receive dividends and do not have voting rights until the rights are exercised. IAG shares are bought on market and held in trust to satisfy future exercise of the rights.

EPR allocations are divided equally into two portions (TSR Allocation and ROE Allocation) and each portion has two vesting conditions. The first vesting condition for both portions is not market related and requires the participant to continue in relevant employment. Rights may be retained when a participant ceases employment in special circumstance such as redundancy.

Under the TSR Allocation, the second vesting condition is a market related performance hurdle based on a comparison of IAG's TSR (the measure of return on an investment in IAG ordinary shares) with the TSR of a peer group of entities in the S&P/ASX 100 Index. The peer group includes insurers and non insurers because the IAG Group competes for capital with a range of large listed companies across many industries. For the performance hurdle, a tiered vesting scale is applied, such that

all rights in the TSR Allocation vest if IAG's relative TSR is at the 75th percentile of the peer group, scaling down so that 50% of rights in the TSR Allocation vest if IAG's TSR performance is at the 50th percentile of the peer group. No rights vest if IAG's TSR performance is below the 50th percentile of the peer group. Testing for the satisfaction of the performance hurdle occurs on the 3rd, 4th and 5th anniversary of the base date. If this vesting condition is not met, the TSR Allocation will lapse. The rights also lapse where the holder chooses to forego the rights and all rights expire 10 years from grant date where they have not previously lapsed or been exercised.

Under the ROE Allocation, the second vesting condition is based on IAG's normalised ROE which is a performance hurdle that is not market related. The ROE hurdle compares IAG's normalised ROE performance with IAG's WACC. Normalised ROE is measured for each six month period during the three financial years over which the performance hurdle is measured. There is only one test date for the ROE portion of the EPRs. For any of the ROE portion of EPRs to be exercisable, the normalised ROE (the average of the six monthly normalised ROE measurements over the three financial years) must reach at least 1.3 times WACC. The number of EPRs that will become exercisable under the ROE allocation is presented in the table below. WACC means the weighted average cost of capital of IAG on a basis determined by the Board.

LEVEL OF NORMALISED ROE PERFORMANCE	VESTING SCALE
>1.6 x WACC	100% vests
=1.5 x WACC	80% vests
=1.4 x WACC	50% vests
=1.3 x WACC	20% vests
<1.3 x WACC	0% vests

A sliding scale operates between the points represented in the table above. If normalised ROE is less than 1.3 times WACC, no rights in the ROE allocation will vest. If this vesting condition is not met, the ROE Allocation will lapse. The rights also lapse where the holder chooses to forego the rights and all rights expire 10 years from grant date where they have not previously lapsed or been exercised.

If there is a change of control of IAG, the board has discretion to determine if and when rights should vest.

The following information relates to the rights issued under the EPRs Plan:

	FAIR VALUE AT GRANT DATE (TSR)	FAIR VALUE AT GRANT DATE (ROE)	RIGHTS ON ISSUE AT BEGINNING OF YEAR	RIGHTS GRANTED DURING YEAR	RIGHTS EXERCISED DURING YEAR	RIGHTS LAPSED DURING YEAR	NUMBER OF RIGHTS AT END OF YEAR	
							On issue	Exercisable
<b>2008</b>								
GRANT DATE								
29/10/2007	\$2.870	\$4.310	–	2,375,300	–	(34,500)	2,340,800	–
29/11/2007	\$2.350	\$3.680	–	250,000	–	–	250,000	–
13/03/2008	\$1.630	\$2.710	–	152,400	–	–	152,400	–
27/05/2008	\$2.120	\$3.220	–	65,370	–	–	65,370	–
			–	2,843,070	–	(34,500)	2,808,570	–

The fair value of the rights is calculated as at the grant date using a Monte Carlo valuation.

	SIGNIFICANT FACTORS AND ASSUMPTIONS USED			
<b>2008</b>				
Grant date	29/10/2007	29/11/2007	13/03/2008	27/05/2008
Share price on grant date (\$)	\$5.03	\$4.39	\$3.46	\$3.99
Risk free interest rate (%)	7.23%	7.35%	7.50%	7.75%
Expected dividend yield (%)	5.96%	6.83%	8.53%	7.39%
Expected life of rights (years)*	3 or 4 years	3 or 4 years	3 or 4 years	3 or 4 years

\* The expected life for the ROE EPRs is three years and four years for TSR EPRs.

### III. PARs Plan

The PARs Plan closed to new offers during the year ended 30 June 2007. The last performance hurdle testing date for the rights is expected to be 29 August 2011. The structure and operation of the plan is the same for employees in each geographical region. The rights were granted for nil consideration, are non transferable, and can be settled only with existing IAG shares. Where the rights vest (the holder becomes entitled to exercise the right), the plan entitles participating employees to acquire one IAG ordinary share for each right. The exercise price for all rights is a nominal value of \$1 per tranche of rights exercised. Holders do not receive dividends and do not have voting rights until the rights are exercised. IAG shares are bought on market and held in trust to satisfy future exercise of the rights.

The rights may vest between three and five years (the performance period) from a base date (calculation date for each tranche) subject to the satisfaction of two vesting conditions. The first vesting condition is not market related and requires the participant to continue in relevant employment. The second vesting condition is a market related performance hurdle based on a comparison of IAG's TSR, (the measure of return on an

investment in IAG ordinary shares) with the TSR of a peer group of companies in the S&P/ASX 100 Index. The peer group includes insurers and non insurers because the IAG Group competes for capital with a range of large listed companies across many industries. For the performance hurdle, a tiered vesting scale is applied, such that all rights vest if IAG's relative TSR is at the 75th percentile of the peer group, scaling down so that 50% of rights vest if IAG's TSR performance is at the 50th percentile of the peer group. No rights vest if IAG's TSR performance is below the 50th percentile of the peer group. Testing for the satisfaction of the performance hurdle occurs quarterly during the performance period. If either of the vesting conditions is not met then the rights lapse. The rights also lapse where the holder chooses to forego the rights, and all rights expire 10 years from grant date where they have not previously lapsed or been exercised.

If there is a change of control of IAG, the board has discretion to determine if and when rights should vest.

The following information relates to the rights issued under the PARs Plan:

GRANT DATE	FAIR VALUE AT GRANT DATE	RIGHTS ON ISSUE AT BEGINNING OF YEAR	RIGHTS GRANTED DURING YEAR	RIGHTS EXERCISED DURING YEAR	RIGHTS LAPSED DURING YEAR	NUMBER OF RIGHTS AT END OF YEAR	
						On issue	Exercisable
<b>2008</b>							
24/12/2002	\$1.870	1,344,659	-	(85,651)	(1,162,288)	96,720	96,720
22/09/2003	\$2.840	3,835,078	-	-	(1,507,296)	2,327,782	-
10/12/2003	\$2.764	400,000	-	-	-	400,000	-
26/03/2004	\$3.287	896,764	-	-	(297,456)	599,308	-
17/09/2004	\$2.715	4,016,000	-	-	(347,000)	3,669,000	-
30/11/2004	\$2.718	882,500	-	-	(5,500)	877,000	-
30/03/2005	\$3.269	41,000	-	-	-	41,000	-
19/09/2005	\$3.187	4,319,000	-	-	(350,500)	3,968,500	-
30/11/2005	\$2.596	693,000	-	-	(22,500)	670,500	-
22/03/2006	\$3.145	189,000	-	-	-	189,000	-
19/12/2006	\$4.013	3,111,750	-	-	(216,550)	2,895,200	-
13/03/2007	\$3.660	301,500	-	-	(3,000)	298,500	-
		<b>20,030,251</b>	<b>-</b>	<b>(85,651)</b>	<b>(3,912,090)</b>	<b>16,032,510</b>	<b>96,720</b>
<b>2007</b>							
24/12/2002	\$1.870	2,188,614	-	(336,246)	(507,709)	1,344,659	186,792
22/09/2003	\$2.840	3,913,469	-	-	(78,391)	3,835,078	-
10/12/2003	\$2.764	400,000	-	-	-	400,000	-
26/03/2004	\$3.287	941,786	-	-	(45,022)	896,764	-
17/09/2004	\$2.715	4,126,000	-	-	(110,000)	4,016,000	-
30/11/2004	\$2.718	905,500	-	-	(23,000)	882,500	-
30/03/2005	\$3.269	41,000	-	-	-	41,000	-
19/09/2005	\$3.187	4,500,000	-	-	(181,000)	4,319,000	-
30/11/2005	\$2.596	693,000	-	-	-	693,000	-
22/03/2006	\$3.145	189,000	-	-	-	189,000	-
19/12/2006	\$4.013	-	3,149,500	-	(37,750)	3,111,750	-
13/03/2007	\$3.660	-	304,500	-	(3,000)	301,500	-
		<b>17,898,369</b>	<b>3,454,000</b>	<b>(336,246)</b>	<b>(985,872)</b>	<b>20,030,251</b>	<b>186,792</b>

2007		
Grant date	19/12/2006	13/03/2007
Share price on grant date (\$)	\$6.16	\$5.96
Exercise price (\$)	\$1 per tranche exercised	\$1 per tranche exercised
Risk free interest rate (%)	6.39%	6.34%
Expected share price volatility (%)	25%	25%
Expected dividend yield (%)	4.79%	4.95%
Expected life of rights (years)	3.673 years	3.660 years

Some of the assumptions, including expected share price volatility, are based on historical data which is not necessarily indicative of future trends. Reasonable changes in these assumptions would not have a material impact on the amounts recognised in the financial statements.

### C. EMPLOYEE SHARE PLANS

There are currently three employee share plans in operation but only one of them represents a form of remuneration (the Exempt Reward Offer (ERO)) with the other two plans simply allowing IAG to facilitate Australian employees choosing to receive part of their base salary or short term incentive in the form of IAG shares (EPO and the DPO) principally to take advantage of taxation concessions available under Australian law.

#### Exempt Reward Offer

The ERO continued in operation during the year ended 30 June 2008. The ERO involves the granting of shares (sometimes restricted shares which are subject to a holding lock) to a substantial percentage of employees in both Australia and NZ from time to time, arranged through different trusts with different terms and conditions.

Each financial year where the IAG TSR is higher than half of the companies in the S&P/ASX 100 Index, and an offer is approved by the NRSC, an award of shares is made to eligible employees. The result of each tranche to date is as follows:

- for the 2009 financial year, the board will determine in August 2008 whether the hurdle for the year ended 30 June 2008 was met and appropriate action will be taken at that time;
- for the 2008 financial year, the hurdle for the year ended 30 June 2007 was not met and so there was no issue of shares under the plan during the 2008 financial year;
- for the 2007 financial year, the hurdle for the year ended 30 June 2006 was not met and so there was no issue of shares under the plan during the 2007 financial year;
- for the 2006 financial year, the hurdle for the year ended 30 June 2005 was met and so there was an issue of shares under the plan during the 2006 financial year;
- for Australia, a grant of 1,472,064 shares was made to 7,872 employees (187 shares to each participant). The grant date was 18 November 2005. The full cost of purchasing the shares on market (used as the proxy for fair value of the grant) of \$8 million (including brokerage) was recognised as an expense in the year ended 30 June 2006; and
- for NZ, a grant of 287,232 shares was made to 1,536 employees (187 shares to each participant). The grant date was 18 November 2005. There were 177,307 shares available from a previous employee share plan arrangement which were able to be used for the current tranche and so only an additional 109,925 shares were purchased for the current tranche. The full cost of purchasing the shares on market (used as the proxy for fair value of the grant) is being expensed over the three year vesting period with the last amount to be expensed in the 2009 financial year.

