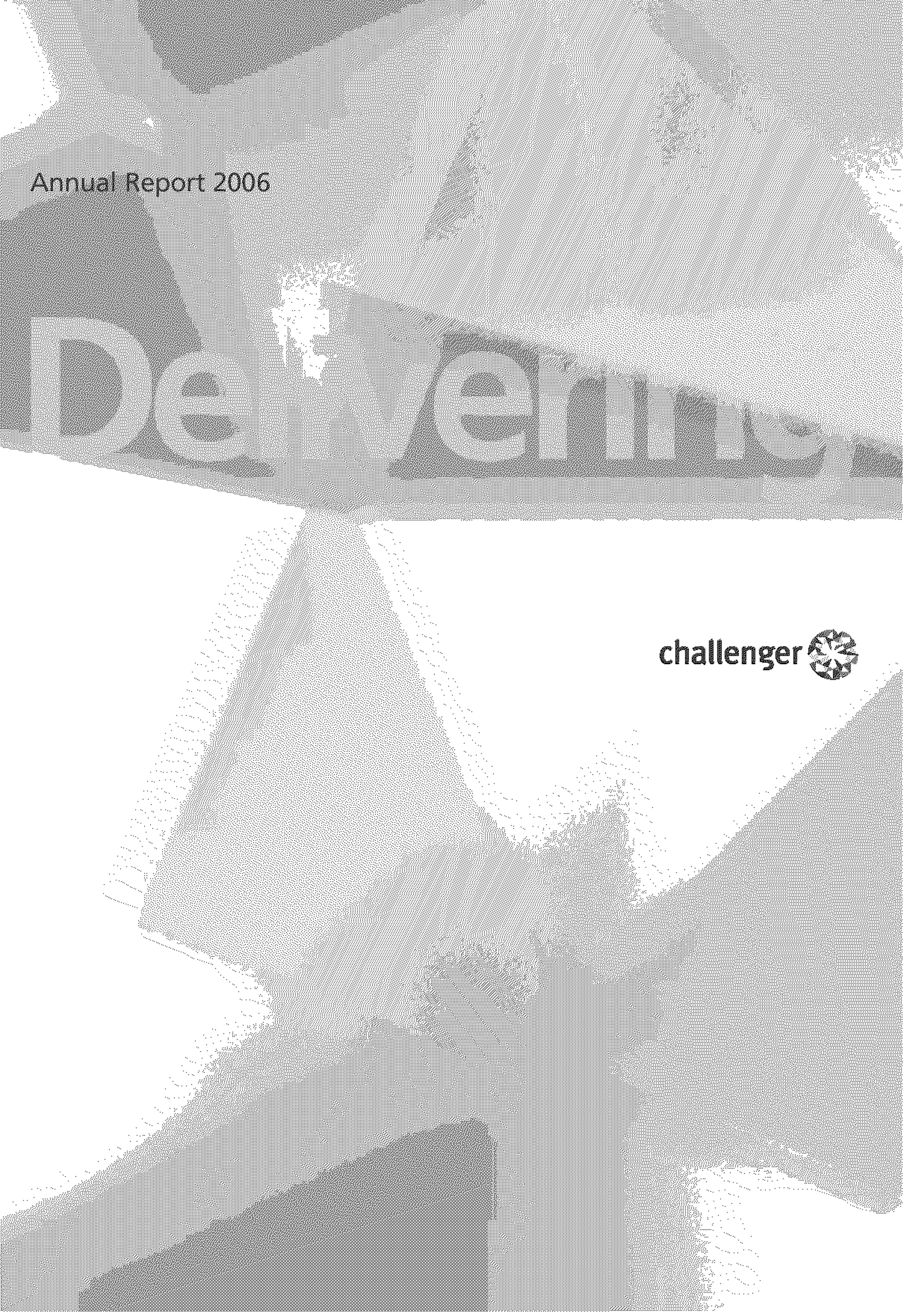
Annual Report 2006



challenger

Our Principles

Compliance Our licence to operate
Creative Customer Solutions Think differently, deliver swiftly, capture the value
Commercial Ownership Run the business as if it is your own
Working Together Success as a team and success as an individual
Integrity Our word is our bond

Contents

Challenger Financial Services Group Limited
ABN 85 106 842 371

Challenger is an established participant in Australian financial services, focusing on four business lines each committed to achieving above-market growth.

Funds Management manufactures investment products for institutional and retail clients. It is a quality investment manager in its own right. And it also acts as a gateway to other investment managers, allowing us to offer a range of funds and investment styles.

Mortgage Management is one of Australia's largest non-bank residential mortgage lenders, funding a comprehensive range of residential mortgage products offered by a network of preferred lenders under their own brands.

Asset Management has particular expertise in infrastructure, property and fixed interest markets; and it continues to develop specialist funds for institutional and retail investors. It is a proprietary investor in its own right, raising funds through retail and wholesale annuities and other sources to invest in assets which are undervalued for risk or where we can add value.

Financial Planning, operated through our Genesys Wealth Advisers business and our funds administration company, Synergy, has over 400 advisers across Australia, offering reliable lifetime wealth advice to around 100,000 Australians.

Delivering

Delivering results

Challenger delivered improved earnings for shareholders in 2006. We announced a fully franked final dividend of 5 cents per share, bringing the full year dividend to 7.5 cents per share – an increase of 50% on the previous year.

Delivering for the future

What differentiates us from our competitors is our commitment and the ability of our teams to deliver the quality products and services that are central to the continued growth of the business.

Delivering growth

Challenger is focused on four core businesses of Mortgage Management, Funds Management, Asset Management and Financial Planning. Each is growing, and improved its contribution to the Group profit results in 2006.

Challenger is dedicated to delivering shareholder value by maintaining focus on the quality of our customer service and products. By maintaining and enhancing our comparative advantages in these areas, we seek to deliver sustainable shareholder returns and growth across our businesses.

Delivering innovation

By challenging the status quo, we look to innovate and create a comparative advantage in each of our markets. We believe there is always a better way.

Delivering for our partners

Challenger is committed to delivering for stakeholders – our customers, our shareholders and the broader community in which we operate.

Delivering through our team

The most important factor for the future is the quality and commitment of Challenger's people, working as a team to achieve our objectives.

Year ended 30 June	2006 historic cost	Percentage change
Portfolio volume	N/A	N/A
Net income	$446m	30.4%
Expenses[1]	$236m	12.4%
EBIT	$209m	58.3%
NPAT	$116m	38.1%
NPAT[1]	$125m	48.8%
EPS basic[1]	21.6¢	35.8%
EPS diluted[1]	20.9¢	29.7%

[1]Before significant items.

Return on net assets

The business has set a target of a return on net assets of 18% for each of its four businesses. Over the year, three divisions, Mortgage Management, Asset Management and Funds Management, exceeded this target and our fourth division, Financial Planning, is on target to achieve this objective by 2009.

Delivering Results

Earnings per share

Statutory basic earnings per share before significant items rose to 28.4 cents, an increase of 25%. Our target is to deliver double digit EPS growth on an ongoing basis.

Year ended 30 June	2006 statutory	Percentage change
Portfolio volume	$36.5bn	15.7%
Revenue	$2.3bn	12.7%
Expenses	$2.0bn	13.6%
EBIT	$290.5m	5.6%
NPAT	$134m	12.3%
NPAT[1]	$153m	27.8%
EPS basic[1]	28.4¢	25.1%
EPS diluted[1]	27.3¢	20.2%

[1] Before significant items.

Fully franked final dividend of 5 cents per share, bringing full year dividend to 7.5 cents per share fully franked.

Challenger reported a statutory net profit after tax and before significant items of $153 million for the year ended 30 June 2006, 28% above the previous corresponding period. After significant items, net profit after tax was $134 million, up 12.3%.

On a historic cost basis, net profit after tax and before significant items for the year ended 30 June 2006 increased 48% to $125 million. After significant items, net profit after tax rose 38% to $116 million. EBIT increased by 58% to $209 million.

Chairman's Report

On behalf of the Board and management, I am pleased to present Challenger's Annual Report for the 12 months to 30 June 2006.

It has been another significant year for Challenger which saw it deliver improved results across the board. This year's Annual Report focuses on how we have been delivering through our strategy and on our objective to achieve acceptable returns on net assets. It also provides an opportunity to read about the high points of Challenger's four businesses, their focus and the outlook for the year ahead.

Full year result to 30 June 2006
Challenger reported a net profit after tax and before significant items of $153 million on a statutory basis, an increase of 28% on the prior year. On a historic cost basis, Challenger reported a net profit after tax and before significant items of $125 million, an increase of 48% on 2005.

Highlights for the year included a 30% increase in net income while costs increased by only 12%. Pleasingly, while we continue to invest for the future, income is growing at two and a half times our costs.

Total assets, funds and mortgages under management and administration grew to $36.5 billion. Historic cost earnings before interest, tax and significant items grew by 58% while basic underlying earnings per share before significant items grew by 25% to 28.4 cents per share on a statutory basis. Throughout the year, Challenger maintained a conservative level of gearing.

Each of Challenger's businesses grew its contribution to the Group profit result. The Group provided for a significant item of $9 million after tax to relocate its head office in Sydney, bringing our operations under one roof in a new work environment which better reflects the way Challenger wants to operate.

Dividend
Your Board has declared a final dividend of 5 cents per share fully franked for the year ended 30 June 2006, this brings the full year dividend to 7.5 cents per share fully franked, an increase of 50% on the previous year. Your Board has also introduced a dividend policy for the first time. Dividends are anticipated to be not less than 30% of statutory profits after tax. Dividends for the year ended 30 June 2006 were almost 33% of statutory profits after tax.

Corporate governance
Good corporate governance is a priority shared by the Board and management of Challenger. We have enshrined this focus in Challenger's Five Principles, two of which focus on the importance of good compliance and integrity.

Challenger subscribes to the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations. To that end the Board has invited two new independent directors, Sarina Russo and Leon Zwier, to join the Board from late September 2006. Both Sarina and Leon will bring different and new skills and disciplines to our Board process and decision making.

Outlook
The last few years have seen major changes in the Challenger businesses. The strategy developed by management and supported by your Board is clearly delivering improving results for shareholders. Your Board believes Challenger can deliver shareholder value by maintaining focus on our strategy, core disciplines and a commitment to providing superior products and services to our customers.

Peter Polson
Chairman

Chief Executive's Report

In the 2006 financial year, Challenger concentrated on continuing to improve outcomes for customers. Our focus was on ensuring better investment returns in funds and asset management, better service in all areas of our business and developing more competitive residential mortgage products, all while maintaining strong disciplines around costs.

In 2005, I was fortunate to be able to report an increase of 100% in net profit after tax on a historic cost basis over the previous year. This year we reported a 48% rise in net profit after tax and before significant items on a historic cost basis.

Our results are the consequence of the efforts of a dedicated team of employees working within strong financial disciplines and our business model.

Highlights during the 2006 year have included:

- achievement of profitability and an 18% return on net assets in our Funds Management business for the first time;
- the award of an 'A' insurer financial strength rating for Challenger Life No. 2 Limited by Standard & Poor's;
- the successful launch of a number of new mortgage products, funds and investment products across our business;
- an increase in our dividend of 50%;
- the development of a strategic relationship with mortgage aggregator Plan Australia; and
- the successful launch campaign for the Genesys Wealth Advisers brand in our Financial Planning business.