Further details regarding the arrangement in Australia and NZ is provided below.

#### a. AUSTRALIA

Participation in the plan is open to employees that are not directors, that are not participants in the PARs Plan, that have completed at least 12 months service on a date set prior to the allocation date and that remain in relevant employment on the allocation date.

Eligible employees who accept the offer receive an allocation of IAG shares to the equivalent value of \$1,000 based on the volume weighted average price at which IAG shares traded on the ASX for the week up to and including the allocation date. The arrangement is designed to comply with the conditions set out in the Australian tax legislation which gives permanent employees the opportunity to acquire up to \$1,000 worth of shares at their tax market value in any one financial year as tax exempt remuneration; known as the tax exemption concession. Although the number of shares paid to each employee is determined by a cash amount, the payment is made in shares and is therefore treated as an equity settled share based payment.

The shares are granted for nil consideration. Shares granted under the plan vest immediately but remain held in trust on behalf of the participants subject to a restriction period of the earlier of three years from the allocation date or cessation of employment. The participants are entitled to dividends, which are paid directly to the participants, and other shareholder rights during the restriction period. There are no circumstances under which the shares can be forfeited. The cost of acquiring the shares on market in the days leading up to the grant is generally used as a proxy for the grant date fair value of the equity instruments. Shares granted under this plan are purchased on market.

#### b. NEW ZEALAND

The general terms of the offer are the same as the Australian plan however because of the different taxation laws, shares granted under the NZ plan are subject to a three year vesting period. Employees that cease relevant employment before completion of the vesting period forfeit any entitlement to the shares. Under certain circumstances such as retirement, death or permanent disability, the vesting period may be waived. Forfeited shares may be reallocated as part of a future approved offer or disposed of at the discretion of the trustee. Dividends received on forfeited shares may, at the trustee's discretion, be used to defray costs of administering the plan. Participants are entitled to dividends and full voting rights during the vesting period.

## NOTE 29. SUPERANNUATION

Contributions are made to a number of superannuation plans in various countries. The majority of employees are defined contribution members with fewer than 6.0% (2007—9.0%) of employees participating on a defined benefit basis. Entry to defined benefit superannuation plans is closed and so all new employees are provided with defined contribution arrangements. The plans provide benefits for members or their dependants in the form of lump sum or pension payments generally upon retiring from relevant employment.

The superannuation expense for the year is included in the claims expense, other underwriting expenses, and corporate, administration and other expenses lines in the income statement.

### A. DEFINED CONTRIBUTION SUPERANNUATION ARRANGEMENTS

Contributions to the plans are made in accordance with the governing rules of each plan together with relevant legislative requirements in each geographical region. The contributions are generally based on a percentage of employees' salaries.

The Consolidated entity contributed \$82 million to the IAG & NRMA Superannuation Plan for defined contribution members during the year (2007—\$67 million) and there were no employer contributions payable at the end of the year for those members (2007—\$nil).

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

### B. DEFINED BENEFIT SUPERANNUATION ARRANGEMENTS

Employees who are entitled to defined benefit superannuation arrangements are members of one of eight superannuation plans each of which are funded plans. The defined benefit sections of those plans are closed to new members and so membership is reducing over time. Contributions to the plans are made in accordance with the governing rules of each plan and the contribution recommendations of an independent actuary. In contrast to defined contribution superannuation arrangements, the future cost of the defined benefit superannuation plans is not known with certainty in advance. The benefits received for defined benefit members are generally based on length of service and final average salary together with the member's own contributions (if any). The net financial positions of the plans are recognised on the balance sheet.

#### Australia

All Australian employees with defined benefit superannuation arrangements are members of the IAG & NRMA Superannuation Plan (the IAG Plan). There were 774 members as at reporting date (2007—812). The Consolidated entity has contributed to the IAG

Plan during the year in accordance with the recommendations of the actuary and has contributed \$5 million for defined benefit members (2007—\$6 million). There were no employer contributions payable at the end of the year (2007—\$nil). The governing rules of the Plan allow any surplus to be used to meet the contributions that would otherwise have been payable for both the defined benefit and defined contribution members of the Plan.

There are two subsidiaries in the Consolidated entity, being Insurance Australia Group Services Pty Limited and Insurance Manufacturers of Australia Pty Limited, with employees that are defined benefit members of the IAG Plan. While separate records are maintained for the liabilities relating to each member, there is effectively a sharing of the risks associated with the assets of the IAG Plan. For the measurement of the net financial position of the IAG Plan for recognition on the balance sheets of the employer sponsors, the assets of the IAG Plan are allocated between the employers in proportion to the actuarial reserves for each entity.

#### United Kingdom

The UK operation contributes to six defined benefit superannuation arrangements being The Christopherson's Final Salary Scheme, The Red Star Insurance Association Limited 1978 Retirement and Death Benefit Scheme, The Anthony Kidd Agencies Scheme, The Open & Direct Insurance Services Final Salary Scheme and two 'B' schemes within the Lloyd's Superannuation Fund (a multi employer scheme) being the Cox Services Limited Staff Pension Scheme and the HML Marketing Limited Staff Pension Scheme (the exposure for the Lloyd's funds is being capped through an arrangement with Lloyd's). They are referred to collectively as the UK Plans. The UK Plans had 555 defined benefit members as at reporting date (2007—559). The Consolidated entity contributed \$7 million to the UK Plans for defined benefit members during the year (2007—\$4 million).

None of the UK plans is individually significant to the financial report and so the information disclosed below is provided for the UK Plans in aggregate.

#### New Zealand

The NZ operation contributes to one defined benefit superannuation arrangement being the NZI Superannuation Fund which had 10 defined benefit members as at 30 June 2008 (2007—11) and a \$nil net deficit (2007—\$nil). There was previously another defined benefit superannuation arrangement being the IAG New Zealand Limited Staff Pension Scheme which had a net surplus of \$3 million as at 30 June 2007 but this arrangement was settled during the current reporting period resulting in a charge to profit of \$2 million being recognised in the current year. These NZ defined benefit superannuation arrangements are not disclosed in more detail as the financial impact of these arrangements is not significant to the Consolidated entity.

	IAG PLAN	UK PLANS	TOTAL	IAG PLAN	UK PLANS	TOTAL
	2008	2008	2008	2007	2007	2007
	\$m	\$m	\$m	\$m	\$m	\$m
<b>I. Reporting date balances</b>						
Fair value of net assets	179	117	296	215	141	356
Present value of defined benefit obligation (net discount rate)	(176)	(124)	(300)	(165)	(162)	(327)
Net defined benefit asset/(liability)	3	(7)	(4)	50	(21)	29
Contribution tax asset/(liability)	–	2	2	9	6	15
Net asset/(liability) recognised on the balance sheet	3	(5)	(2)	59	(15)	44

Where a plan incorporates both defined benefit and defined contribution arrangements, the amounts disclosed in this note represent only the defined benefit portion of the plan. Actuarial valuations are performed at each reporting date by an independent specialist. The financial information disclosed has been prepared in accordance with AASB 119 Employee Benefits except where otherwise noted.

Those plans with a net financial position that is an asset are presented with the defined benefit superannuation asset on the balance sheet while those plans with a net financial position that is a liability are presented within the employee benefits provision.

	IAG PLAN	UK PLANS	IAG PLAN	UK PLANS
	2008	2008	2007	2007
	\$m	\$m	\$m	\$m
<b>II. Recognition of movement in net asset/(liability)</b>				
Contributions expensed during the year	5	7	6	5
Reporting date valuation adjustment to profit	(1)	(7)	(2)	(4)
	4	-	4	1
Reporting date valuation adjustment to retained earnings	56	(4)	(52)	(5)
Total amount recognised for financial year in closing retained earnings	60	(4)	(48)	(4)
REPORTING DATE VALUATION ADJUSTMENTS REPRESENT				
Current service cost	6	1	8	-
Past service cost	1	-	-	-
Interest cost (net of tax)	12	7	9	5
Expected return on plan assets	(15)	(7)	(13)	(4)
Actuarial (gains) and losses	56	(5)	(52)	(5)
Total net amount recognised from reporting date valuation	60	(4)	(48)	(4)
<b>III. Reconciliation of the movement in the present value of the defined benefit obligation</b>				
Defined benefit obligation at the beginning of the financial year	165	162	187	164
Current service cost	6	-	8	-
Past service cost	1	-	-	-
Interest cost	12	7	9	5
Contributions by plan participants	2	-	4	-
Actuarial (gains) and losses	7	(16)	(28)	(5)
Benefits paid	(17)	(9)	(15)	(2)
Net exchange difference on translation of foreign operations	-	(20)	-	-
Defined benefit obligation at the end of the financial year	176	124	165	162
<b>IV. Reconciliation of the movement in the fair value of assets</b>				
Fair value of assets at the beginning of the financial year	215	141	191	135
Expected return on plan assets	15	7	13	4
Actuarial gains and (losses)	(41)	(11)	16	-
Contributions by employers	5	7	6	4
Contributions by plan participants	2	-	4	-
Benefits paid	(17)	(9)	(15)	(2)
Net exchange difference on translation of foreign operations	-	(18)	-	-
Fair value of assets at the end of the financial year	179	117	215	141

The UK Plans information disclosed in sections III and IV for the comparative period provide the full year movement and not the period since the acquisitions.

#### V. Plan assets

The percentage invested in each asset class at reporting date was:

	ALLOCATION PERCENTAGE			
	IAG Plan	UK Plans	IAG Plan	UK Plans
	2008	2008	2007	2007
	%	%	%	%
Australian shares	34.0	-	36.0	-
Overseas shares	26.0	38.0	24.0	38.0
Listed property trusts	10.0	-	10.0	-
Fixed interest	25.0	62.0	25.0	61.0
Cash	5.0	-	5.0	1.0

The assets of the IAG Plan are managed by the IAG Group. The assets of the IAG Plan do not include any shares issued by the Consolidated entity nor any property or other assets used by the Consolidated entity. The assets of the UK Plans are managed by independent trustee boards.

To determine the expected rate of return on assets, the actuary has considered the expected future investment returns for each major asset class net of investment tax and investment fees. These estimated returns for each asset class have been used to calculate the expected rate of return on the assets supporting the defined benefits based on the plans' target asset allocation

and allowing for correlations of the investment returns between asset classes. The actual return on the IAG Plan assets for the year ended 30 June 2008 was a loss of 11.3% (2007—a gain of 13.9%). The actual return on the UK Plans assets for the year ended 30 June 2008 was a loss of 4.1% (2007—a gain of 2.7%).