Each of these achievements arose as a consequence of our commitment to our scalable business model and its focus on developing sustainable comparative advantages. Our objective is to provide high quality, innovative and differentiated financial services products, along with outstanding service.

Our business model is helping to deliver continuing improvements to shareholder returns. In 2006, we grew revenue at 2.5 times costs, suggesting our strategy does deliver for both customers and shareholders alike.

This model is based on only operating in environments offering market growth of better than 10% per annum. Our intention is to grow faster than the market rate by only operating in environments where we can leverage our comparative advantages. It is these advantages that help differentiate us – the features and performance of our products, the customer focus of our service and the excellence of our execution.

Our products are distributed by third parties who are attracted to partnering with us, we believe, because of the quality of our products, our attention to detail in our service and excellence in our execution. However, within our business model the most important factor for the future is the quality and commitment of our people, working as a team to achieve our objectives. A quality team is essential if we are to deliver long-term, sustainable growth. It is our people that create the platforms, the products and ensure a culture of service. Hence one of the most satisfying aspects of the past year has been the achievements of so many of the teams across Challenger.

The true test of the health of any business and its future prospects is its ability to attract and retain top-line people. Another indication therefore that Challenger is moving in the right direction is the number of new, high calibre people who have joined our team during the year.

During the 2006 year, our costs rose by $27 million on a historic cost basis. Within this, employee costs rose by $31 million and non-employee costs fell by $4 million.

This year we reported a 48% rise in net profit after tax and before significant items on a historic cost basis. The increase arose as a consequence of our scalable business model and our commitment to developing sustainable comparative advantages.

Employee costs account for approximately 70% of the Company's costs. However, without our employees we would have no business. The essence of Challenger is its people.

New employees tell us that the things they like most about working for Challenger are our lack of bureaucracy, our ability to innovate, our desire to differentiate and the fact that they very quickly feel as if they both can and are making a real difference to the success of the Company. These are key elements of our business culture and are reflected in two of Challenger's Five Principles, working together and creative customer solutions.

During the past year, we have invested heavily in new employees, particularly in frontline revenue generating roles. This investment will begin to pay off in 2007 and deliver growth for us for many years to come. We intend to continue our investment in top quality, revenue generating people in the year ahead to ensure that we can maintain and enhance our comparative advantage.

The Challenger team believes passionately that it can deliver products and services which better meet the needs of our customers than those delivered by our competitors.

By doing this we believe we can generate an 18% return on net assets in each of our businesses and double digit growth in earnings per share for shareholders. To do these things we need to build upon our comparative advantages and maintain strong financial disciplines. This will continue to be our focus in 2007.

Mike Tilley
Chief Executive Officer

Funds Management Report

Funds Management earned its maiden profit in the 2006 financial year. The business also achieved its return on net assets target for the first time at 18.6%.

The significant investment made in previous years in systems, product, investment capability and building our distribution reach is now being realised, with strong growth in profits and fund inflows.

Funds Management is focused on utilising scalable, best-of-breed systems to ensure a low cost structure.

While funds under management grew by 21.6% to $12.9 billion, expenses in the corresponding period were flat, rising just 1.5%. As a result, the division's cost to income ratio dropped significantly to 74%.

Funds Management has a clear growth strategy and regulated growth in superannuation provides a strong basis for continued growth. During the year, the business continued to refine its product range, creating new growth opportunities, as well as increased diversity in the revenue profile of the business.

In-house investment capability across key asset classes has been strengthened over the period and alliances with external funds managers to distribute product on their behalf have also been developed. The launch of the Custom Choice range of funds enhanced our multi-manager offer, as we entered into a partnership with Queensland Investment Corporation (QIC) to leverage its investment manager research and selection capabilities.

Mortgage Management Report

Mortgage Management grew profit to $78 million in the year ended 30 June 2006, an improvement of 28% on the prior corresponding period.

This performance is being driven by solid growth in its mortgage loan book, which totalled $20.9 billion at 30 June. Residential mortgages grew at a rate faster than market – achieving 14% growth to reach $18.3 billion during the period.

Mortgage Management is one of Australia's largest non-bank providers of mortgages. It offers residential mortgages to the prime and non-conforming market. It also participates in the commercial lending sector.

Residential loan products are offered on a white label basis via third party intermediaries. With no Challenger branded distribution channel, Challenger does not compete with its customers. We believe this provides an advantage over many competitors, making us an attractive partner for mortgage originators.

In response to the evolving needs of our customers, Mortgage Management implemented a number of product and service enhancements during the year.

The business entered new market segments by expanding its residential mortgage product range to include jumbo and uninsured products. New product features such as transactional banking services were also added to increase the competitiveness of our products.

Partial ownership equity stakes in boutique investment managers – including Five Oceans, Kinetic Investment Partners and Greencape Capital – have now also been taken. Challenger provides back office administration support, marketing and distribution services for a fee and a percentage of profits.

Strong investment performance relative to its peers was achieved across many key products during the year. This has led to growth in funds under management (FUM) and a corresponding growth in fee revenue.

With the continued expansion of our distribution network, we anticipate this growth in FUM will continue. Our growing acceptance by intermediaries is highlighted by the continued broadening of our presence on investment menus of dealer groups and platforms, and our growing third party research endorsements.

The investment made in our administration and technology platforms that support our front, middle and back office, has provided an efficiency dividend. This efficiency reinforces the scalability of the business well into the future.

The focus of Funds Management in the year ahead will be to deliver continued, sustainable investment performance. This will assist in further growing FUM and fee revenue.

Rob Adams
Chief Executive
Funds Management

Service to customers was enhanced through the introduction of initiatives such as Litework, a technology solution designed to automate and speed up processes around loan applications. The introduction of this service has resulted in Mortgage Management offering one of the fastest application approval times in the market, while also increasing operational efficiency.

It is a combination of these enhanced products and services, along with a continued focus on offering competitive pricing, which assisted with growth during the period.

Enhancements to operational efficiency and tight cost control contributed to an improvement in the division's cost to income ratio.

The key to Mortgage Management's continued growth in the future will be an ongoing focus on service, maintaining a competitive product range and remaining disciplined in the management of costs.

Brian Benari
Chief Executive
Mortgage Management

Residential mortgages grew at a rate faster than market – achieving 14% growth to reach $18.3 billion.

Asset Management Report

The 2005/2006 financial year was a key one for Asset Management, producing a return on net assets of 22%.

Earnings grew by 23% as the strategy for the business became more clearly defined. New capabilities and expertise, central to the delivery of this strategy, were also developed.

The business seeks to grow and generate profit by leveraging its skills and teams in managing infrastructure, property and other assets.

It seeks to generate returns as an investor in its own right from assets under management which are held on the Challenger balance sheet. It also generates fee income from assets it manages on behalf of other investors through a number of specialist funds.

It is anticipated that this second revenue stream where fees are generated from specialist funds will provide significant growth opportunities in the future. Asset Management reported that fee income rose to $51 million from just $15 million in the previous period.

Asset Management saw assets under management rise by 13.2% to $3.67 billion during the period. We foresee future increase as market interest in asset classes such as property and infrastructure continues to grow.

This increase in interest in these assets means Asset Management is operating in an environment of underlying strength. We believe the business is well placed to participate in the sector's growth. To further develop capabilities in this sector

Financial Planning Report

Following the departure of Chris Cuffe from his Chief Executive, Wealth Management role, Financial Planning was separated from Funds Management. Greg Kirk was appointed to head the division and its financial results are for the first time being reported separately.

The Financial Planning division comprises Genesys Wealth Advisers, a financial planner dealership which provides a range of services to member firms and advisers, including the operation of an investment administration platform.

In 2006, following the merger of two financial planning businesses to form Genesys Wealth Advisers, we successfully launched an advertising campaign to support this new brand. With a noticeable absence of strong financial planning brands in Australia, this campaign has already started to build significant brand awareness in the category.

The fundamentals of this business are beginning to strengthen, with net income increasing 10.3%, versus an expense increase of 5.9% over the corresponding period. EBIT increased by 40% to $7 million.

Financial Planning has over 400 advisers, offering reliable lifetime wealth advice to around 100,000 Australians.

and enhance our competitiveness, the business invested in a series of high profile appointments in key revenue generating roles during the period.

The launch of both the unlisted Challenger Global Infrastructure Fund and the listed Challenger Infrastructure Fund were key achievements for the year. Challenger now manages almost $1 billion in infrastructure assets on the group balance sheet and in infrastructure funds.

The Challenger Infrastructure Fund is focused on growth orientated global utility investments. We are continuing to build expertise in the global utility sector through recruiting those with specific skills and experience from the utilities industry.

Another achievement for Asset Management during the period was the initiation by Standard & Poor's of an 'A' insurer financial strength rating, with a stable outlook, for Challenger Life No. 2 Limited. This recognition will help provide greater flexibility to access capital markets, while also helping to contain cost of funding.

During the year ahead, the specialist funds range will continue to be expanded, particularly in the property sector. It is anticipated that ongoing fee income from this growing range of specialist funds is likely to play a more and more important role in Asset Management's future results.

Rob Woods
Chief Executive
Asset Management

Revenue generated per planner improved during the period, largely driven by a targeted recruitment program focused on recruiting large, high quality practices to the Group.

During the period, significant investment in new expertise and systems and the development of the brand were made. These investments will support future growth plans for the business. The new leadership team is focused on meeting the required return on net assets target of 18% and believes the business can reach this target in 2009.

The division, like the other Challenger businesses, operates in a growth environment. The intergenerational transfer of wealth and changing demographics of Australia should continue to enhance the necessity for people to seek advice. This will provide a strong basis for growth from the division in the coming years.

Greg Kirk
Chief Executive
Financial Planning

Challenger's teams are encouraged to innovate by developing new products and services; enhancing comparative advantages; and implementing improvements to our operational capabilities.

Delivering Innovation

Delivering better solutions
Members of the Challenger team are encouraged to challenge the status quo and deliver a better way forward. As a Group, we look to innovate to create a competitive advantage.

Delivering revenue
We seek to develop innovative new products and services, in response to our customers' needs.

An example of this is the equity seeding we have provided to a number of boutique investment managers. By leveraging our existing best practice platform and infrastructure, Challenger is able to match high quality back office administration support, marketing and distribution services with best-of-breed fund managers, by offering these services to boutique managers. In turn, we then offer our intermediaries access to these specialist managers.

These investments in boutique investment firms will become an important source of revenue for Funds Management in the years to come.

Delivering operational strength
To achieve economies of scale superior to our competitors, we must be able to rapidly deploy and integrate products and services into multiple markets and channels.

Our focus is on bespoke solutions that best support execution of business and product strategy, while managing and mitigating operational risk. We look for synergies and business solutions with the ultimate aim of increasing revenue and decreasing cost for Challenger as a whole.

Litework, introduced by Mortgage Management in the past year, is another example of an innovative technology solution that has delivered increased operational efficiencies. The system is designed to automate and speed up processes around loan applications. This allows us to increase operational efficiency while also improving service to customers through offering one of the fastest application approval times in the market.

We believe it is this type of innovation which helps provide a better service at a lower cost and creates a comparative advantage.

Challenger recognises its responsibilities to its partners, whether they are financial planners, mortgage brokers, shareholders or the wider community. Challenger is committed to delivering for these various stakeholders.

Delivering for our Partners

Intermediaries
We recognise that key to our future success are our relationships with intermediaries – mortgage managers and brokers, financial planners and other third parties who distribute our products. Our products are distributed by third parties who, we believe, are attracted to us because of the excellence of our products and the excellence in execution delivered by our high quality teams and through our state-of-the-art systems.

We believe the intermediary market will continue to grow its share of distribution. Challenger is working to become the partner of choice for financial intermediaries across our markets, and we believe this focus will position us well to take advantage of the growing channels of mortgage brokers, mortgage managers and financial planners.

Shareholders
Our objective is to achieve double digit earnings per share growth each year. We take a long-term perspective on creating shareholder value. Management and the Board engage with the investment community and our stakeholders through a range of investor relations activities. Challenger participates in local and international roadshows, hosts market briefings and investor education sessions, all as part of this engagement process.

Community
Challenger recognises its responsibility to the communities in which it operates. This year we teamed up with a not-for-profit organisation, Habitat for Humanity, whose charter is to assist those in need of adequate shelter to build simple, decent, affordable houses. Since its founding, by working in partnership with low-income families and corporate and individual supporters, Habitat for Humanity has built more than 200,000 houses in more than 100 countries, including 59 in Australia.

Underprivileged families, chosen on the basis of need alone, purchase their own homes on no-interest mortgages with Habitat for Humanity. The families also contribute 500 hours of 'sweat equity' to the building of their own home, or that of another family.

As a financial services organisation, we understand that owning your home is an important part of attaining financial security and helping to break the rent-induced poverty cycle of many Australian families. For this reason we chose Habitat for Humanity as our community partner.

This year Challenger sponsored the purchase of a plot of land on which a new home will be built for a deserving family. And in recognition of the importance of involving the Challenger team in our community partnerships, the 10 winners of our annual employee recognition program, the 'Can Do' awards, will spend a week helping the Habitat for Humanity team build the home.

Challenger recognises a quality team is essential if we are to deliver long-term, sustainable growth. It is our people that will create our comparative advantage.

Delivering through our Team

Dominic Stevens
Deputy Managing Director

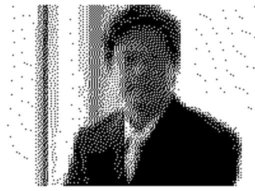
Our team has the privilege of adding value across all of Challenger's fast growing business lines. This happens in many ways, such as allocating capital, accessing capital markets, overseeing group risks, developing strategy and conveying our story to the investor market. Our team has a diverse skill base to draw on and has played a key role in the transformation of the Company over the past three years.

Paul Rogan
Chief Financial Officer

Challenger's environment is fast paced and not bogged down in bureaucracy. Each division is able to innovate and move quickly to capture value. The challenge for the teams in Business Services is to assist each of our businesses to execute with excellence, by providing proactive, high quality advice and services. Our teams are always looking at how we can improve our delivery and we are now in the process of implementing new systems and capabilities to support our people to achieve these goals.

Jennifer Wheatley
Executive General Manager
Human Resources

We are passionate about creating an environment that facilitates the growth and success of our people. We do this by focusing on inspiring individuals to demonstrate outstanding leadership. We empower the team by providing development opportunities and ensuring our remuneration programs recognise and reward superior performance.



Derek Goh
Executive General Manager
IT & Facilities Management

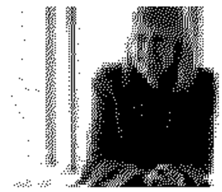
I feel proud to lead a collective group of highly talented, innovative and committed individuals who have contributed to transform Challenger's Information Technology platform to better align and support Challenger's strategic and business objectives. Such transformation provides the common technology base required to support a scalable business.

Greg Martin
Chief Executive
Infrastructure

Challenger's multi-disciplinary team of professionals provide investors with access to quality global investment opportunities that deliver highly predictable, quality earnings with excellent growth potential.

Greg Kirk
Chief Executive
Financial Planning

There is a lot of meaning in what we do because we influence people's lives and create well-being for their future. As a consequence, we live to a set of high performance behaviours. This is what differentiates us from our competitors. Our team, which includes our member firms, takes its responsibilities seriously but we like to encourage a working environment which also celebrates its successes.



Lynn Anderson
Executive General Manager
Corporate Marketing & Communications

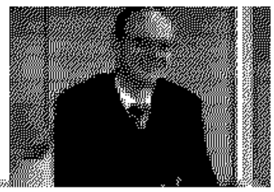
In an increasingly competitive environment, strength of brand can contribute significantly to a business's overall success. The team recognises this and is passionate about continuing to build brand equity and enhance our reputation with stakeholders. We see significant opportunities to further develop our brand in the year ahead and look forward to the challenge.

Brian Benari
Chief Executive
Mortgage Management

Our business is driven by a highly skilled team, sharing a passion to strengthen our position as Australia's leading non-bank mortgage lender. The team is nimble in the way it operates, ensuring that in a dynamic market we can offer leading products and service while being competitive on price. We recognise that the success of our business depends on the success of our third-party originators. The team is, therefore, focused on their needs and continually works to arm them with the tools they require to succeed.

Rob Adams
Chief Executive
Funds Management

Our Funds Management business benefits from being focused on delivering investment and service excellence to intermediaries and their clients. Our investment-led culture ensures that we attract, retain and motivate the best investment managers. As a result, we have delivered strong investment performance across all asset sectors and across our key business strategies. Our people have a clear understanding of what our clients need and expect from us and we work together to deliver to those needs.



Robert Woods
Chief Executive
Asset Management

We have a talented team with a lot of commitment and a high level of energy because the opportunities at Challenger are so vast and our people see a real ability to make a difference. The exciting challenge for our team is building a business operating in a global environment. Challenger has become an employer of choice because of the working environment we have built. It has been fulfilling to see from where we have come in recent years.

Financials

Contents

Directors' Report

The Directors of Challenger Financial Services Group Limited ('the Company') submit their report together with the financial report of the Company and its controlled entities ('the Group'), for the year ended 30 June 2006.

1. Directors

The names and details of the Company's Directors holding office during the financial year and until the date of this report are as follows. Directors were in office for this entire period unless otherwise stated.

Peter Leith Polson – Independent Chairman

Experience/Qualifications

Peter Polson holds a Bachelor of Commerce from the Witwatersrand University in South Africa, a Master of Business Leadership from the University of South Africa and completed the Harvard Management Development Program.

Mr Polson retired from the Commonwealth Bank in October 2002, where he held the position of Group Executive, Investment and Insurance Services, responsible for all investment and insurance services for the group, including the funds management, master funds, superannuation, insurance and third party support services for brokers, agents and financial advisers. Mr Polson joined the Colonial group in 1994 prior to its acquisition by the Commonwealth Bank. Previously, Mr Polson was Managing Director of National Mutual Funds Management (International) Limited. Mr Polson was previously a director of the previously listed company Australian Leisure and Hospitality Group Limited.

Special responsibilities

Mr Polson is Chairman of the Remuneration Committee and a member of the Nomination Committee.

Other directorships

Mr Polson is also a Director of AWB Limited, AWB International Limited, and Professional and Indemnity Company Australia Limited.

Michael Tilley – Chief Executive Officer

Experience/Qualifications

Michael Tilley holds a Post Graduate Diploma in Business Administration from the Swinburne University in Victoria, Australia.

Mr Tilley was previously Vice-Chairman, Investment Banking Group, JP Morgan, a position he resigned from upon his appointment as Chief Executive Officer (CEO) of the Company in June 2004. Until 31 March 2003, Mr Tilley was a Director of Incitec Limited. Prior to this, up until February 2002, Mr Tilley was employed with investment bank Merrill Lynch where he held the positions of Executive Chairman, Merrill Lynch (Australasia), Head of Mergers and Acquisitions in the Asia Pacific region, and was a member of the Merrill Lynch Asia Executive Committee. Prior to joining Merrill Lynch in 1997, Mr Tilley was principal and a Managing Partner of Centaurus Corporate Finance Pty Limited and before that a partner at Deloitte Touche Tohmatsu. Mr Tilley is a past member of the Australian Takeovers Panel.

Other directorships

Mr Tilley is also a Non-Executive Director of Orica Limited.

Graham Allan Cubbin – Non-Executive Director

Experience/Qualifications

Graham Cubbin holds a Bachelor of Economics (Hons) from Monash University and is a Fellow of the Australian Institute of Company Directors.

Mr Cubbin was a Senior Executive with Consolidated Press Holdings Limited (CPH) from 1990 until September 2005, including Chief Financial Officer for 13 years. Prior to joining CPH, Mr Cubbin held senior finance positions with a number of major companies including Capita Financial Group and Ford Motor Company.

Special responsibilities

Mr Cubbin is a member of the Group Audit and Compliance Committee and the Nomination Committee.

Other directorships

Within the last three years, Mr Cubbin has also been a Director of Publishing and Broadcasting Limited.

Russell Richard Roberts Hooper – Non-Executive Director, *Independent*

Experience/Qualifications

Russell Hooper is a Fellow of the Australian Institute of Company Directors, a Fellow of the Australian Society of Practising Accountants, a Fellow of the Financial Services Institute of Australasia and has completed the Advanced Management Program, Harvard Business School.

Mr Hooper was a Director of and Chairman of the audit committee for Commonwealth Insurance Limited, a subsidiary of the Commonwealth Bank. Mr Hooper was also previously Chief General Manager, Funds Management at St George Bank Limited and prior to that held various positions within the financial services group at St George Bank Limited and Advance Bank Limited for more than 13 years. He has experience at chief executive level in life insurance, wealth management and listed investment trusts.

Special responsibilities

Mr Hooper is a member of the Remuneration Committee, the Group Audit and Compliance Committee and the Nomination Committee.

Ashok Peter Jacob – Non-Executive Director
Experience/Qualifications
Ashok Jacob holds a Master of Business Administration from the Wharton School and a Bachelor of Science from the University of Pennsylvania.

Mr Jacob is Chief Executive Officer of Consolidated Press Holdings Limited (CPH). Prior to joining CPH he was the Managing Director of the investment arm of the Pratt group of companies.

Special responsibilities
Mr Jacob is a member of the Nomination Committee.

Other directorships
Mr Jacob is a Director of Publishing and Broadcasting Limited. Within the last three years, Mr Jacob has also been a Director of Ecorp Limited, which was delisted in March 2003.

James Douglas Packer – Non-Executive Director
Experience
James Packer is Executive Chairman of Consolidated Press Holdings Limited.

Special responsibilities
Mr Packer is a member of the Remuneration Committee and the Nomination Committee.

Other directorships
Mr Packer is Executive Chairman of Publishing and Broadcasting Limited, a position he has held since May 1998, Chairman of Seek Limited, and a Director of Qantas Airways Limited. Within the last three years, Mr Packer has also been a Director of Ecorp Limited, which was delisted in March 2003.

James Glen Service – Non-Executive Director, Independent
Experience/Qualifications
James Service is a Fellow of the Australian Society of CPAs, a Fellow of the Chartered Institute of Secretaries, and is an Honorary Life Fellow of the Australian Institute of Building. Mr Service is an Officer in the order of Australia, was awarded the Silver Jubilee Medal, was Canberra Citizen of the year 2001 and is a recipient of the Centenary Medal.