#### VI. Actuarial assumptions

Assumptions used in the determination of the financial position of the plans are reviewed annually and determined in conjunction with the independent actuaries to the plans. The principal actuarial assumptions used in determining the financial position of the plans include:

	IAG PLAN	UK PLANS	IAG PLAN	UK PLANS
	2008	2008	2007	2007
	%	%	%	%
Discount rate (gross)*	7.2	5.8	5.8	5.3
Expected rate of return on plan assets supporting pension liabilities	7.4	5.8	7.4	5.8
Expected rate of return on other plan assets	6.9	5.8	6.9	5.8
Expected future salary increases	4.0	4.6	4.0	4.6
Future pension increases—adult/child	2.5/0.0	3.7	2.5/0.0	3.1

\* The discount rate for the IAG Plan has been determined by reference to the market yields on 10 year government bonds in Australia (2007—AA rated corporate bonds). The UK Plans discount rate has been determined by reference to the market yields on AA rated corporate bonds in the UK.

#### VII. Sensitivity of measurement to actuarial assumptions

The superannuation arrangements are by nature long term. The majority of the assumptions reflect this and are not changed to reflect short term variations in factors. The discount rate required to be applied for the IAG Plan must reflect the market yields on government bonds (2007—corporate bonds) and so is subject to change if those yields change. A 1% reduction in the discount rate would result in a \$13.9 million increase in the present value of the defined benefit obligation of the IAG Plan and result in the net financial surplus becoming a \$13.1 million deficit.

#### VIII. Historical information

The experience adjustments are as follows:

	IAG PLAN	UK PLANS	IAG PLAN	UK PLANS	IAG PLAN	IAG PLAN
	2008	2008	2007	2007	2006	2005
	\$m	\$m	\$m	\$m	\$m	\$m
Plan liabilities	(6)	(9)	6	2	6	6
Plan assets	(41)	6	16	—*	10	19

\* Amount rounds to zero.

The experience adjustments are based on the actuarial gain or loss after removing the impact of any change in assumptions.

#### IX. Funding obligations for the IAG & NRMA Superannuation Plan in Australia

The financial information disclosed below has been determined in accordance with AAS 25 Financial Reporting by Superannuation Plans, using the Attained Age Actuarial Funding method.

	CONSOLIDATED	
	2008	2007
	\$m	\$m
Net market value of plan assets	176	206
Present value of accrued benefits	(168)	(165)
Defined benefit surplus/(deficit)	8	41
Vested benefits	162	160

The principal actuarial assumptions used in determining the financial position of the IAG Plan in accordance with AAS 25 and the funding recommendation include:

Expected investment returns—pension assets/other assets (gross)	7.5	7.5
Expected future salary increases	4.0	4.0
Future pension increases—adult/child	2.5/0.0	2.5/0.0

The accrued benefits are determined on the basis of the present value of expected future payments that arise from membership up to the measurement date. The accrued benefits are determined by reference to expected future salary levels and are discounted by using a market based, risk adjusted discount rate. Vested benefits are the benefits which would be payable to members if they all voluntarily resigned as at the reporting date.

Assumptions used in the determination of the financial position of the IAG Plan are reviewed annually and determined in conjunction with the independent actuary to the IAG Plan. Changes in financial and/or demographic assumptions, or changes in the relevant regulatory environment, could significantly impact the financial position of the IAG Plan. The financial position of the IAG Plan is calculated at a specific point in time, however the superannuation arrangements are by nature long term. Short term variations between long term actuarial assumptions and actual experience will cause the net funding status of the Plan to change without impacting on the long term viability of the Plan.

The contribution recommendation uses a different actuarial methodology and a different discount rate assumption to that used in determining the financial position for measurement on the balance sheet of the employer sponsor. In determining the contribution recommendation, the actuarial valuation method focuses on the funding of benefits for current members, irrespective of whether they stem from past or future membership, whereas, for financial reporting purposes, the present value of expected future benefit payments does not include benefits that have not yet accrued. The difference in methodologies used for determining the employer contributions and the measurement of the asset/liability recognised on the balance sheet mean that a liability may be recognised even where the employer has met all of the superannuation contribution obligations.

## NOTE 30. COMMITMENTS

	CONSOLIDATED	
	2008 \$m	2007 \$m
Commitments are not recorded on the balance sheet but are disclosed here at face value.		
<b>A. CAPITAL COMMITMENTS</b>		
<b>Software development</b>		
Due within 1 year	10	11
Due within 1 to 2 years	10	11
Due within 2 to 5 years	33	36
Due after 5 years	24	26
	<b>77</b>	<b>84</b>
<b>B. OPERATING LEASE COMMITMENTS</b>		
<b>Property</b>		
Due within 1 year	108	88
Due within 1 to 2 years	90	92
Due within 2 to 5 years	247	205
Due after 5 years	451	435
<b>Plant and equipment</b>		
Due within 1 year	33	16
Due within 1 to 2 years	22	14
Due within 2 to 5 years	28	8
	<b>979</b>	<b>858</b>
Certain property, motor vehicles and computer equipment are leased under non cancellable operating leases. Most leases are subject to annual reviews with increases subject to a set percentage or based on either movements in consumer price indices or operating criteria. Where appropriate, a right of renewal has been incorporated into the lease agreements at which time all terms and conditions may be renegotiated. There are no options to purchase the relevant assets on expiry of the lease. The operating lease commitments for property are to an extent offset by the receipt of sub lease income of approximately \$6 million per year from non cancellable sub leases.		
<b>C. SOFTWARE LICENCE AND RENTAL COMMITMENTS</b>		
Due within 1 year	34	29
Due within 1 to 2 years	18	7
Due within 2 to 5 years	19	3
	<b>71</b>	<b>39</b>
<b>D. OTHER COMMITMENTS</b>		
Due within 1 year	24	5
Due within 1 to 2 years	5	6
Due within 2 to 5 years	–	6
	<b>29</b>	<b>17</b>

## NOTE 31. CONTINGENCIES

The IAG Group is exposed to a range of contingencies with some specific to instruments or transactions while others relate more to operational risk faced in the normal course of business.

### A. CONTINGENT LIABILITIES

Contingent liabilities are not recognised on the balance sheet but are disclosed here where the possibility of settlement is less than probable but more than remote. Provisions are not required with respect to these matters as it is not probable that a future sacrifice of economic benefits will be required or the amount is not reliably measurable. If settlement becomes probable, a provision is recognised. The best estimate of the settlement amount is used in measuring a contingent liability for disclosure. The measurement involves judgement.

In the normal course of business, transactions are entered into that may generate a range of contingent liabilities. These include:

- litigation arising out of insurance policies;
- Hastings, a wholly owned subsidiary of IAG, has received a claim for alleged breaches of its duties under an agency agreement. The claim is for loss and damage suffered of approximately £10 million. Hastings was acquired by the Consolidated entity on 29 September 2006. The claims against Hastings may, if proved, constitute a breach of warranty under the Share Purchase Agreement (SPA) relating to the Hastings acquisition, which if proved, would give rise to warranty claims against the previous owner;
- undertakings for maintenance of net worth and liquidity support to subsidiaries in the Consolidated entity. It is normal practice to provide wholly owned subsidiaries with support and assistance as may be appropriate with a view to enabling them to meet their obligations and to maintain their good standing. Such undertakings constitute a statement of present intent only and are not intended to give rise to any binding legal obligation;
- guarantees for performance obligations, including a guarantee in relation to a standby letter of credit issued in support of the Consolidated entity's participation in Lloyd's of London; and
- there is a potential assessment by the UK tax authority of outstanding tax payments relating to Hastings for tax years prior to the date when the company was acquired by the IAG Group. The amount of the assessment would not be significant to the IAG Group. The claim, if successful, would give rise to a claim under a tax indemnity provided by the previous owner.

It is not believed that there are any other potential material exposures to the Consolidated entity and there are no known events that would require it to satisfy the guarantees or take action under a support agreement.

### B. RESET EXCHANGEABLE SECURITIES

In respect of the issue of RES by a wholly owned subsidiary, IAG Finance (New Zealand) Limited (IAGF NZ):

- IAGF NZ has granted to Permanent Trustee Company Limited (Trustee), the trustee of the RES, a fixed charge over its right, title and interest in the payments to it under the Portfolio Management Agreement and certain intragroup receivables. IAG Portfolio Limited, a wholly owned subsidiary of IAG, has granted to the Trustee a mortgage over IAG Portfolio Limited's portfolio of investments (Portfolio) and a floating charge over its rights, property and undertaking as security to the RES holders;
- IAL has put in place an interest rate floor with IAG Portfolio Limited in the event the bank bill rate applicable to the calculation of the interest rate payable on the RES falls below a specified rate. This will enable IAG Portfolio Limited to generate sufficient income to allow IAGF NZ to make part or full interest payments on the RES;
- in the event of an interest payment on the RES being unfranked, IAG must pay an amount into IAG Portfolio Limited to fund a gross up of the interest payment on the RES;
- IAG may exchange some or all of the RES for preference shares issued by IAG at any time. The dividend rate will be calculated in a similar manner to the interest rate on the RES. The exchange right is considered an embedded derivative within the RES and is recognised at fair value on balance sheet;
- IAGF NZ may, in relation to the RES, change their terms, redeem them for cash or convert them into ordinary shares issued by IAG on any reset date. The next reset date is 15 March 2010;
- IAGF NZ may, in relation to the RES, redeem them for cash or convert them into ordinary shares issued by IAG, if a tax event, regulatory event or acquisition event, as defined in the RES terms, occurs;
- RES holders may redeem the RES on any reset date or if a trigger event, as defined in the RES terms, occurs;
- IAG has an obligation to pay all costs, charges and expenses in managing the Portfolio including costs of the trustee and custodian; and
- IAG and other members of the IAG Group may be entitled to any surplus in the Portfolio from excess income from the Portfolio after the payment of aggregate interest payments on the RES or from excess net assets of the Portfolio after the payment of aggregate redemption amounts on the RES.

### C. FIDUCIARY ACTIVITIES

The Consolidated entity's fiduciary activities consist of investment management and other fiduciary activities conducted as manager, custodian or trustee for a number of investments and trusts. The funds managed on behalf of third parties which are not included in the Consolidated entity's balance sheet had a fair value as at 30 June 2008 of \$932 million (2007—\$2,012 million). This does not include the investment by third parties in the IAG Asset Management Wholesale Trusts presented as minority interests in unitholders' funds on the balance sheet. The Consolidated entity is exposed to operational risk relating to managing these funds on behalf of third parties.

## NOTE 32. RELATED PARTY DISCLOSURES

### A. CONTROLLING ENTITIES

The ultimate parent entity in the Consolidated entity is IAG which is incorporated in Australia.

### B. SUBSIDIARIES

The Consolidated entity consists of IAG and its subsidiaries (information in relation to ownership interests is provided in note 25). The IAG Group operated a shared services model throughout the year with the use of dedicated units (such as head office finance providing accounting and processing services to operational entities) and entities (such as dedicated entities that provide employee services, technology development services, and reinsurance services which provide services across the Group). All such intragroup transactions are charged to the relevant entities on normal commercial terms and conditions, a direct and actual cost recovery basis or time allocation basis. Certain entities are economically dependent on other entities in the IAG Group. There are also loans between entities in the Consolidated entity. Only the transactions between the Parent and the wholly owned subsidiaries are disclosed here because all other transactions that have occurred among entities within the Consolidated entity have been eliminated for consolidation purposes.

	PARENT	
	2008 \$m	2007 \$m
<b>I. Transactions during the year</b>		
Aggregate amounts included in the determination of profit/(loss) before income tax for the year that resulted from transactions with related parties within the wholly owned group were as follows:		
INCOME		
Dividend revenue	716	396
EXPENSES		
Interest expense	-	23
<b>II. Balances outstanding at reporting date</b>		
Aggregate amounts receivable from, and payable to, subsidiaries were as follows:		
RECEIVABLES		
Amounts receivable	120	155
Loans receivable	671	667
PAYABLES		
Amounts payable	48	109
Loans payable	173	211

These intragroup balances are considered highly liquid and of negligible credit risk and so the carrying amount is a reasonable approximation of the fair value of the balances except for the fixed rate loans for which the fair value currently exceeds the carrying value. The intragroup balances either bear a fixed or variable interest rate or bear no interest but are repayable on demand.

There are no amounts past due though some amounts outstanding represent part of the IAG Group's cash flow management operations which do not have fixed payment terms. Other than one loan denominated in British pound of \$87 million at reporting date (2007—\$150 million) all other balances are denominated in Australian dollar and so the Parent has limited exposure to currency risk from these balances.

#### Other notes

##### a. DIVIDENDS AND TAX ARRANGEMENTS

While the Parent does not transact directly with all subsidiaries, the Parent does however generally receive dividends from all subsidiaries even if indirectly through other subsidiaries. Details of the tax sharing and tax funding agreements are disclosed in note 1.M.II.

##### b. IAG & NRMA SUPERANNUATION PLAN

Two subsidiaries in the Consolidated entity, Insurance Manufacturers of Australia Pty Limited and Insurance Australia Group Services Pty Limited, have employees that are defined benefit members of the IAG & NRMA Superannuation Plan (refer note 29). While separate records are maintained for the liabilities relating to each member, there is effectively a sharing of the risks associated with the assets of the plan.

##### c. TRANSACTIONS WITH IAG ASSET MANAGEMENT WHOLESALE TRUSTS

IAG Asset Management Wholesale Trusts (some of which are disclosed as non wholly owned subsidiaries in note 25), were established to enable higher investment yields for smaller investment portfolios. All subsidiaries within the IAG Group can invest in the trusts in accordance with their investment mandates. All investments in these trusts are on normal commercial terms and conditions.

The IAG Plan, the net financial position of which is recognised on the balance sheet, has a significant holding in some of the IAG Asset Management Wholesale Trusts. All transactions between the IAG Plan and the trusts are on normal commercial terms and conditions.

##### d. OTHER

Both the amount of the transactions and the outstanding balances at reporting date relating to transactions between the Parent and other subsidiaries are not significant and no further information is disclosed.

### C. KEY MANAGEMENT PERSONNEL

#### I. Details of compensation

KMP are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. It is important to note that the Company's non-executive directors are specifically required to be included as KMP in accordance with AASB 124 Related Party Disclosures. However, the non-executive directors do not consider that they are part of 'management'.

The aggregate compensation of the KMP is set out below:

	CONSOLIDATED	
	2008 \$000	2007 \$000
Short term employment benefits	19,325	15,108
Post employment benefits	1,483	1,266
Other long term benefits	97	169
Termination benefits	3,739	-
Share based payments	4,018	3,925
	<b>28,662</b>	<b>20,468</b>

The KMP receive no compensation specifically in relation to the management of the Company. The compensation disclosed in the table above represents the KMP's estimated compensation received from the IAG Group in relation to their involvement in the activities with the Consolidated entity.

## II. Interest in securities

The tables below disclose the movements in total number of DARs, EPRs, PARs and PSRs on issue held by each of the KMP. The DARs, EPRs, PARs and PSRs were granted as payment for the share based remuneration in accordance with the remuneration policy. The non-executive directors, who are KMP, did not receive share based payments in the form of DARs, EPRs, PARs and PSRs.

### a. MOVEMENTS IN TOTAL NUMBER OF DARs ON ISSUE

	DARs ON ISSUE 1 JULY NUMBER	DARs GRANTED DURING THE YEAR NUMBER	DARs EXERCISED DURING THE YEAR NUMBER	DARs LAPSED DURING THE YEAR NUMBER	DARs ON ISSUE 30 JUNE NUMBER	DARs VESTED AND EXERCISABLE 30 JUNE NUMBER
<b>2008</b>						
MJ Wilkins	-	-	-	-	-	-
JP Breheny	35,250	47,900	-	-	83,150	-
AM Coleman	35,250	55,700	-	-	90,950	-
NB Hawkins	35,250	47,900	-	-	83,150	-
JS Johnson	35,250	57,100	-	-	92,350	-
CF McLoughlin	31,875	41,500	-	-	73,375	-
LC Murphy	-	-	-	-	-	-
N Utley	33,375	37,500	-	-	70,875	-
J van der Schalk	35,250	28,600	-	-	63,850	-
G Venardos	42,375	61,900	-	-	104,275	-
DG West	-	-	-	-	-	-
<b>Total</b>	<b>283,875</b>	<b>378,100</b>	<b>-</b>	<b>-</b>	<b>661,975</b>	<b>-</b>
Executives who ceased as key management personnel						
MJ Hawker	187,500	144,500	-	(259,750)	72,250	-
DA Issa	42,375	73,800	-	(14,760)	101,415	-
SJ Mostyn	31,875	45,400	-	-	77,275	-
MJ Pirone	42,375	61,500	-	(12,300)	91,575	-
<b>Total</b>	<b>304,125</b>	<b>325,200</b>	<b>-</b>	<b>(286,810)</b>	<b>342,515</b>	<b>-</b>
<b>2007</b>						
MJ Hawker	-	187,500	-	-	187,500	-
JP Breheny	-	35,250	-	-	35,250	-
AM Coleman	-	35,250	-	-	35,250	-
NB Hawkins	-	35,250	-	-	35,250	-
DA Issa	-	42,375	-	-	42,375	-
JS Johnson	-	35,250	-	-	35,250	-
CF McLoughlin	-	31,875	-	-	31,875	-
SJ Mostyn	-	31,875	-	-	31,875	-
MJ Pirone	-	42,375	-	-	42,375	-
N Utley	-	33,375	-	-	33,375	-
J van der Schalk	-	35,250	-	-	35,250	-
G Venardos	-	42,375	-	-	42,375	-
<b>Total</b>	<b>-</b>	<b>588,000</b>	<b>-</b>	<b>-</b>	<b>588,000</b>	<b>-</b>

### b. MOVEMENTS IN TOTAL NUMBER OF EPRs ON ISSUE

	EPRs ON ISSUE 1 JULY NUMBER	EPRs GRANTED DURING THE YEAR NUMBER	EPRs EXERCISED DURING THE YEAR NUMBER	EPRs LAPSED DURING THE YEAR NUMBER	EPRs ON ISSUE 30 JUNE NUMBER	EPRs VESTED AND EXERCISABLE 30 JUNE NUMBER
<b>2008</b>						
MJ Wilkins	-	250,000	-	-	250,000	-
JP Breheny	-	98,500	-	-	98,500	-
AM Coleman	-	103,000	-	-	103,000	-
NB Hawkins	-	96,000	-	-	96,000	-
JS Johnson	-	99,500	-	-	99,500	-
CF McLoughlin	-	96,000	-	-	96,000	-
LC Murphy	-	35,000	-	-	35,000	-
N Utley	-	143,500	-	-	143,500	-
J van der Schalk	-	95,000	-	-	95,000	-
G Venardos	-	113,500	-	-	113,500	-
DG West	-	100,000	-	-	100,000	-
<b>Total</b>	<b>-</b>	<b>1,230,000</b>	<b>-</b>	<b>-</b>	<b>1,230,000</b>	<b>-</b>
Executives who ceased as key management personnel						
MJ Hawker	-	350,000	-	(350,000)	-	-
DA Issa	-	117,000	-	-	117,000	-
SJ Mostyn	-	28,500	-	-	28,500	-
MJ Pirone	-	103,000	-	-	103,000	-
<b>Total</b>	<b>-</b>	<b>598,500</b>	<b>-</b>	<b>(350,000)</b>	<b>248,500</b>	<b>-</b>

## c. MOVEMENTS IN NUMBER OF PARs ON ISSUE

	PARs ON ISSUE 1 JULY NUMBER	PARs GRANTED DURING THE YEAR NUMBER	PARs EXERCISED DURING THE YEAR NUMBER	PARs LAPSED DURING THE YEAR NUMBER	PARs ON ISSUE 30 JUNE NUMBER	PARs VESTED AND EXERCISABLE 30 JUNE NUMBER
<b>2008</b>						
MJ Wilkins	-	-	-	-	-	-
JP Breheny	147,000	-	-	-	147,000	-
AM Coleman	341,019	-	-	(42,568)	298,451	-
NB Hawkins	215,456	-	-	(30,931)	184,525	-
JS Johnson	128,328	-	-	(4,693)	123,635	-
CF McLoughlin	122,500	-	-	-	122,500	-
N Utley	44,500	-	-	-	44,500	-
J van der Schalk	196,004	-	-	(17,879)	178,125	22,753
G Venardos	394,803	-	-	(52,444)	342,359	-
DG West	-	-	-	-	-	-
<b>Total</b>	<b>1,589,610</b>	<b>-</b>	<b>-</b>	<b>(148,515)</b>	<b>1,441,095</b>	<b>22,753</b>
Executives who ceased as key management personnel						
MJ Hawker	1,882,000	-	-	(1,482,000)	400,000	-
DA Issa	315,502	-	-	(37,460)	278,042	-
SJ Mostyn	291,299	-	-	(35,757)	255,542	-
MJ Pirone	338,706	-	-	(37,460)	301,246	-
<b>Total</b>	<b>2,827,507</b>	<b>-</b>	<b>-</b>	<b>(1,592,677)</b>	<b>1,234,830</b>	<b>-</b>
2007						
MJ Hawker	1,632,000	250,000	-	-	1,882,000	-
JP Breheny	100,000	47,000	-	-	147,000	-
AM Coleman	294,019	47,000	-	-	341,019	-
NB Hawkins	168,456	47,000	-	-	215,456	-
DA Issa	259,002	56,500	-	-	315,502	-
JS Johnson	81,328	47,000	-	-	128,328	-
CF McLoughlin	80,000	42,500	-	-	122,500	-
SJ Mostyn	248,799	42,500	-	-	291,299	-
MJ Pirone	282,206	56,500	-	-	338,706	-
N Utley	-	44,500	-	-	44,500	-
J van der Schalk	149,004	47,000	-	-	196,004	22,753
G Venardos	338,303	56,500	-	-	394,803	-
<b>Total</b>	<b>3,633,117</b>	<b>784,000</b>	<b>-</b>	<b>-</b>	<b>4,417,117</b>	<b>22,753</b>

d. MOVEMENTS IN TOTAL NUMBER OF PSRs

The PSRs Plan was closed for issuing further PSRs from the financial year ended 30 June 2003.