Mr Service was a Non-Executive Director of Challenger International Limited (CIL) from 2002. Following the merger of CIL and CPH Investment Corp in July 2003 he continued as a Non-Executive Director of Challenger Financial Services Group Limited. Mr Service has extensive experience in the areas of financial services and property. Mr Service is also a past National President of the Property Council of Australia and was Chairman of Advance Bank Limited prior to its merger with St George Bank Limited.

Special responsibilities
Mr Service is a member of the Nomination Committee.

Other directorships
Mr Service is Deputy Chairman of Australand Holdings Limited.

Brenda Mary Shanahan – Non-Executive Director, Independent
Experience
Brenda Shanahan became a Non-Executive Director of Challenger International Limited (CIL) in 2002 and joined the Board of Challenger Financial Services Group Limited as a Non-Executive Director following the merger of CIL and CPH Investment Corp in July 2003. Ms Shanahan is a finance specialist who possesses extensive marketing and promotion experience in the financial services sector. Ms Shanahan is also a former member of the Australian Associated Stock Exchange, and former Executive Director of a stockbroking firm, a fund management company and an actuarial company.

Special responsibilities
Ms Shanahan is Chairman of the Group Audit and Compliance Committee and a member of the Nomination Committee.

Other directorships
Ms Shanahan is a Non-Executive Director of JM Financial Group Limited, Chairman of St Vincent's Health and St Vincent's Medical Research Institute and Chair of Loop Limited.

2. Company Secretary
Christopher Robson was appointed to the position of company secretary in March 2005. Mr Robson is also the Group General Counsel. He has been qualified as a solicitor for over 20 years, with 13 years experience in the financial services industry.

3. Company information
The Company was incorporated in New South Wales on 6 November 2003 and its shares were admitted to the official list for quotation on the Australian Stock Exchange (ASX) on 23 December 2003. The registered office of the Company is Level 41, Aurora Place, 88 Phillip Street, Sydney NSW 2000.

4. Principal activities
The principal activities of the Group are the provision of financial services, in particular:

- Mortgage Management – commercial and residential lending and securitisation business;
- Funds Management – funds management business;
- Asset Management – structures and manages assets to generate long-term income streams; and
- Financial Planning – financial planning and funds administration business.

There have been no significant changes in the nature of these activities during the year.

5. Operating and financial review
Review and results of operations
The consolidated net profit after tax attributable to the shareholders of the Company was $134.3 million (2005: $119.6 million).

A review of the operations and the results for the Group for the year ended 30 June 2006 are contained in the Chairman's Report to shareholders.

6. Likely developments and expected results
Further information about likely developments in the operations of the Group and the expected results of those operations in future financial years have not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the Group.

No other matter or circumstances have arisen that has affected or may significantly affect:

(a) the Group's operations in future financial years; or

(b) the results of those operations in future financial years; or

(c) the Group's state of affairs in future financial years.

7. Significant changes in the state of affairs
There were no significant changes to the state of affairs of the Group during the year ended 30 June 2006.

On 1 August 2006, the Group announced that the Company's business divisions will now report financial performance along four instead of three separate business lines: Mortgage Management, Funds Management, Asset Management and Financial Planning.

The change reflects the evolution of four distinct revenue generating businesses within Challenger and will provide the opportunity for more detailed analysis of the key drivers and financial performance of each division. It will also further clarify the contribution of fee based revenue as it continues to grow in proportion to total revenue.

Key elements of these changes include:

- The renaming of Challenger Wholesale Finance to Mortgage Management – this name more accurately describes the core competencies of the division, predominantly residential mortgage backed lending and securitisation.
- The separation of management and reporting lines for Funds Management and Financial Planning (including Synergy) – until recently the management reporting line of Funds Management and Financial Planning have been combined and reported under Challenger Wealth Management. The separation of these reporting lines recognises the management changes and the distinct operating environments and underlying performance drivers of these respective businesses.
- The renaming of Challenger Life to Asset Management – in recognition of Challenger Life's increased focus on generating origination and management fees from asset management activities. This name better reflects the strategic objectives of this division, with an emphasis on investment performance and associated fee income rather than funding sources.

8. Environmental regulation and performance

The Group acts as a trustee or responsible entity for a number of property trusts, which have major properties throughout Australia. These properties are subject to environmental regulations under both Commonwealth and state legislation. The Directors are satisfied that adequate systems are in place for the management of its environment responsibilities and compliance with various legislative, regulatory and licence requirements. Further the Directors are not aware of any breaches of these requirements and to the best of their knowledge all activities have been undertaken in compliance with environmental requirements.

9. Dividends

On 25 August 2006, the Directors of the Company declared a final dividend on ordinary shares in respect of the year ending 30 June 2006. The amount of the dividend is $29.6 million which represents a fully franked dividend of 5 cents per share from current year profits. The dividend has not been provided for in the 30 June 2006 financial statements. The dividend will be paid on 18 October 2006.

On 24 February 2006, the Directors of the Company declared an interim dividend on ordinary shares. The total amount of the dividend was $14.6 million which represented a fully franked dividend of 2.5 cents per share from current year profits. This dividend was paid on 21 April 2006.

On 26 August 2005, the Directors of the Company declared a final dividend on ordinary shares in respect of the 2005 financial year. The total amount of the dividend was $28.8 million which represented a fully franked dividend of 5 cents per share. This dividend was paid on 21 October 2005.

10. Transition to Australian equivalents to International Financial Reporting Standards (AIFRS)

The financial statements for the year ended 30 June 2006, together with the comparative figures, have been prepared in accordance with AIFRS. Changes to comparative information have resulted in a cumulative decrease in equity at 1 July 2005 amounting to $188.8 million including a decrease to retained earnings amounting to $59.1 million.

11. Indemnification and insurance of officers and Directors

In accordance with its Constitution, and where permitted under relevant legislation or regulation, the Company indemnifies the Directors and officers against all liabilities to another person that may arise from their position as directors or officers of the Company and its subsidiaries, except where the liability arises out of conduct involving lack of good faith, wilful misconduct, gross negligence, reckless misbehaviour or fraud.

In accordance with the provisions of the Corporations Act 2001, the Company has insured the Directors and officers against liabilities incurred in their role as directors and officers of the Company and its subsidiaries. The terms of the insurance policy, including the premium, are subject to confidentiality clauses and as such the Company is prohibited from disclosing the nature of the liabilities covered and the premium. The Company has not given or agreed to give any indemnity to an auditor of the Group and has not paid any premium for insurance against that auditor's liabilities for legal costs.

12. Significant events after the balance date

The following significant events have occurred since 30 June 2006:

Challenger Life No. 2 Limited, a wholly owned subsidiary of the Group, paid $226.3 million in respect of the second instalment on its investment in the Challenger Infrastructure Fund (a controlled entity of the Group).

The Group intends to explore market interest in an initiative to launch a listed Australian Real Estate Investment Trust which will be announced on 28 August 2006. If the initiative proceeds, it is anticipated that no less than $500 million in directly held real estate investment properties will be released from the Group's balance sheet. If this proposed transaction proceeds the Directors do not expect any material impact on the profit and loss of the Group, as all real estate investment properties were independently valued as at balance date.

13. Remuneration report

This report outlines the remuneration arrangements in place for the Company's Directors and Executives. This section (Section 13) of the Directors' Report has been audited by the Company's external auditor Ernst & Young and the valuation of our long-term incentive scheme has been independently valued by PricewaterhouseCoopers.

Remuneration philosophy

The performance of the Company depends upon the quality of its Directors and Executives. To prosper, the Company must attract, motivate and retain highly skilled and experienced Directors and Executives.

Challenger's approach to performance and remuneration management can be characterised as:

- actively supporting the execution of business strategy and the development of an entrepreneurial team culture;
- providing competitive rewards to attract and retain high calibre Executives;
- align remuneration outcomes with shareholder wealth creation thus underpinning the critical link between the Company's performance, individual performance and individual reward;

- establishing appropriate and demanding performance hurdles in relation to at-risk Executive remuneration;
- allocating a significant portion of Executive remuneration at-risk, dependent upon meeting pre-determined performance hurdles; and
- being competitive with contemporary marketplace practice.

Overview of elements of remuneration

Non-Executive Directors

Non-Executive Directors' fees are set at levels which reflect the responsibilities and time commitments required to discharge their duties. In order to maintain independence and impartiality, these fees are not linked to the performance of the Company.

Executive Directors/Senior Managers

Executive remuneration comprises both fixed and at-risk components. Fixed remuneration provides a guaranteed level of reward based on the Executive's role, skills, knowledge, experience, individual performance and the employment market.

At-risk remuneration rewards Executives for achieving financial and business targets and increasing shareholder value. The mix between fixed and at-risk remuneration depends on the seniority of the Executive.

	Elements of remuneration	Directors		Senior Executives
		Non-Executive	Executive	
Fixed	Fees	✓	✗	N/A
	Salary	✗	✓	✓
	Compulsory Super	✓	✓	✓
	Other Benefits	✗	✓	✓
At-risk	Short-term Incentive	✗	✓	✓
	Long-term Incentive	✗	✓	✓
Post Employment	Service Agreements	✗	✓	✓
	Termination Payments – former executive directors and senior executives	N/A	✓	✓

Remuneration Committee

Role of the Remuneration Committee

The Remuneration Committee assists the Board in achieving fairness and transparency in relation to remuneration issues whilst overseeing the remuneration and human resources policies and practices of the Company. The Remuneration Committee endeavours to ensure that the Company's remuneration policies and outcomes strike an appropriate balance between the interests of the Company's shareholders and the reward and motivation of the Company's Executives and employees.

The responsibilities of the Remuneration Committee include:

- ensuring the Company has coherent remuneration policies and practices to attract, retain and motivate Executives and Directors who will create value for shareholders;
- establishing criteria to be used for assessing the Employee Incentive Plan (EIP) and determining the actual EIP allocation having regard to how those criteria are met in the relevant year;
- considering employee equity plans and allocations under those plans as part of the Long Term Incentive Plan (LTIP);
- reviewing the terms of remuneration for the Chairman, Chief Executive Officer and other senior management of the Company, including the criteria for assessing performance;
- reviewing and establishing the level of remuneration for Non-Executive Directors; and
- ensuring compliance with the provisions of the ASX Listing Rules, the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations and the Corporations Act.

Since Challenger's listing in December 2003, the Remuneration Committee has continued to review and amend the Company's remuneration framework to ensure that employee rewards drive the desired behaviours and that a robust link exists between remuneration and performance.

Membership of the Remuneration Committee
The members of the Remuneration Committee throughout 2006 were:

- Peter Polson (Chairman)
- Russell Hooper
- James Packer

Company performance and remuneration linkages
Five year performance
Since listing, the Board has set challenging financial performance targets for Executives and has directly aligned Executive incentives to the achievement of those targets.

Link to performance
All of the at-risk component of executive remuneration is tied to performance.

Executive short-term incentives are tied to overall performance measures for Challenger and specific measures for business platforms in the areas of financial performance, Earnings Before Interest and Tax (EBIT), Return on Net Assets (RONA), Funds Under Management (FUM) and their individual performance. Each year a performance contract specifying performance measures is set and agreed with the Executives, by that Executive's manager. The performance contract of the Chief Executive Officer is set and agreed with the Chairman.

Executive long-term incentives (delivered through the Long Term Incentive Plan) are tied to growth in Challenger's share price and absolute growth in Total Shareholder Return.

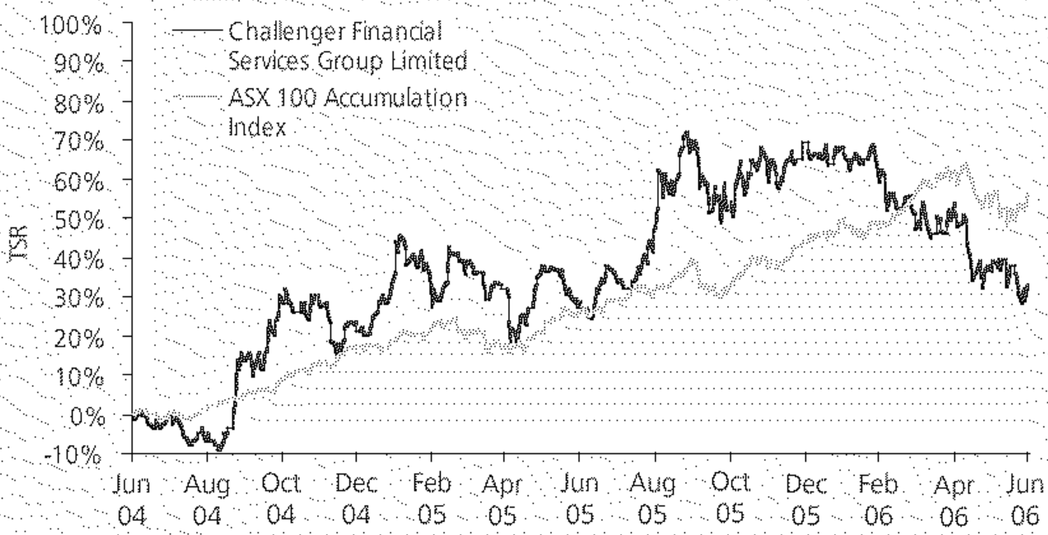
The table below shows how specific measures of Company performance and shareholder value link to Executive at-risk rewards.

	Measure	**2004**	**2005**	**2006**
Executive **short-term incentives** are linked to earnings	EBIT ($m)	148.6[1]	275.0	290.5

[1] Before $280 million write-down in goodwill.

Executive **long-term incentives** are directly linked to share price and TSR growth	Dividends per share (cents)	0	5	7.5
	Earnings per share (cents)	9.1	22.8	24.9
	Year end share price ($)	2.43	3.12	3.16

Challenger Total Shareholder Return and ASX 100



Executive Directors' and senior executives' remuneration

Executive team

The following persons were Executives of the Company during the financial year with the highest remuneration and strategic authority:

Executive name	Position	
Current		**Commencement date**
M Tilley	Chief Executive Officer	
R Woods	Chief Executive, Asset Management	
B Benari	Chief Executive, Mortgage Management	
C Cuffe	Ex-Chief Executive, Funds Management and Financial Planning[1]	
D Stevens	Deputy Managing Director	
P Rogan	Chief Financial Officer[3]	13 March 2006
R Adams	Chief Executive, Funds Management	
R Miles	Managing Director, Financial Planning[2]	
Former		**Cessation date**
T Foster	Chief Financial Officer	12 March 2006

[1] Mr Cuffe stepped down from this role on 30 June 2006 and is transitioning to a consulting role.

[2] Mr Gregory Kirk commenced in the role of Managing Director, Financial Planning on 26 June 2006. Mr Raymond Miles has taken on the role of Managing Director, Member Firm Relations and Acquisitions.

[3] Mr Rogan commenced employment with the Company on 1 November 2005 as Chief Financial Officer, Asset Management.

Executives' remuneration policy

The Board recognises that the Company operates in a global marketplace and its success is ultimately dependent on its people.

Attracting, developing, motivating and retaining talent is essential for the Company's ongoing success.

The remuneration policies of the Company are designed to reward Company, business unit and individual performance and closely align the interests of employees to those of shareholders through the use of short-term and long-term incentives. The Company's remuneration policy focuses on:

- driving performance over and above shareholder and market expectations;
- ensuring at-risk remuneration is directly linked to the Company's performance and that individuals who contribute to this performance are rewarded;
- ensuring pay structures are commensurate with peers; and
- ensuring key Executives have a personal interest in the Company through equity ownership.

Philosophy and framework

The remuneration framework has three components. These are consistent with those of competitors and have been designed to drive superior levels of performance and to closely align Executive and shareholder interests. These are:

- Fixed remuneration – base salary and superannuation.
- Short term incentive plan (Employee Incentive Program (EIP)) – annual cash bonus with deferral for some key Executives.
- Long term incentive plan (LTIP) – Executive loan funded share plan (treated as an Option plan under AIFRS).

The remuneration philosophy provides for Executive remuneration to be predominantly at-risk, meaning that base salary and benefits form the only part of potential annual remuneration known at the commencement of a financial year.

EIP awards (including annual cash bonus and deferral) are entirely dependent on the overall annual performance of the Company and the individual's contribution to that performance. This approach ensures a direct and strong link between the Company's annual performance and Executive reward.

In addition, the LTIP provides a direct link between Executive reward and the creation of shareholder value through the issue of shares to key employees.

Target reward mix

As short-term incentive allocations are determined after the end of the financial year and are directly dependent on the Company's financial performance, Executives are not advised of a target bonus amount. As such, Chapter 2M.3.03(2)(c) of the Corporations Act 2001 Regulations does not apply to the Company.

Fixed remuneration

All Executive Directors and Executives receive a fixed remuneration component. Fixed remuneration is reviewed annually and is determined by the scope of the individual's role, their level of knowledge, skills and experience, previous performance and market benchmarking.

The Board assists to set fixed remuneration for its Executive Directors and Executives at the median for comparable Executives in ASX companies. This complements the strategy of heavily weighting the at-risk amount of Executive pay to encourage superior performance consistent with a strong performance drive. Adjustments to fixed remuneration are made annually, if at all, and are based on role, pay position relative to comparable market pay and performance in the role.

The fixed remuneration component for the Executive Directors and Executives includes cash salary as well as other benefits, primarily superannuation and ancillary benefits.

In general, the fixed remuneration component is calculated on a 'total cost to company' basis with the cost of employee benefits such as superannuation, motor vehicles together with fringe benefits tax applicable to those benefits, being borne by the employee.

At-risk remuneration – Short Term Incentive Plan

Challenger's Short Term Incentive plan is called the Employee Incentive Plan (EIP).

Overview

The aim of the EIP is to reward (and in some circumstances retain) Executives who have made a significant positive contribution over the course of the financial year.

The EIP is provided entirely at the discretion of the Board and may be subject to amendment or withdrawal in respect of any future financial year. Participation in the EIP is not a contractual right.

Eligibility

All permanent Challenger employees who commence prior to 1 April in the given year are eligible to participate in the EIP.

Determining EIP bonus amounts

Bonus amounts are dependent upon the Company's overall performance, as well as Executive's performance against objectives and their behaviours in reference to principles.

The Board determines whether an Executive is entitled to an EIP payment, and if so, the quantum of such payment through performance rating both achievement against set objectives and performance in line with the Company Principles.

EIP performance linkage

The key financial performance condition assessed in determining the total amount available for the EIP is Company Earnings before Bonus, Interest, Tax and Amortisation (EBBITA). It is the Board's view that the level of EBBITA used is appropriate given it is a key measure of the affordability of the Company to allocate an EIP amount and it is also a factor used in determining the relative level of the total EIP amount.

Broadly speaking, the key performance indicators for the Company's Executives are used as applicable to the division and may include:

1. Earnings Before Interest and Tax (EBIT).
2. Return on Net Assets (RONA).
3. Funds (Assets and Loans) Under Management (FUM) Growth.

These performance conditions are set in line with Challenger's annual budget and are intended to improve the financial performance resulting in greater shareholder wealth.

Performance assessment

The Chief Executive Officer assesses the performance of senior Executives at the end of each financial year and confers with the Remuneration Committee regarding his assessment.

The Chairman agrees the Chief Executive Officer's performance target at the beginning of each year and assesses performance against those targets at the end of the financial year, having conferred with the Remuneration Committee.

At-risk remuneration – Long Term Incentive Plan (LTIP)

Overview

The Board considered it necessary and appropriate to establish the LTIP to retain key Executives and encourage behaviour in the long-term best interests of Challenger. The Board considered that a reward strategy for Executives with a heavy weighting on long-term incentives was essential in aligning Executive and shareholder interests. The LTIP was approved at the time of corporatisation by unitholders.

The LTIP design principles seek to satisfy the following requirements:

- incentivise senior Executives and reward them in alignment with growing share prices over the long term;
- attract and retain an outstanding Executive team with a proven track record in a scarce skills labour market;
- to be market competitive in providing suitable long-term incentive arrangements for its senior Executives; and
- to follow through on the intentions expressed at the time of the Merger between CPH Investment Corp and Challenger International Limited.

Vesting under the LTIP will typically be at regular intervals over five years and be subject to performance hurdles. The performance hurdle set by the Board for these awards is the Total Shareholder Return (TSR) of 15% compounded per annum. The vesting is described in more detail below.

Key features

Participation

Participation in the LTIP is determined by the Remuneration Committee, the CEO and the Executive General Manager HR.

There are two types of participants of Challenger's LTIP:

- Participants; and
- Initial Participants.

Mike Tilley and Chris Cuffe have separate plan rules which fundamentally mirror the LTIP design for Initial Participants.

Loan to Executives

Under the terms of the LTIP, eligible employees may acquire Challenger shares, with the cost being financed by a non-recourse loan from Challenger which is repayable either when the shares vest or on the six year anniversary of the reference date. Dividends paid on the shares issued under the plan are to be paid to the Company as interest on the non-recourse loan.

Performance hurdle

The performance hurdle set by the Board for LTIP grants is an absolute Total Shareholder Return (TSR) hurdle. The Board has chosen TSR as the performance hurdle for LTIP grants because this hurdle ensures the greatest alignment between Company performance and the creation of shareholder value.

The TSR is determined by reference to the 20 day volume weighted average share price (VWAP) prior to the vesting date for Challenger shares adjusted for capital restructures and distributions (dividends, capital returns and other distributions excluding franking credits).

The TSR return of the Company must equal or exceed 15% per annum compounded annually from the date of grant (target return) for Participants' shares to be released, at each vesting date. If so, shares will be immediately released. See below for specific conditions applying to Initial Participants.

Shares will not be released if the TSR of Challenger for a particular period is less than the required return. However, if the TSR of Challenger for any subsequent period equals or exceeds the target return, then shares that could have, but (because of the target return for an earlier period failing to equal or exceed the target return for that period) have not previously been released will be released with effect from the end of that subsequent period.

On the release of participating shares (once vesting and performance criteria have been met) Participants may, but are not obliged to sell the shares. Proceeds from any sale must first be used to pay down any remainder of the loan.

Vesting period

For all equity grants, the vesting period is 5 years. With the exception of Mr Cuffe, shares granted under the LTIP vest as follows (subject to performance except where noted):

	LTIP 1 Participant proportion vesting	LTIP 2 Participant proportion vesting
Year 0	0%	0%
Year 1	0%	0%
Year 2	20%[1]	20%
Year 3	20%	20%
Year 4	20%	20%
Year 5	40%	40%

[1] These shares are only subject to time based vesting (see Participant categories below).