During the year ended 30 June 2008, J van der Schalk, the only KMP that held PSRs, exercised all of the 40,000 vested PSRs (2007—no movements).

e. HOLDING OF ORDINARY SHARES

The relevant interest of each KMP and their related parties in ordinary shares of IAG:

	SHARES HELD AT 1 JULY NUMBER	SHARES ACQUIRED IN LIEU OF IAG BOARD FEE DURING THE YEAR NUMBER	SHARES RECEIVED ON EXERCISE OF PSRs NUMBER	SHARES RECEIVED ON SHARE ALLOCATION <sup>(i)</sup> NUMBER	NET MOVEMENT OF SHARES DUE TO OTHER CHANGES <sup>(ii)</sup> NUMBER	TOTAL SHARES HELD AT 30 JUNE NUMBER	SHARES HELD NOMINALLY AT 30 JUNE <sup>(iii)</sup> NUMBER
<b>2008</b>							
JA Strong	294,927	50,643	–	–	–	345,570	332,995
YA Allen	12,769	6,752	–	–	–	19,521	19,521
JF Astbury	70,996	(1,137)	–	–	–	*	*
PM Colebatch	10,251	16,881	–	–	–	27,132	27,132
GA Cousins	180,775	(1,137)	–	–	–	*	*
HA Fletcher	–	30,386	–	–	20,740	51,126	51,126
ND Hamilton	122,327	30,386	–	–	390	153,103	147,203
A Hynes	–	6,752	–	–	11,000	17,752	17,752
RA Ross	177,308	16,881	–	–	–	194,189	91,386
BM Schwartz	17,781	10,128	–	–	–	27,909	27,663
MJ Wilkins	–	–	–	–	100,000	100,000	100,000
JP Breheny	–	–	–	–	–	–	–
AM Coleman	2,544	–	–	19,349	716	22,609	2,544
NB Hawkins	24,578	–	–	14,047	–	38,625	–
JS Johnson	7,315	–	–	2,133	2,500	11,948	3,843
CF McLoughlin	9,216	–	–	–	14,357	23,573	23,327
LC Murphy	–	–	–	–	–	–	–
N Utley	–	–	–	–	101,852	101,852	101,852
J van der Schalk	–	–	40,000	8,126	–	48,126	–
G Venardos	136,671	–	–	23,838	9,290	169,799	50,985
DG West	–	–	–	–	–	–	–
Executives who ceased as key management personnel							
MJ Hawker	1,438,122	–	–	60,000	202,000	*	*
DA Issa	47,675	–	–	17,027	–	*	*
SJ Mostyn	130,507	–	–	16,253	–	*	*
MJ Pirone	79,063	–	–	17,027	–	*	*

\* These non-executive directors or executives ceased as KMP during the financial year. Information on shares held is disclosed up to the date of their cessation.

- (i) During the year, the board approved an ex gratia grant of shares to some of these KMP following a PwC review of IAG's executive remuneration arrangements in 2007.
- (ii) Net movement of shares relates to acquisition and disposal transactions by the KMP and their related parties during the year. It includes any opening balances of shares, if any, held by KMP who commenced during the year.
- (iii) Nominally held shares are included in the column headed total shares held at 30 June. Total shares are held by the KMPs' related parties, inclusive of domestic partner, dependants and entities controlled, jointly controlled or significantly influenced by the KMP.

There were no shares received on exercise of DARs or PARs by the KMP as no DARs or PARs vested during the year.

	SHARES ACQUIRED IN LIEU OF IAG BOARD FEE DURING THE YEAR	SHARES RECEIVED ON EXERCISE OF PSRs NUMBER	SHARES RECEIVED ON EXERCISE OF PARs NUMBER	NET MOVEMENT OF SHARES DUE TO OTHER CHANGES <sup>(i)</sup> NUMBER	TOTAL SHARES HELD AT 30 JUNE NUMBER	SHARES HELD NOMINALLY AT 30 JUNE <sup>(ii)</sup> NUMBER	
SHARES HELD AT 1 JULY NUMBER	NUMBER	NUMBER	NUMBER	NUMBER	NUMBER	NUMBER	
2007							
JA Strong	259,465	34,232	–	–	1,230	294,927	282,352
YA Allen	7,959	4,564	–	–	246	12,769	12,523
JF Astbury	65,694	4,564	–	–	738	70,996	60,421
PM Colebatch	–	10,251	–	–	–	10,251	10,251
GA Cousins	176,211	4,564	–	–	–	180,775	30,775
ND Hamilton	101,268	20,539	–	–	520	122,327	116,817
RA Ross	165,406	11,410	–	–	492	177,308	74,505
BM Schwartz	10,689	6,846	–	–	246	17,781	17,535
MJ Hawker	1,378,059	–	–	–	60,063	1,438,122	59,817
JP Breheny	–	–	–	–	–	–	–
AM Coleman	62,052	–	–	–	(59,508)	2,544	2,544
NB Hawkins	24,332	–	–	–	246	24,578	–
DA Issa	47,675	–	–	–	–	47,675	–
JS Johnson	5,972	–	–	–	1,343	7,315	1,343
CF McLoughlin	–	–	–	–	9,216	9,216	8,970
SJ Mostyn	130,261	–	–	–	246	130,507	–
MJ Pirone	79,063	–	–	–	–	79,063	11,432
N Utley	–	–	–	–	–	–	–
J van der Schalk	–	–	–	–	–	–	–
G Venardos	110,780	–	–	–	25,891	136,671	48,795

(i) Nominally held shares are included in the column headed total shares held at 30 June. Total shares are held by the KMPs' related parties, inclusive of domestic partner, dependants and entities controlled, jointly controlled or significantly influenced by the KMP.

(ii) Net movement of shares relates to acquisition and disposal transactions by the KMP and their related parties during the year. It includes any opening balances of shares held by KMP who were appointed during the year.

#### f. HOLDING OF RESET PREFERENCE SHARES

No KMP had any interest in RPS at any time during the financial year (2007—nil).

#### g. HOLDING OF RESET EXCHANGEABLE SECURITIES

Other than MJ Hawker who held 1,000 RES nominally at the beginning and the end of the financial year, there were no KMP who held a relevant interest in RES of IAG Finance (New Zealand) Limited (2007—no movements).

#### III. Other related party transactions with key management personnel

N Utley was a shareholder of the Equity Insurance Group at the time it was acquired by the IAG Group. As part of that acquisition, N Utley received consideration for the sale of his shares. The consideration was paid in the form of unsecured notes with face value of £15 million (comprising three tranches that bear different terms and conditions) and 1.2 million DARs with a grant date fair value of \$5.73 per right. The DARs issued as part of the consideration for the sale of shares, are not included as part of his share based remuneration. £12 million of the outstanding unsecured notes as at 30 June 2007 was settled during the year ended 30 June 2008 (2007—no payment made). Further, £3 million of the outstanding unsecured loan notes were redeemed during the year into a trust account, to be held until their due dates for payment under the terms and conditions. As at 30 June 2008, no unsecured notes remain outstanding (2007—£15 million).

N Utley is a non-executive director of, and has a 25.77% ownership interest in, Destiny Legal Services Limited (DLSL) and Destiny Business Services Limited (DBSL). N Utley received £50,000 (2007—£60,000) for his service as a non-executive director and has not received any income (2007—no income) from his ownership interest in DLSL and DBSL. DLSL and DBSL derive fees for legal services performed for the Equity Insurance Group and Hastings. The services provided relate to uninsured loss recovery legal cases and personal injury litigation. The Equity Insurance Group has advances outstanding at 30 June 2008 to DLSL and DBSL of £0.5 million (2007—£0.5 million) which are not interest bearing. The share of fees earned by the Equity Insurance Group and Hastings are more than £1.57 million (2007—£1.1 million). All transactions are conducted on normal commercial terms and conditions.

#### D. OTHER RELATED PARTIES

Contributions are made to various superannuation plans, both defined contribution and defined benefit plans. Information regarding transactions with the plans is provided in note 29.

## NOTE 33. FINANCIAL RISK MANAGEMENT

### THE PARENT

The Parent is a non operating holding company and so has limited direct exposure to financial risks. The board of the Parent sets the risk management policies for the IAG Group.

The financial assets and liabilities of the Parent are limited to amounts receivable from/payable to related bodies corporate, loans to/from related bodies corporate, and interest bearing liabilities. The Parent does not use derivative instruments but is party to an embedded derivative in relation to RES outlined in note 31.B.

For information regarding the significant risk exposures on these financial instruments as at reporting date refer to:

- note 16 receivables;
- note 21 interest bearing liabilities; and
- note 32 related party disclosures.

### THE CONSOLIDATED ENTITY

The Consolidated entity is exposed to a variety of financial risks in the normal course of business; market risk (including currency risk, interest rate risk and price risk), credit risk and liquidity risk. The board and senior management of the IAG Group have developed, implemented and maintain RMS which is discussed in more detail in note 10.

That part of the IAG Group's RMS concerning financial risk focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance. Key aspects of the processes established in the RMS to mitigate financial risks include:

- having an Asset and Liability Committee (ALCo) comprised of key executives with relevant oversight responsibilities that meets on a regular basis;
- monthly stress testing is undertaken to determine the impact of adverse market movements and the impact of any derivative positions; and
- maintenance of an approved counterparty credit risk policy which is reviewed at least annually.

The IAG Group's risk management policies include the use of derivatives for both investment operations and corporate treasury operations. The RMS sets out the permissible use of derivatives in relation to investment strategies, the parameters within which the derivatives may be used, and the control environment within which they are used.

#### A. MARKET RISK

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments from fluctuations in foreign currency exchange rates, interest rates, and equity prices. Market risk arises in business units due to fluctuations in both the value of liabilities and the value of investments held. At IAG Group level, it also arises in relation to the overall portfolio of international businesses and in the value of investment assets owned directly by the shareholders. For each of the major components of market risk, described below in more detail, the IAG Group has in place policies and procedures to set out how each risk should be managed and monitored.

##### I. Currency risk

###### a. NATURE OF THE RISK AND HOW MANAGED

Currency risk is the risk of loss arising from an unfavourable movement in market exchange rates. The Consolidated entity operates internationally and so is exposed to currency risk from various activities conducted in the normal course of business.

The key currency risk exposures relate to the following:

- the investment of shareholders' funds in assets denominated in currencies different to the functional currency of the investing subsidiary being primarily Australian dollar, US dollar and British pound. Where a subsidiary that has a functional

currency other than Australian dollar holds investments and cash in that functional currency the impact to the Consolidated entity from exchange rate movements is through the translation of the net investment in the foreign operation (refer below). Note that assets held to back insurance liabilities are held in the same currency as the related insurance liabilities eliminating any net foreign exchange exposure;

- foreign currency denominated borrowings of a capital nature however note that some of these are designated as hedging instruments; and
- net investment in foreign operations (note that this investment is technically not a financial instrument for accounting purposes but is included here because movements in exchange rates have a financial impact on this process and because the outcome is hedged with derivatives which are financial instruments) through the translation of the financial position and performance of foreign operations that have a functional currency other than the Australian dollar with the key currencies being NZ dollar, British pound and Thai Baht.