Performance on the unvested component of any award will be retested after each year from the date of grant. The Plan allows for re-testing because the impacts of long-term decision making may not be reflected within the prior period. It is noted that relative performance in the subsequent years would need to be significant to make up for any underperformance over the prior year test periods.

All shares that remain unvested as at the 6th anniversary of the date of grant will lapse. Any unvested participating LTIP shares will be sold by the Custodian to reduce any outstanding loan, bought back under the LTIP or cancelled by Challenger, subject to compliance with the Law.

Mr Cuffe has voluntarily reduced his participating share entitlement on two occasions, upon stepping down as CEO on 2 August 2004 (4.4 million reduction in post share consolidation shares) and subsequently in March 2005 (395,000 reduction in post share consolidation shares). Therefore Mr Cuffe has an interest in 3,205,000 participating shares, subject to performance hurdles being met, these shares have been/are to be released as follows:

- 1,600,000 released on 10 April 2005
- 500,000 released on 10 April 2006
- 500,000 to be released on 10 April 2007
- 605,000 to be released on 10 April 2008.

Unreleased participating shares are forfeited upon the resignation of participants except in the case of Mr Cuffe who would maintain his LTIP shares if he leaves by his choice on or after 30 June 2006. Note that while Mr Cuffe has stepped down as Chief Executive, Funds Management and Financial Planning effective 1 July 2006, his employment continues with Funds Management as he transitions to a consulting arrangement.

Participant categories

In 2004, the Board identified a number of Initial Participants for whom special conditions will apply, having regard to:

- the improvement in the share price since the relevant senior Executives were recruited;
- the significant efforts made to date by the relevant senior Executives in restructuring the Challenger business to prepare for future growth; and
- the fact that the Company continues to be in a significant development phase for the next few years and the Board wishes to ensure that absolute performance hurdles do not drive short-term behaviour at the expense of long-term planning and decision-making.

The special conditions to apply to Initial Participants are as follows:

- the release dates of shares will be calculated from a reference date which is nominated by the Board (rather than the date of issue of shares), being no earlier than April 2003;
- the issue price for the initial participating shares to be allocated to the Initial Participants was $2.65 (as adjusted for the share consolidation on 25 November 2005) rather than the market price at the date of issue;
- no performance hurdle was required to be met for the initial 20% of the participating shares which were released after two years from the reference date; and

- a 15% per annum compound TSR performance hurdle will be required to be met for the release of shares on the third, fourth and fifth anniversaries from the reference date, with the starting price for that calculation being $2.65 (post share consolidation) and the starting date for that calculation being the second anniversary of the reference date.

Legacy Long Term Incentive Plans

Cash LTIP

Prior to corporatisation, certain Executives were entitled to incentive payments under a cash based shadow scheme. Following the approval of the LTIP the executives continue to have an entitlement to receive cash payments capped between 3c and 13c per (pre-consolidation) share granted.

The amount of this remuneration paid in the period has been disclosed as Cash LTIP paid. The fair value of this remuneration in the period has been disclosed under the heading 'Fair value at grant date'.

General remuneration policies across Challenger

The principles underlying Executive remuneration structures are generally consistent with those underlying the design and application of all remuneration practices across the Company.

Fixed remuneration is market aligned, and subject to either industrial instruments or annual review. All permanent employees participate in short-term incentive schemes, with specific reference to the nature of the role and to market competitiveness.

Additionally, a range of short-term incentive schemes have been designed in recognition of business needs and varying key person risk and retention concerns.

Awards of long-term performance incentives (under the LTIP) are available to select employees who are regarded as business critical or of high potential.

The Group Employee Share Plan (GESP)

The Plan is a share plan providing Employees with an effective way of acquiring an ownership interest in and a chance to share in the future growth of the Company. Computershare currently administers the Plan.

Eligible employees are those who:

- have been a permanent employee (full-time or part-time) of the Company or its associated companies for at least two years as at 1 July 2006;
- are still an employee and have not tendered their resignation or been made redundant or had their employment otherwise terminated, at the time shares are acquired;
- are an Australian resident for tax purposes;
- are not participating in the Company's Long Term Incentive Plan at the time shares are acquired; and
- are not a Director of the Company.

Provided employees are eligible to participate in the GESP (see above), Challenger will gift approximately (but not more than) $1,000 worth of Challenger ordinary shares.

Participants are not permitted to deal with their shares acquired under the GESP until the earlier of three years from the date of grant, or cessation of employment.

Details of remuneration

The nature and amount of each component of remuneration paid and accrued to the CEO and each of the Executive officers and other key management personnel who have the greatest authority for managing the operations of Challenger and the five highest remunerated Company Executives of Challenger in the year ended 30 June 2006 is set out below.

Table 1: Remuneration of the Executive Directors and Executives for the year ended 30 June 2006

		Short-term employee benefits			Post employment	Other long-term employee benefits	Termination benefit	Share based payments		Total
Name	Year	Salary[1]	STI	Non-monetary benefits	Superannuation			Cash LTIP Paid[4]	LTIP[3,5,6]	
		$	$	$	$	$	$	$	$	$
M Tilley	**2006**	**987,861**	**1,300,000**	**40,560[2]**	**12,139**	**–**	**–**	**–**	**2,340,564**	**4,681,124**
	2005	663,415	–	136,515	11,585	–	–	–	52,103	863,618
R Woods	**2006**	**587,861**	**1,200,000**	**–**	**12,139**	**–**	**–**	**–**	**353,726**	**2,153,726**
	2005	388,415	170,000	–	11,585	–	–	–	366,169	936,169
B Benari	**2006**	**587,861**	**1,200,000**	**–**	**12,139**	**–**	**–**	**325,000**	**283,021**	**2,408,021**
	2005	388,415	50,000	–	11,585	–	–	325,000	338,212	1,113,212
C Cuffe	**2006**	**587,861**	**1,010,000**	**–**	**12,139**	**–**	**–**	**–**	**161,152**	**1,771,152**
	2005	594,665	1,096,875	–	11,585	–	–	–	(165,801)	1,537,324
D Stevens	**2006**	**521,194**	**1,250,000**	**–**	**12,139**	**–**	**–**	**165,000**	**464,137**	**2,412,470**
	2005	488,415	250,000	–	11,585	–	–	–	670,527	1,420,527
P Rogan	**2006**	**293,189**	**–**	**–**	**8,093**	**–**	**–**	**–**	**43,291**	**344,573**
	2005	–	–	–		–	–	–	–	–
R Adams	**2006**	**487,861**	**500,000**	**–**	**12,139**	**–**	**–**	**325,000**	**253,595**	**1,578,595**
	2005	488,415	400,000	–	11,585	–	–	–	366,169	1,266,169
R Miles	**2006**	**374,861**	**328,000**	**–**	**12,139**	**–**	**–**	**–**	**50,591**	**765,591**
	2005	250,277	–	–	7,723	–	–	–	39,919	297,919
T Foster	**2006**	**224,011**	**846,575**	**–**	**9,104**	**–**	**–**	**–**	**(230,657)**	**849,033**
	2005	313,415	243,750	–	11,585	–	–	195,000	150,333	914,083

[1] Salary may include salary sacrificed superannuation and motor vehicle expenses.

[2] Mr Tilley's non-monetary benefits include rental payments following relocation.

[3] LTIP represents amortised fair value during the period.

[4] Fair value of cash LTIP is based on reporting date fair value.

[5] Equity LTIP fair value has been determined in accordance with the principles outlined in note 30 to the financial statements. Executive Director and Senior Executives' total holdings in Challenger shares and managed investment schemes are set out in note 29 to the financial statements.

[6] Negative LTIP figures are due to modifications reducing holdings or forfeiture on resignation.

Table 2: Remuneration components as a % of total remuneration for the year ended 30 June 2006

Executive	Fixed remuneration	Performance based remuneration		Total
		STI	LTIP	
M Tilley	22%	28%	50%	100%
R Woods	28%	56%	16%	100%
B Benari	25%	50%	25%	100%
C Cuffe	34%	57%	9%	100%
D Stevens	22%	52%	26%	100%
P Rogan	87%	0%	13%	100%
R Adams	32%	32%	37%	100%
R Miles	51%	43%	7%	100%
T Foster	22%	78%	–	100%

Table 3: Value of remuneration that vests in future years[1]

Executive	2007	2008	2009	2010
	$	$	$	$
M Tilley	848,322	550,619	335,197	29,487
R Woods	269,834	181,171	79,136	23,042
B Benari	221,161	133,079	37,476	23,042
C Cuffe	93,623	40,520	–	–
D Stevens	306,918	191,119	15,844	–
P Rogan	147,676	134,497	91,028	58,866
R Adams	167,694	104,424	8,657	–
R Miles	37,186	24,663	15,442	2,915
T Foster	–	–	–	–

[1] The value has been calculated as the fair value expense for the year for the unvested shares.

Table 4: Terms and conditions of loan funded share allocations for the year ended 30 June 2006[1]

Executive	Granted	Grant date	Grant	Fair value at grant	First vest date	Last vest date
	Number		$	$		
M Tilley	3,000,000	19/12/05	2.65	1.32	02/08/06	02/08/09
R Woods	500,000	15/09/05	3.77	0.51	15/09/07	15/09/10
B Benari	500,000	15/09/05	3.77	0.51	15/09/07	15/09/10
P Rogan	1,000,000	15/03/06	3.67	0.50	15/03/08	15/03/11

[1] The loan funded shares are treated as an option under AASB 124: *Related Party Disclosures*

Executive service agreements

Chief Executive Officer (CEO)

The Remuneration Committee is responsible for reviewing the remuneration of the CEO, which must be approved by the full Board.

CEO remuneration

Under the terms of his appointment as CEO, Mr Tilley is entitled to:

- a base salary of $1,000,000;
- a short-term incentive subject to achieving qualitative and quantitative hurdles set by the Board;

- a $500,000 interest free loan for the purpose of investing in Challenger investment products, other than Challenger shares; and
- a retention bonus of $250,000 after three years of employment as CEO and a further retention bonus of $250,000 at the end of year five.

Mr Tilley is not entitled to participate in the Challenger Long Term Incentive Plan (LTIP). However, following shareholder approval at the Company Annual General Meeting on 23 November 2004 Mr Tilley was allocated 1,000,000 restricted post share consolidation Challenger shares, funded via limited recourse loan and issued at $2.65. Following shareholder approval at the following Annual General Meeting, Mr Tilley was allocated a further 3,000,000 restricted post share consolidation Challenger shares. These shares were issued substantially on the same terms as the Long Term Incentive Plan limited recourse loan and escrow conditions, with a reference date of 2 August 2004, the date Mr Tilley became CEO.

Mr Tilley may terminate his service agreement by giving 12 months notice to Challenger, in which event he will receive accrued statutory and contractual entitlements, but he will not be entitled to any termination payment, short-term incentive payments, unvested shares or future retention payments. Challenger may terminate Mr Tilley's service agreement, in which event (other than in the case of termination for serious misconduct, poor performance or incapacity) Mr Tilley will be entitled to a payment of $2 million, if termination is within the first three years; a $1.75 million payment if termination is during years 3-5 or a $1.5 million payment if termination is after year 5, in all cases, in addition to accrued entitlements.

Where termination is for serious misconduct or poor performance, Mr Tilley will be entitled to accrued entitlements, but he will not be entitled to a termination payment, except where termination is due to incapacity in which case he will be entitled to a termination payment of $750,000.

Other Executives

Name	Term of agreement	Fixed annual remuneration $[3]	Notice period by Executive	Sign on statements	Notice period by Challenger	Termination payment[1]	Non-compete clauses
Current							
R Woods	Open	600,000	26 weeks	–	26 weeks	Good leaver retain unvested LTIP, Pro-rata bonus	26 weeks non-compete and non-solicitation
B Benari	Open	600,000	26 weeks	–	26 weeks	Good leaver retain unvested LTIP, Pro-rata bonus	26 weeks non-compete and non-solicitation
C Cuffe	9 April 2008[2]	600,000	26 weeks	–	26 weeks	Good leaver retain unvested LTIP, Pro-rata bonus	–
D Stevens	Open	600,000	26 weeks	–	26 weeks	Good leaver retain unvested LTIP, Pro-rata bonus	26 weeks non-compete and non-solicitation
P Rogan	Open	600,000	26 weeks	–	26 weeks	Pro-rata bonus	26 weeks non-compete and non-solicitation
R Adams	Open	500,000	26 weeks	–	26 weeks	Good leaver retain unvested LTIP, Pro-rata bonus	26 weeks non-compete and non-solicitation
R Miles	Open	387,000	13 weeks	–	13 weeks	Pro-rata bonus	13 weeks non-compete and 26 weeks non-solicitation
Former							
T Foster	Open	325,000	13 weeks		26 weeks		26 weeks non-solicitation

[1] Termination payment if Challenger terminates the Executive's employment other than for cause.

[2] Up to 15 September 2006 Mr Cuffe will continue on the arrangements above with Challenger Funds Management after which he will transition to a consulting arrangement.

[3] Fixed remuneration is the current rate of fixed pay for FY06.

Restraint of trade

In appropriate circumstances, Challenger negotiates a restraint of trade with senior Executives, upon cessation of their employment, to protect the legitimate business interests of the Company.

Non-Executive Director remuneration

Policy

Challenger's remuneration policy for Non-Executive Directors aims to ensure that the Company can attract and retain suitably skilled, experienced and committed people to serve on the Board. Total remuneration for Non-Executive Directors is required to be approved by shareholders. The current maximum approved by shareholders to be paid to Non-Executive Directors amounts to $1,500,000.

Non-Executive Directors are not entitled to receive performance related remuneration or to receive shares through participation in any Challenger incentive plan. There are no schemes for retirement benefits with the exception of statutory superannuation for Non-Executive Directors.

The following persons were Directors of the Company during the financial year:

Name	Position	Independent	First appointed
Peter Polson	Chairman	Yes	2003
Mike Tilley	Chief Executive Director	No	2003
Graham Cubbin	Non-Executive Director	No	2004
Russell Hooper	Non-Executive Director	Yes	2003
Ashok Jacob	Non-Executive Director	No	2003
James Packer	Non-Executive Director	No	2003
James Service	Non-Executive Director	Yes	2003
Brenda Shanahan	Non-Executive Director	Yes	2003

Fees payable to Non-Executive Directors are set out below:

Boar/Committee	Role	Fee $
Board	Chairman	150,000[1]
	Member	100,000
Remuneration Committee	Chairman	5,000[1]
	Member	10,000
Company Audit and Compliance Committee	Chairman	10,000[1]
	Member	15,000

[1] Chairman fees are in addition to member fees.

Details of the nature and amount of each element of the emoluments of each Non-Executive Director of the Company and of the Group for the year ended 30 June 2006 are set out in the table below.

Table 5: Remuneration of Non-Executive Directors for the year ended 30 June 2006

		Short-term benefits	Post-employment	Other long-term benefits	Term benefits	Share based payments	Total
	Year	Director Fees[5]	Super				
		$	$	$	$	$	$
P Polson[2]	**2006**	**292,907**	**12,093**	**–**	**–**	**–**	**305,000**
	2005	262,114	11,584	–	–	–	273,698
G Cubbin[4]	**2006**	**127,272**	**–**	**–**	**–**	**–**	**127,272**
	2005	–	–	–	–	–	
R Hooper[3,4]	**2006**	**245,725**	**–**	**–**	**–**	**–**	**245,725**
	2005	182,914	2,896	–	–	–	185,810
A Jacob[1]	**2006**	**–**	**–**	**–**	**–**	**–**	**–**
	2005	–	–	–	–	–	–
J Packer[1]	**2006**	**–**	**–**	**–**	**–**	**–**	**–**
	2005	–	–	–	–	–	–
J Service[4]	**2006**	**100,417**	**–**	**–**	**–**	**–**	**100,417**
	2005	115,000	–	–	–	–	115,000
B Shanahan	**2006**	**137,861**	**12,139**	**–**	**–**	**–**	**150,000**
	2005	138,415	11,585	–	–	–	150,000

[1] Acts as a Director in connection with discharging their duties as an executive of Consolidated Press Holdings (CPH) and consequently do not currently take fees for their service.

[2] Includes Challenger Listed Investments Limited (CLIL) fees of $40,000.

[3] Includes CLIL committee fees of $55,000.

[4] Exclusive of GST.

[5] Salary may include salary sacrificed superannuation.

Details of Directors' and senior Executives' holdings in Challenger shares and schemes are set out in note 29 to the financial statements.

Non-Executive Director contracts

Directors' service contracts may be summarised as follows:

- The duration of contracts is from 6 November 2003 until terminated. If Directors retire and are reappointed at an Annual General Meeting the appointment is deemed to be continuous.
- No period of notice by either Director or the Company is required to terminate a Director's service contract.
- No termination payments are stipulated in the service contracts. However, the Company's constitution allows payments to Directors on their retirement subject to the restrictions of the law and the ASX Listing Rules.

Shares under option
Unissued ordinary shares of Challenger Financial Services Group Limited under option plans at 30 June 2006 are set out in the following table:

	Expiry date	Exercise price	Number
Consolidated Press Holdings Limited	22 December 2013	\$3.250	60,000,000

Options issued to Consolidated Press Holdings Limited are non-transferable call options and may be exercised at any time within 10 years from their grant date (22 December 2003).

No options were granted to employees of the Group during the year. No options were exercised during the year ended 30 June 2006.

14. Rounding
The amounts contained in the annual financial report have been rounded off to the nearest \$1,000,000 under the option available to the Company under Australian Securities & Investments Commission (ASIC) Class Order 98/0100. The Company is an entity to which the class order applies.

15. Auditor independence and non-audit services
The Directors received the following declaration from the auditor of Challenger Financial Services Group Limited.

ERNST & YOUNG

Ernst & Young Centre
680 George Street
Sydney NSW 2000
Australia

GPO Box 2646
Sydney NSW 2001

Tel 61 2 9248 5555
Fax 61 2 9248 5959
DX Sydney Stock Exchange 10172

Auditor's Independence Declaration to the directors of Challenger Financial Services Group Limited

In relation to our audit of the financial report of Challenger Financial Services Group Limited for the year ended 30 June 2006, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

Brian Long
Partner
Sydney
25 August 2006

Ernst & Young
Limited liability by the Accountants Scheme, approved under the Professional Standards Act 1994 (NSW)

Non-Audit Services

The following non-audit services were provided by the entity's auditor, Ernst & Young. The Directors are satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The nature and scope of each type of non-audit service provided means that auditor independence was not compromised.

Ernst & Young received or is due to receive the following amounts for the provision of non-audit services:

	$000
Tax compliance services	$1,553
Due diligence services	$2,219
Actuarial	–
Other assurance services	$473

Signed in accordance with a resolution of the Directors of Challenger.

M Tilley
Director
Sydney

25 August 2006

G A Cubbin
Director
Sydney

25 August 2006

Corporate Governance Statement

1. The Company's approach to Corporate Governance
The Board and management of Challenger Financial Services Group Limited ('the Company') recognise their duties and obligations to stakeholders to implement and maintain a robust system of corporate governance. The Company believes that the adoption of good corporate governance adds real value to stakeholders and enhances investor confidence.

The Company acknowledges the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations (Guidelines). This report provides details of the Company's compliance with those recommendations or, where appropriate, indicates a departure from the Guidelines with an explanation. In preparing this report, the requirements of the amendments to the Corporations Act under CLERP 9 have also been addressed.

This statement reflects the Company's corporate governance system as at 26 August 2006.

This report applies to the Company and its subsidiaries, however, some subsidiaries have adopted their own policies and procedures to deal with specific issues relevant to their business, for instance investment management compliance. Where such policies and procedures have been adopted they have been developed in line with the standards referred to throughout this report.

2. The Board of Directors
2 (a) The role of the Board and delegations
The Board is accountable to shareholders for the activities and performance of the Company by overseeing the development of sustainable shareholder value within an appropriate framework of risk and regard for all stakeholder interests. The Board has identified the key functions which it has reserved for itself. These duties are outlined below and set out in the Board Charter, a copy of which is available on the Company's website:

- establishment, promotion and maintenance of the strategic direction of the Company;
- approval of business plans, budgets and financial policies;
- consideration of management recommendations on strategic business matters;
- establishment, promotion and maintenance of proper processes and controls to maintain the integrity of accounting and financial records and reporting;
- fairly and responsibly rewarding Executives, having regard to the interests of shareholders, the performance of Executives, market conditions and the Company's performance;
- adoption and oversight of implementation of appropriate corporate governance practices;
- oversight of the establishment, promotion and maintenance of effective risk management policies and processes;
- determination and adoption of the Company's dividend policy;
- review of the Board's composition and performance;
- appointment, duration, evaluation and remuneration of the CEO and approval of the appointment of the Chief Financial Officer, the General Counsel and the Company Secretary; and
- determination of the extent of the CEO's delegated authority.

The Board has delegated to the CEO the authority and powers necessary to implement the strategies approved by the Board and to manage the business affairs of the Company within the policies and specific delegation limits specified by the Board from time to time. The CEO may further delegate within those specific policies and delegation limits, but remains accountable for all authority delegated to management. [Guideline 1.1]

2 (b) Membership of the Board
(i) Board members
The Company's constitution provides for a minimum of three Directors and a maximum of 12 Directors. The table below summarises the current composition of the Board.

Name	Position	Independent	First appointed
Peter Polson	Chairman	Yes	2003
Mike Tilley	Chief Executive Director	No	2003
Graham Cubbin	Non-Executive Director	No	2004
Russell Hooper	Non-Executive Director	Yes	2003
Ashok Jacob	Non-Executive Director	No	2003
James Packer	Non-Executive Director	No	2003
James Service	Non-Executive Director	Yes	2003
Brenda Shanahan	Non-Executive Director	Yes	2003

The Chairman is selected by Non Executive Directors of the Board. The roles of Chairman and Chief Executive Officer are not exercised by the same person. [Guidelines 2.2 and 2.3; and explanation re Guideline 2.1]

(ii) Nominations and appointment of new Directors
Recommendations for nominations of new Directors are made by the Nomination Committee and considered by the Board as a whole. If a new Director is appointed during the year, that person will stand for election by shareholders at the next annual general meeting. Shareholders are provided with appropriate information to judge the adequacy of candidates. All new Directors are provided with an appropriate induction into Challenger's business. A copy of the Nomination Committee Charter can be found on the Company's website. [Guideline 2.4]

(iii) Retirement and re-election of Directors
The Company's constitution requires that, excluding the CEO, one third of the remaining Directors must retire each year. In addition, any Director who is appointed during the year must retire at the next annual general meeting.