Foreign currency is a centrally managed risk, with hedging coordinated at the corporate office. The IAG Group's policy is to actively manage, where possible, both its operational foreign currency exposures at a controlled entity level and its exposures arising on the translation of net investments in foreign operations at a consolidated entity level. The IAG Group manages the foreign currency exposures at the controlled entity level by matching foreign currency positions on local balance sheets within prescribed limits. Residual foreign currency exposures arising at a consolidated entity level on translation of net investments in foreign operations are hedged to between 75%–100% of the value on an after tax basis through the use of derivatives and the designation of certain foreign currency borrowings as hedging instruments.

###### b. CURRENCY RISK EXPOSURE

For information regarding the significant currency risk exposures on financial instruments at reporting date refer to:

- note 7 segment reporting—each of the segments conducts business predominantly in the local currency and so the segment reporting note provides information regarding the relevant portions of the financial position and performance that are denominated in various currencies;
- note 15 investments;
- note 21 interest bearing liabilities; and
- note 33.D financial risk management, net investment hedges.

The financial impact from exposure to currency risk is reflected in the financial report through two mechanisms:

- translation of foreign currency transactions—these financial impacts relating primarily to investments and interest bearing liabilities are recognised directly in profit (except that some of the interest bearing liabilities are hedged); and
- translation of the financial results of foreign operations—these financial impacts are recognised directly in equity in the foreign currency translation reserve and so have no impact on profit.

###### c. USE OF DERIVATIVES

Derivatives are used to manage currency risk.

The currency risk arising from the translation of net investments in foreign operations to Australian dollars is managed using a combination of foreign currency borrowings designated as hedging instruments and derivative instruments being forward foreign exchange contracts and cross currency swaps designated as hedging instruments.

The currency risk arising from certain other financial instruments is managed using forward foreign exchange contracts.

For information regarding the notional contract amounts associated with these derivative financial instruments together with a maturity profile and reporting date fair values refer to section D.

#### d. SENSITIVITY

The sensitivity analyses provided in this note demonstrates the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. The sensitivities do not include dependencies among the currencies, but rather show isolated exchange rate movements. It should also be noted that these sensitivities are not necessarily linear, and larger or smaller impacts should not be interpolated or extrapolated from these results. The sensitivity analyses do not take into consideration that the assets and liabilities are actively managed and so assume no action by management in response to movements in the factor. Additionally, the financial position may vary at the time that any actual market movement occurs.

The impact on the measurement of various financial instruments held at reporting date of an instantaneous 10% depreciation of the Australian dollar at reporting date compared with selected currencies, on the profit before tax and equity, net of related derivatives, is provided in the table below. An appreciation of the Australian dollar would have the opposite impact.

	CONSOLIDATED	
	2008 \$m	2007 \$m
	<b>Impact to profit</b>	<b>Impact to profit</b>
Shareholders' funds including related derivatives		
Australian dollar	<b>13</b>	17
United States dollar	<b>5</b>	12
British pound	<b>6</b>	4
	<b>24</b>	33
	<b>Impact to equity</b>	<b>Impact to equity</b>
Net investments in foreign operations and related hedge arrangements		
New Zealand dollar	<b>3</b>	11
British pound	<b>11</b>	31
Thai Baht	<b>1</b>	2
Other currencies where considered significant	<b>1</b>	1
	<b>16</b>	45

The sensitivity to currency fluctuations is mitigated by the extensive currency hedging measures.

The IAG Group has interest bearing liabilities denominated in a range of currencies but has limited sensitivity to currency risk from these liabilities because the instruments are either denominated in Australian dollar and issued by an entity with Australian dollar as the functional currency, denominated in US dollar and fully hedged with derivatives, or denominated in another currency and forming part of a net investment hedge of a foreign operation. The Parent's profit for the year would have been impacted by \$52 million (2007—\$59 million) from a 10% depreciation at reporting date of the Australian dollar to British pound exchange rate from its holding of British pound denominated interest bearing liabilities.

## II. Interest rate risk

### a. NATURE OF THE RISK AND HOW MANAGED

Interest rate risk is the risk of loss arising from an unfavourable movement in market interest rates. Fixed interest rate assets and liabilities create exposure to fair value interest rate risk which is a market risk. Financial assets and liabilities with floating interest rates create exposure to cash flow interest rate risk.

Interest rate risk arises primarily from investments in money market securities. Interest bearing liabilities are exposed to interest rate risk but as they are measured at amortised cost and are not traded they therefore do not expose the IAG Group to fair value interest rate risk. In addition, the majority of these interest bearing liabilities bear fixed interest rates (subject to some reset conditions) and so expose the Group to limited cash flow interest rate risk.

Interest rate risk is monitored and managed by the Group ALCo. Exposure to interest rate risk is monitored through several measures that include Value At Risk analysis, position limits, scenario testing, stress testing, and asset and liability matching using measures such as duration.

The assets held to back insurance liabilities are invested principally in fixed interest securities matched to the expected settlement durations of the outstanding claims payments. This minimises the interest rate risk arising directly from underwriting insurance contracts as the movement in investment income on assets backing insurance liabilities offsets the impact of movements in discount rates on the outstanding claims liabilities.

### b. INTEREST RATE RISK EXPOSURE

For information regarding the significant interest rate risk exposures on financial instruments as at reporting date refer to:

- note 15 investments;
- note 21 interest bearing liabilities;
- note 23 notes to the cash flow statements; and
- note 32 related party disclosures.

### c. USE OF DERIVATIVES

Derivatives are used to manage interest rate risk. The interest rate risk arising from money market securities is managed using interest rate swaps and futures. For information regarding the notional contract amounts associated with these derivative financial instruments together with a maturity profile and reporting date fair values refer to section D.

#### d. SENSITIVITY

When considering the sensitivity analysis below, note should be taken of the limiting conditions provided as the introduction to the sensitivity section for currency risk provided above.

The investments in money market securities are recognised on balance sheet at fair value. Movements in market interest rates impact the price of the securities (and hence their fair value measurement) and so would impact profit. The impact from the measurement of the money market securities held at reporting date of a change in interest rates at reporting date by +1% or -1% (eg a move from 4% to 5% or 3%) on profit before tax, net of related derivatives, is shown in the table below.

		CONSOLIDATED	
		2008	2007
		\$m	\$m
		Impact to profit	Impact to profit
Investment—money market securities and related interest rate derivatives	+1%	(169)	(200)
	-1%	169	200

All investments are measured at fair value through profit and so there would be no direct impact to equity from those movements. The majority of the money market securities are expected to be held to maturity and so movements in the fair value are expected to reverse upon maturity of the instruments. While movements in interest rates impact the fair value measurement of the securities there is no impact to the contractual cash flows of the securities.

The interest bearing liabilities are recognised on balance sheet at amortised cost. Hence the reporting date measurement of the liabilities is not sensitive to movements in interest rates and so a change in interest rates as at reporting date would have had no impact on either profit or equity from the measurement of interest bearing liabilities for the current financial year. The interest rate risk would be more relevant for the valuation of these instruments upon a reset date when the terms of the liabilities, including the interest rate, may need to be reset to market rates or upon maturity when the instrument may need to be replaced. Movements in interest rates would have an impact on the future payment of interest payments on those liabilities bearing a variable interest rate (refer note 21).

The reporting date measurement of the cash and cash equivalents is not sensitive to movements in interest rates and so a change in interest rates as at reporting date would have had no impact on either profit or equity from the measurement of cash and cash equivalents for the current financial year.

The other financial assets and liabilities of the Parent being amounts receivable from/payable to related bodies corporate, and loans to/from related bodies corporate, would be impacted by movements in interest rates at reporting date in the same manner as provided above for interest bearing liabilities.

### III. Other price risk

#### a. NATURE OF THE RISK AND HOW MANAGED

Price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded on the market. The only other price risk to which the IAG Group has significant exposure is equity price risk.

The IAG Group is exposed to equity price risk from its investment in equities and trust securities.

Equity price risk is monitored and managed by the Group ALCo. Exposure to equity price risk is monitored through several measures that include Value At Risk analysis, position limits, scenario testing, and stress testing. The exposure is actively managed against a broad equity market index utilising the experience of a small number of external fund managers.

#### b. REPORTING DATE INFORMATION

For information regarding the significant equity price risk exposures on financial instruments as at reporting date refer to:

- note 15 investments; and
- note 33.D financial risk management, use of derivatives.

#### c. USE OF DERIVATIVES

Derivatives are used to manage equity price risk. The equity price risk arising from investing in equity securities is managed using share price index futures and options. For information regarding the notional contract amounts associated with these derivative financial instruments together with a maturity profile and reporting date fair values refer to section D.

#### d. SENSITIVITY

When considering the sensitivity analysis below, note should be taken of the limiting conditions provided as the introduction to the sensitivity section for currency risk provided above.

The impact from the measurement of the investments held at reporting date of a change in equity and trust market values at reporting date by +10% or -10% on profit before tax, net of related derivatives, is shown in the table below.

		CONSOLIDATED	
		2008	2007
		\$m	\$m
Investments—equity and trust securities and related equity derivatives	+10%	140	248
	-10%	(140)	(248)

All equity investments are measured at fair value through profit and so there would be no direct impact to equity from those movements.

## **B. CREDIT RISK**

### **I. Nature of the risk and how managed**

Credit risk is the risk of loss from a counterparty failing to meet their financial obligations. The Consolidated entity's credit risk arises predominantly from investment activities, reinsurance activities (refer note 12), and dealings with intermediaries (refer note 10.E). The Consolidated entity's credit quality management roles, principles and processes are detailed in the IAG Group Credit Risk Management Policy document which is approved by the IAG board and complies with APRA's requirements for credit risk management by a general insurer. The policy outlines the framework and procedures in place to ensure an adequate and appropriate level of monitoring and management of credit quality throughout the IAG Group. The IAG Group treasury function is responsible for ensuring that the policies governing the management of credit quality risk are properly implemented. The IAG Group's credit risk appetite relies heavily on credit rating agency research and is heavily weighted towards counterparties of high quality investment grade. All new, changed and continuing credit risk exposures must be approved in accordance with the IAG Group's approval authority framework.

The IAG Group is exposed to credit risk from investments in third parties where the IAG Group holds debt and similar securities issued by those companies. The credit risk relating to investments is monitored and assessed, and maximum exposures are limited. The investments comprising assets held to back insurance liabilities are restricted to investment grade securities.

The IAG Group risk management framework also includes the market related aspect of credit risk. This is the risk of a fall in the value of fixed interest securities from changes in the perceived worthiness of the issuer and is manifested through changes in the credit spreads of the fixed interest securities.

Concentrations of credit risk exist if a number of counterparties have similar economic characteristics. At the reporting date, there were no material concentrations of credit risk as the Consolidated entity transacts with a large number of counterparties in various geographical regions without any individual debtor having a material outstanding balance.

### **II. Reporting date information**

For information regarding the significant credit exposures on financial instruments as at reporting date refer to:

- note 15 investments; and
- note 16 receivables.

### **III. Use of derivatives**

Derivatives are not used to manage credit risk but instead they themselves expose the IAG Group to credit risk. A distinction is made between over the counter derivatives and standardised derivative contracts traded on an exchange. As the exchange traded derivatives are typically settled on a daily basis with the clearing house of the respective exchange, credit risk associated with these contracts is negligible. Over the counter contracts on the other hand harbour a theoretical risk in the amount of the replacement costs. As the primary purpose for using derivatives is hedging, any over the counter derivatives used have been transacted with investment grade quality financial institutions only. The IAG Group's credit policy and procedures ensure that exposures to counterparty risks are monitored constantly to operate within the risk limits approved by the IAG board.

## **C. LIQUIDITY RISK**

### **I. Nature of the risk and how managed**

Liquidity risk is concerned with the risk of there being insufficient cash resources to meet payment obligations without affecting the daily operations or the financial condition of the Consolidated entity. Liquidity facilitates the ability to meet expected and unexpected requirements for cash. The liquidity position is derived from operating cash flows, investment portfolios and

access to outside sources of liquidity such as bank lines of credit, established debt funding programs, reinsurance arrangements and other sources. The balance sheet is prepared using the liquidity format in which the assets and liabilities are presented broadly in order of liquidity. The liquidity management roles, principles and processes are detailed in the IAG Group Liquidity Risk Management Policy document which is approved by the IAG board and complies with APRA's requirements for liquidity risk management by a general insurer. The policy outlines the framework and procedures in place to ensure an adequate and appropriate level of monitoring and management of liquidity.

Sound liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities and the ability to close out market positions. The nature of insurance activities means that the timing and amount of cash flows are uncertain. The liquidity risk management policy is concerned with ensuring the ongoing ability to meet the payment obligations to policyholders and other creditors across a wide range of operating conditions without suffering any significant additional cost. These processes are principally in the control of the IAG Group treasury function.

Management of liquidity risk includes asset and liability management strategies. The assets held to back insurance liabilities consist predominantly of government securities (the most liquid of securities) and other very high quality securities which can generally be readily sold or exchanged for cash. The assets are managed so as to effectively match the maturity profile of the assets with the expected pattern of claims payments. The debt securities are restricted to investment grade securities with concentrations of investments managed by various criteria including issuer, industry, geography and credit rating. The proportion, by market value, of the technical reserves fund invested in high quality liquid assets for each group insurer must exceed 35% of the fund balance. There is a transition period for newly acquired businesses to comply with these policies.

A significant source of liquidity risk for the IAG Group relates to the interest bearing liabilities. The management of this risk includes the issuance of a range of borrowings denominated in different currencies with different maturities.

Information regarding access to unutilised credit facilities is available in note 21.J.

The RES (refer note 1.HH) are a part of the liquidity management of the Consolidated entity. The ability to access external sources of liquidity from domestic and international capital market raisings is assisted by the strong financial strength rating of the IAG Group.

### **II. Reporting date information**

For information regarding the significant liquidity risk exposures as at reporting date refer to:

- note 11.F claims, maturity analysis; and
- note 21.D interest bearing liabilities, maturity analysis.

### **D. USE OF DERIVATIVES**

Derivatives are used across the IAG Group to manage various risks. Derivatives are used solely to manage risk exposures and are not used for trading or speculation. Given the complexity and heightened risk typically associated with the use of derivatives we provide information here summarising the use of derivatives.

A distinction is made between over the counter derivatives which are individually negotiated between the contracting parties and standardised derivative contracts traded on an exchange. Over the counter derivatives theoretically bear higher risk. As the primary purpose for using derivatives is hedging, any over the counter derivatives used have been transacted with investment grade quality financial institutions only.

## I. Derivatives for which hedge accounting is applied

### a. CASH FLOW HEDGES

At reporting date, cash flow hedge accounting was applied in relation to only a single economic hedge relating to the currency and interest rate risk on the US subordinated term notes (refer note 21.C.II).

### b. NET INVESTMENT HEDGES

To manage the IAG Group's exposure to currency risk from investing in foreign operations, the following arrangements were designated as net investment hedges for which hedge accounting is applied:

#### i. New Zealand

AUD/NZD forward foreign exchange contracts are used to hedge between 75%–100% of the net investment in the NZ operation.

#### ii. United Kingdom

AUD/GBP forward foreign exchange contracts, cross currency swaps, the GBP subordinated term notes, a portion of the Euro and USD floating rate notes and an intragroup loan are used to hedge between 75%–100% of the net investment in the UK operation.

#### iii. Thailand

AUD/THB forward foreign exchange contracts and an intragroup loan are used to hedge between 75%–100% of the net investment in the Thailand operation.

#### iv. Malaysia

AUD/MYR forward foreign exchange contracts are used to hedge between 75%–100% of the net investment in the Malaysia based associate.

Each of these hedging relationships have been broadly effective throughout the current period or since inception with the small amount of ineffectiveness recognised in the income statement.

### c. FAIR VALUE HEDGES

There was no fair value hedge activity during the year (2007—none).

### d. REPORTING DATE POSITIONS

The notional contract amounts associated with derivative financial instruments which form arrangements for which hedge accounting is applied together with maturity profile for the current reporting period and reporting date fair value is provided below.

	2008						2007		
	Maturity profile			Notional contract amount	Fair value asset	Fair value liability	Notional contract amount	Fair value asset	Fair value liability
	Within 1 year \$m	1 to 5 years \$m	Over 5 years \$m	\$m	\$m	\$m	\$m	\$m	\$m
Cash flow hedges									
AUD/USD cross currency swaps	–	250	–	250	–	(162)	283	–	(135)
Interest rate swaps	–	350	–	350	14	–	400	10	–
Net investment hedges									
AUD/THB forward foreign exchange contracts	131	–	–	131	12	–	102	–	–
AUD/NZD forward foreign exchange contracts	249	–	–	249	13	–	146	–	(2)
AUD/GBP forward foreign exchange contracts	490	–	–	490	13	–	584	27	(4)
AUD/GBP cross currency swaps	433	128	–	561	99	–	740	17	1
AUD/MYR forward foreign exchange contracts	95	–	–	95	6	–	82	3	–

## II. Derivatives for which hedge accounting is not applied (derivatives held for economic hedging purposes only)

While a variety of derivatives are used to hedge specific risks on various financial instruments, the majority of these derivatives are not designated as part of a hedge for which hedge accounting is applied. These derivatives are measured at fair value with movements in fair value being recognised in the income statement.

In addition to the derivatives described above, certain contracts entered into include embedded derivative features. Such embedded derivatives are assessed at inception of the contract and, depending on their characteristics, are accounted for as separate derivative financial instruments.

### REPORTING DATE POSITIONS

The notional contract amounts associated with derivative financial instruments for which hedge accounting is not applied together with maturity profile for the current reporting period and reporting date fair value is provided below.

	2008						2007		
	Maturity profile			Notional contract amount	Fair value asset	Fair value liability	Notional contract amount	Fair value asset	Fair value liability
	Within 1 year \$m	1 to 5 years \$m	Over 5 years \$m						
Presented in investments (investment related derivatives)									
<b>FOREIGN EXCHANGE CONTRACTS</b>									
Over the counter:									
Forward foreign exchange contracts	-	3	-	3	20	(17)	608	-	-
Exchange traded:									
Forward foreign exchange contracts	-	-	-	-	9	(9)	-	6	(7)
<b>INTEREST RATE CONTRACTS</b>									
Over the counter:									
Interest rate swap contracts	-	-	-	-	-	-	361	-	-
Exchange traded:									
Interest rate swap contracts	-	-	-	-	-	-	158	15	(16)
Futures	1,144	328	150	1,622	8	(4)	4,162	3	-
<b>EQUITY/INDEX CONTRACTS</b>									
Over the counter:									
Share price index futures	(94)	-	-	(94)	-	(4)	(96)	-	-
Options—purchased	2	-	-	2	2	-	4	1	-
Options—written	2	-	-	2	-	-	(2)	-	-
Presented in trade and other receivables/payables (treasury related derivatives)									
AUD/NZD forward foreign exchange contracts	86	-	-	86	3	-	154	-	(3)
AUD/USD forward foreign exchange contracts	17	31	-	48	-	(5)	31	-	(3)
AUD/GBP forward foreign exchange contracts	126	-	-	126	-	(1)	152	1	-
Interest rate swaps	359	359	-	718	-	-	-	-	-
Cross currency swaps	-	20	-	20	-	(3)	-	-	-
Embedded derivative									
RES exchange right*	-	-	-	-	69	-	-	-	-

\* The RES exchange right is an asset of the Parent.

## III. Fair value information

The notional contract amounts associated with derivative financial instruments are not recorded as assets or liabilities on the balance sheet as they do not represent the fair value of these transactions.

The following techniques are used to determine the fair value of various derivative instruments:

- interest rate swap contracts—the fair value is the estimated amount that the IAG Group would receive or pay to terminate the swap at balance date taking into account current interest rates; and
- forward foreign exchange contracts—the fair value is calculated by reference to current forward exchange contracts for contracts with similar maturity profile as at reporting date.

### EMBEDDED DERIVATIVE

- The fair value of the RES exchange right has been determined as the difference between the fair value of the RES instrument as a whole identified by reference to the ASX listed offer price at reporting date and the estimated fair value of an instrument with comparable terms to those of the RES instrument but without an exchange right.

## NOTE 34. CAPITAL MANAGEMENT

### A. CAPITAL MANAGEMENT STRATEGY

The capital management strategy plays a central role in managing risk to create shareholder value whilst meeting the crucial and equally important objective of providing an appropriate level of capital to protect policyholders' and lenders' interests and satisfy regulators. Capital finances growth, capital expenditure and business plans and also provides support in the face of adverse outcomes from insurance and other activities and investment performance.

The IAG Group actively manages its capital on two key parameters:

- an estimated risk of ruin of no more than one in 750 years; and
- maintaining a minimum Probability of Adequacy of at least 90% on outstanding claims.

The amount of capital required to meet these parameters varies according to the business and asset mix and is estimated using dynamic financial analysis modelling. For ease of communication, internally and externally, the IAG Group has translated the outcome into a multiple of the MCR set by applying the APRA methodology for measuring Australian licensed insurer capital as if the rules applied to the IAG Group. On this basis, the IAG Group has been using a benchmark MCR multiple of 1.55 times for the past three years.

From 1 July 2008, the IAG Group has revised its benchmark of 1.55 times down to 1.50 times to reflect the increase in regulatory capital charges that APRA has implemented in relation to various asset classes. These changes have no effect on the amount of capital the IAG Group believes it requires to hold to meet its risk appetite. The reduction in the benchmark reflects the higher MCR now sought by APRA from the general insurance industry.

Internal policies are in place to ensure significant deviations from this benchmark will result in the Group's board considering how any shortfall should be made good or any surplus utilised.

#### I. Regulatory capital

All insurers within the IAG Group that carry on insurance business in Australia are registered with APRA and are subject to prudential standards which set out the basis for calculating the MCR which is a minimum level of capital that the regulator deems must be held to meet policyholder obligations. An insurer's capital base is expected to be adequate for the size, business mix, complexity and risk profile of its business and so the MCR utilises a risk based approach to capital adequacy. IAG uses the standardised framework for calculating the MCR detailed in the relevant prudential standard and referred to as the prescribed method which is determined to be the sum of the capital charges for insurance, investment, investment concentration and catastrophe concentration risk. It is IAG Group policy to ensure that each of the licensed insurers maintains an adequate capital position from an entity perspective. The IAG Group voluntarily applies the MCR prudential standards to the IAG Group as a whole, as if the Consolidated entity was an APRA regulated entity (refer section D).

It is IAG Group policy to hold regulatory capital levels in excess of the MCR as required by APRA. The current target capital multiple for the Consolidated entity is 1.50 times (2007—1.55 times) the MCR which is a derivation of the required capital to meet the one in 750 year risk of absolute ruin needed to maintain the target credit rating (refer below). The policy also requires management to not take any action that would further reduce the capital multiple if an identified minimum capital multiple is reached, currently set as 1.35 times MCR for the Consolidated entity. APRA also imposes some restrictions on the composition of capital eligible to meet the MCR.

The IAG Group sets an ongoing capital target sufficient to maintain a probability no larger than 10% per annum of the IAG Group's available Group capital being lower than 1.2 times Australian MCR. This is also factored into the derivation of the 1.50 times MCR target.

Capital calculations for regulatory purposes are based on the premium liabilities model which is different to the deferral and matching model which underpins the measurement of assets and liabilities in the financial statements. The premium liabilities model assesses future claims payments arising from future events insured under existing policies. This differs to the measurement of the outstanding claims liability on the balance sheet which considers claims relating to events that occur only up to and including the reporting date.

#### II. Economic capital

In conjunction with the considerations set out above, which are important to the functioning of the business, consideration is given to the operational capital needs of the business. Targeting a capital multiple above the minimum regulatory requirement aims to ensure the ongoing strength and security of the IAG Group whilst suitably protecting policyholders and lenders.

An important influence on the capital levels is the payment of dividends. The Consolidated entity aims to maintain cash earnings payouts within a ratio range approved by the IAG board. In view of the Group's recent performance, the final dividend has been reduced to 9 cents per share (2007—final dividend paid on 8 October 2007 was 16 cents per share).

The capital objectives are achieved through dynamic management of the balance sheet and capital mix, the use of a risk based capital adequacy framework for capital needs that relies on explicit quantification of uncertainty or risk, and the use of modelling techniques such as dynamic financial analysis which provide valuable input to the capital management process and provide the capacity to quantify and understand this risk/return trade off. The influence on capital needs of product mix, the reinsurance program, catastrophe exposure, investment strategy, profit margins and capital structure are all assessed through the dynamic financial analysis modelling.

#### B. CREDIT RATING

During the current financial year, S&P lowered the counterparty credit rating of IAG to A+ from AA and the counter party credit ratings and financial strength ratings of IAG's key wholly owned insurers to AA- from AA. The outlook is stable.

Key wholly owned insurers within the IAG Group had the following ratings published by S&P at 30 June 2008:

ENTITY	ISSUER CREDIT RATING	FINANCIAL STRENGTH RATING
<b>Parent</b>		
Insurance Australia Group Limited	<b>A+ / Stable</b>	<b>n/a</b>
<b>Licensed insurers</b>		
Insurance Australia Limited	<b>AA- / Stable</b>	<b>AA- / Stable</b>
IAG New Zealand Limited	<b>AA- / Stable</b>	<b>AA- / Stable</b>
CGU Insurance Limited	<b>AA- / Stable</b>	<b>AA- / Stable</b>
Swann Insurance (Aust) Pty Ltd	<b>AA- / Stable</b>	<b>AA- / Stable</b>
IAG Re Labuan (L) Berhad	<b>n/a</b>	<b>A+ / Stable</b>
IAG Re Australia Limited (formerly NZI Insurance Australia Limited)	<b>AA- / Stable</b>	<b>AA- / Stable</b>

### C. CAPITAL COMPOSITION

The IAG Group's capital comprises ordinary shares and interest bearing liabilities. The balance sheet capital mix at reporting date was:

	Target %	CONSOLIDATED	
		2008 %	2007 %
Ordinary equity	<b>68</b>	<b>75</b>	70
Interest bearing liabilities—hybrid securities*	<b>12</b>	<b>6</b>	8
Interest bearing liabilities—debt	<b>20</b>	<b>19</b>	22
	<b>100</b>	<b>100</b>	100

\* Currently the only hybrid security on issue by the IAG Group is the RPS which have characteristics of both debt and equity.

The change in the balance sheet capital mix to reporting date has been primarily driven by the issuance of ordinary equity to fund dividends, the repayment of \$200 million of AUD RPS, the repayment of \$300 million of AUD subordinated term notes, the repayment of GBP unsecured notes and issuance of NZ\$100 million of NZD subordinated term notes.

The capital disclosed above does not include the \$550 million of contingent capital made available through the RES (refer note 1.HH).

### D. REGULATORY CAPITAL COMPLIANCE

The insurers within the Consolidated entity have at all times during the current and prior financial year complied with the externally imposed capital requirements to which they are subject. The MCR calculation for the Consolidated entity provided below is based on applying in principle the APRA standards for individual entities to the consolidated position, pending the publication by APRA of a comprehensive standard to determine prudential capital at a consolidated level (such a standard is currently undergoing a consultation process). A similar basis is used for both the Australian and international insurance businesses.

	CONSOLIDATED	
	2008 \$m	2007 \$m
<b>Statutory capital</b>		
TIER 1 CAPITAL		
Fundamental tier 1 capital		
Ordinary shares	<b>4,740</b>	4,361
Reserves	<b>(7)</b>	(4)
Retained earnings/(accumulated losses)	<b>(458)</b>	372
Excess technical provisions (net of tax) <sup>(i)</sup>	<b>359</b>	431
Innovative residual tier 1 capital		
Reset preference shares, net of transaction costs	<b>350</b>	549
Deductions from tier 1 capital <sup>(ii)</sup>		
Treasury shares held in trust <sup>(iii)</sup>	<b>(15)</b>	(36)
Goodwill	<b>(1,875)</b>	(2,222)
Intangible assets	<b>(585)</b>	(815)
Net deferred tax assets	<b>(263)</b>	(223)
Other	<b>(49)</b>	(112)
Total tier 1 capital	<b>2,197</b>	2,301
TIER 2 CAPITAL		
Subordinated term notes	<b>844</b>	1,151
Total statutory capital	<b>3,041</b>	3,452
<b>Minimum capital requirement</b>		
Insurance risk	<b>1,224</b>	1,295
Investment risk	<b>530</b>	573
Investment concentration risk <sup>(iv)</sup>	<b>-</b>	-
Catastrophe concentration risk	<b>118</b>	200
Total MCR	<b>1,872</b>	2,068
MCR multiple	<b>1.62</b>	1.67

(i) The excess technical provisions represent the difference between the insurance liabilities incorporating a risk margin (refer note 11.G) on the balance sheet based on the deferral and matching model and the insurance liabilities incorporating a risk margin equivalent to a probability of adequacy of 75% used for regulatory reporting purposes based on the premium liabilities model.

(ii) Certain assets that are considered acceptable from an accounting perspective are, from a supervisory perspective, considered to be generally not available or of reduced value should an insurer encounter difficulties. Holdings of such assets are therefore required to be deducted from the regulatory capital base.

(iii) The portion of the treasury shares held in trust that does not meet eligibility criteria under APRA prudential rules.

(iv) The investment concentration risk charge is zero reflecting that the holding of particular assets, including reinsurance recoveries, and exposure to a particular obligor, are sufficiently diversified for the purposes of the regulatory capital calculations.

The IAG Group's MCR was affected by the following:

- the decrease in the insurance risk charge is due to reduction in net insurance liabilities from the large amounts recognised as at the comparative reporting date reflecting the June 2007 storms;
- the decrease in the investment risk charge is due to changes in investment mix. The reductions in charges due to a decrease in equity holdings during the year exceeded the increase in the charges from increased exposure to subordinated debt issued by banks. This debt carries a capital charge equivalent to unlisted equities (10%) though the debt is issued by financial institutions with strong credit ratings; and
- the decrease in catastrophe concentration risk charge is due to increased reinsurance cover which became effective from 1 July 2007.

The MCR calculation does not include the \$550 million of contingent capital made available through the RES (refer note 1.HH), which if exchanged, would bring the MCR multiple to 1.92 times (2007—1.94 times).

#### Changes during the year

APRA have introduced a number of changes that will impact the MCR calculation methodology going forward.

- Reinsurance documentation rules transition provisions—refer to note 12.
- From 1 July 2008 the capital factors to be applied for listed equities and listed trusts has increased to 16% from 8% and for unlisted equities, direct property, unlisted trusts and investments classified as 'other' has increased to 20% from 10%. Changes have also been made to the treatment of certain derivative and trust investments.
- For unsecured reinsurance recoverables on outstanding claims recognised from non APRA authorised reinsurers in relation to reinsurance contracts entered into from and including 31 December 2008, capital charges will apply based on the credit rating of the reinsurance counterparty on and after the second balance date after the underlying claim event occurred. Prior to this second balance date, an additional charge will apply to reinsurance recoverables from non APRA authorised reinsurers compared to those from APRA authorised reinsurers. For undisputed reinsurance recoveries due and payable a 100% capital factor is to be applied for those amounts outstanding from a non APRA authorised reinsurer for more than six months.

The changes in the MCR calculation methodology noted above do not apply retrospectively for the determination of regulatory compliance and so have no impact on the reporting date compliance position.

## NOTE 35. NET TANGIBLE ASSETS

	CONSOLIDATED	
	2008	2007
	\$	\$
Net tangible assets per ordinary share	<b>0.93</b>	0.90

Net tangible assets per ordinary share has been determined using the net assets on the balance sheet adjusted for minority interests, intangible assets and goodwill.

## NOTE 36. RESTRUCTURING PROVISION

	CONSOLIDATED	
	2008	2007
	\$m	\$m
<b>A. COMPOSITION</b>		
Other restructuring provision	<b>1</b>	4
IAG Group restructuring	<b>60</b>	—
Balance at the end of the financial year	<b>61</b>	4
<b>B. RECONCILIATION OF MOVEMENTS FOR THE FINANCIAL YEAR</b>		
Balance at the beginning of the financial year	<b>4</b>	4
Additions during the financial year	<b>60</b>	—
Settled during the financial year	<b>(3)</b>	—
Balance at the end of the financial year	<b>61</b>	4

All of the provision outstanding at the reporting date is expected to be settled within 12 months (2007—all). The balance has not been discounted.

## NOTE 37. EVENTS SUBSEQUENT TO REPORTING DATE

As the following transactions occurred after reporting date and did not relate to conditions existing at reporting date, no account has been taken of them in the financial statements for the year ended 30 June 2008.

#### DECLARATION OF FINAL DIVIDEND

On 22 August 2008, a final dividend of 9.0 cents per share, 100% franked, was declared by the Company. The dividend will be paid on 3 October 2008. The DRP will operate by issuing new ordinary shares to participants with no discount applied.