(iv) Succession planning
In conjunction with the Nomination Committee, the Board considers the succession of its members, the CEO, the Chief Financial Officer, the Chief Executives of each of the four Challenger businesses, and the Deputy Managing Director as required.

(v) Review of Board and senior management performance
The Board Charter sets out the requirement for a formal review of the Board's performance at least every two years. A formal review of the Board's performance was conducted in May 2005. Senior management performance is assessed annually as part of the Company's annual formal performance reviews. [Guideline 8.1]

2 (c) Director independence
The Board has adopted an Independence Policy that states that an Independent Director should be independent of management and free from any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the exercise of their unfettered and independent judgement.

The Board will regularly consider and assess the independence of each Director in light of the interests and information which Directors disclose. In accordance with the Corporations Act, Directors are required to advise the Company of any material personal interests they have in a matter.

In assessing independence, the Board will have regard to whether the Director or an immediate family member has any of the following relationships with the Company or any of Challenger's group companies:

1. a substantial shareholder (as defined by section 9 of the Corporations Act) of the Company, or within the last three years has been a Director or officer of, or otherwise associated directly with, a substantial shareholder of the Company;
2. within the last three years, employment in an executive capacity by the Company or been a Director of the Company after ceasing employment with the Company;
3. within the last three years, been a principal of a material professional adviser or a material consultant to the Company, or an employee materially associated with the service provided;
4. a material supplier or customer of the Company, or an officer of or otherwise associated directly or indirectly with a material supplier or customer of the Company;
5. a material contractual relationship with the Company other than as a Director or committee member of the Company;
6. has served on the Board of the Company for a period in excess of 12 years or which having regard to all the circumstances could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the Company; or
7. has an interest or a business or other relationship which could, or could reasonably be perceived to, materially interfere with the Director's ability to act in the best interests of the Company.

The Board will state its reasons if it considers a Director to be independent notwithstanding the existence of a relationship of the kind referred to in paragraphs 1–7 above.

Under the terms of the Company's Constitution, in situations where there is a deadlock in a decision of the Board of Directors, the Chairman shall have a casting vote. The Company currently has a balance of Independent and Non-Independent Directors. However, as the chairman is independent, the Board considers that independent Directors control a majority of voting rights on the Board.

Determination of materiality
The materiality of a relationship is assessed on a case-by-case basis after having regard to each Director's individual circumstances.

In line with the Company's Independence Policy, Messrs Packer and Jacob are not considered independent due to their association with a major shareholder. Mr Cubbin is also not considered independent due to his continuing association with a substantial shareholder, and also by reason of the fact that within the last three years he has been a Director and executive officer of a substantial shareholder.

Corporate Governance Statement (continued)

The construction of the Board did not comply with ASX Guideline 2.1 during the 2006 financial year, as the Board does not have a majority of Independent Directors. The Board through its Governance processes has regularly monitored this departure from the guidelines and believes that throughout the transition in the Company's businesses and business model over the past two years the relevant mix of skills, experience and make-up of the existing Board has served the Company well as the Board has been of an optimal size for effective decision making. Independent Directors have held the balance of power throughout this period as a result of the Independent Chairman holding a casting vote in the event of a deadlock. [Guideline 2.2 explanation]. The Board believes that the transition in the Company's business is now largely complete and intends as part of its ongoing review of Governance matters to continue to review the size and make-up of the Board through the Board Nomination Committee.

Conflicts of interest

In accordance with the Board Charter and the Corporations Act 2001 (Cth), any Director with a material personal interest in a matter being considered by the Board must declare such an interest and may only be present when the matter is being considered at the Board's discretion. Directors with a material interest may not vote on any matter in which they have declared a personal interest.

Meetings of the Board

During the year the Board generally met formally approximately every six weeks. In addition, the Board may meet whenever necessary to deal with specific matters needing attention between scheduled meetings. The CEO, in consultation with the Chairman, establishes the meeting agendas to ensure adequate coverage of strategic, financial and material risk areas throughout the year. Senior Executives are invited to attend Board meetings and are available for contact by Non-Executive Directors between meetings. The Non-Executive Directors hold a private session without any executive involvement as part of each Board meeting.

Board access to information and advice

All Directors have unrestricted access to the Company records and information. The company secretary provides Directors with guidance on corporate governance issues and developments and on all other matters reasonably requested by the Directors and monitors compliance with the Board Charter. The Board or each individual Director has the right to seek independent professional advice at the Company's expense to assist them to discharge their duties. Whilst the Chairman's prior approval is required, it may not be unreasonably withheld or delayed.

Board committees

To assist it in undertaking its duties, the Board has established the following committees:

- the Audit and Compliance Committee
- the Nomination Committee
- the Remuneration Committee.

Each committee has its own charter, copies of which are available on the Company's website at www.challenger.com.au. The Charters specify the composition, responsibilities, duties, reporting obligations, meeting arrangements, authority and resources available to the committees and the provisions for review of the charter. Details of Directors' membership of each committee and their attendance at meetings throughout the period is set out below. [Guidelines 2.4, 4.2, 9.2]

Directors' meetings

Director	Board		Audit and Compliance Committee		Remuneration Committee		Nomination Committee[1]	
	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
P Polson	12	11	N/A	N/A	4	4	N/A	N/A
M Tilley	12	12	N/A	N/A	N/A	N/A	N/A	N/A
G Cubbin	12	12	6	6	N/A	N/A	N/A	N/A
R Hooper	12	12	6	6	4	4	N/A	N/A
A Jacob	12	8	N/A	N/A	N/A	N/A	N/A	N/A
J Packer	12	10	N/A	N/A	4	1	N/A	N/A
J Service	12	12	N/A	N/A	N/A	N/A	N/A	N/A
B Shanahan	12	10	6	5	N/A	N/A	N/A	N/A

[1] There were no meetings of the Nomination Committee during the year.

Integrity of Challenger financial reporting

In accordance with its charter, the Audit and Compliance Committee must have at least three members and is comprised of all Non-Executive Directors and a majority of independent members. A principal aim of the Audit and Compliance Committee is to assist the Board in overseeing the integrity of the Company's financial reporting. The committee makes recommendations to the Board in relation to the appointment, review and removal of an external auditor, assessment of the external auditor's independence and the appropriateness of non-audit services that the external auditor may provide. A copy of the Audit and Compliance Committee Charter is available on the Company's website.

The CEO and CFO periodically provide formal assurance statements to the Board that:

- the Company's financial statements present a true and fair view of the Company's financial condition and operational results; and
- the risk management and internal compliance and control systems are sound, appropriate and operating efficiently and effectively.

Independent audit

The Company requires its independent audits to:

- provide stakeholders with assurance over the true and fair view of the financial reports; and
- ensure accounting practices comply with applicable accounting rules and policies.

The Company's independent external auditor is Ernst & Young (E&Y). E&Y was appointed upon constitution of the Company in November 2003, and this appointment was ratified by members at the annual general meeting held in November 2004. External auditors will be required to rotate the engagement partner assigned to the Company on a five year basis.

The Board has requested that E&Y attend the Company's annual general meeting, and that they be available to answer questions arising in relation to the conduct of their audit.

Risk management and compliance

The management of risks is fundamental to the Company's business and to building shareholder value. The Board recognises the broad range of risks which apply to a participant in the financial services industry, including, but not limited to, market risk, liquidity risk, credit risk, legal risk, compliance and operational risk and reputational risk. The Board is responsible for determining the Company's risk management strategy. Management is responsible for implementing the Board's strategy and for developing policies and procedures to identify, manage and mitigate risks across the whole of the Company's operations.

The Board has adopted an Operational Risk Framework and formal policies in respect of Compliance and Operational Risk Management. The framework and policies were developed and approved by management, reviewed and approved by the Audit and Compliance Committee, and then made available to all staff of the Company and its subsidiaries. Training sessions are held with all business teams to ensure the Operational Risk Framework is understood and applied in a consistent manner throughout the Group. The Company has implemented an Operational Risk Management function which has day to day responsibility for monitoring the implementation of the framework and policy and reporting regularly to the Audit and Compliance Committee on the adequacy and effectiveness of management controls for risk. The Committee reports regularly to the Board on compliance with the framework and policy. A copy of the Operational Risks Policy can be found at the Company's website.

Code of conduct

The Board has adopted a Code of Conduct which applies to all Directors, Executives, management and employees of the Company and its subsidiaries. The Code articulates the standards of honest, ethical and law-abiding behaviour expected by the Company. Employees are actively encouraged to bring any problems to the attention of management or the Board, including activities or behaviour which may not comply with the Code of Conduct, other policies and procedures in place, or other regulatory requirements or laws. A copy of the Code can be found at the Company's website.

Political donations policy

The Board has adopted a policy of not making political donations in any country or jurisdiction of operation. Representatives of the Company will often attend party conferences and attend political functions. This attendance is for strictly commercial reasons and is predicated on the price charged not being in excess of the commercial value (in terms of access) of the function.

Staff trading policy

Directors and staff are subject to restrictions under the law relating to dealing in securities, including the securities issued by the Company if they are in possession of insider information. The Board has approved the Company's Staff Trading Policy which prescribes the manner in which staff can trade in the Company's shares. A summary of the policy is available on the Company's website. The policy applies to all Directors and staff and places restrictions and reporting requirements on staff, including limiting trading in the Company (or other listed entities within the Group) to specific trading windows and in a specified manner. Those staff designated as potentially having access to insider information are required to seek prior approval to trade in other securities.

Corporate Governance Statement (continued)

Continuous disclosure policy and shareholder communication processes

The Company is committed to providing relevant information about its operations to all shareholders and to fulfil its duties to comply with its continuous disclosure obligations to the market generally.

The Board approved and implemented a Continuous Disclosure Policy. The policy is designed to ensure compliance with the Corporations Act and ASX Listing Rules continuous disclosure requirements. The Company has a Continuous Disclosure Committee which is responsible for:

- making decisions on what should be disclosed publicly under the Continuous Disclosure Policy;
- maintaining a watching brief on information; and
- ensuring disclosure is made in a timely and efficient manner.

The Company also publishes annual and half yearly reports, announcements, media releases and other relevant information on its website at www.challenger.com.au. Internet web-casting and teleconferencing facilities are provided for market briefings to encourage participation from all stakeholders, regardless of their location. The Company is also intending to encourage greater use of electronic media by providing shareholders with greater access to the electronic receipt of reports and meeting notices. The Company also provides a facility to ask questions about the Company and have them answered directly via electronic means.

Financial Report

30 June 2006

This year-end financial report covers Challenger Financial Services Group Limited ('the Company') and its controlled entities ('the Group').

Income Statement

For the year ended 30 June 2006	Notes	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m
Revenue	2	2,333.1	2,070.9	69.4	33.8
Expenses	3	(2,042.6)	(1,798.0)	(1.3)	–
Share of profits/(losses) of associates	36	–	2.1	–	–
Earnings before interest and tax		290.5	275.0	68.1	33.8
Finance costs	4	(109.5)	(110.5)	–	–
Profit before income tax		181.0	164.5	68.1	33.8
Income tax (expense)/benefit	5	(51.1)	(44.9)	4.3	(0.2)
Profit after income tax		129.9	119.6	72.4	33.6
(Profit) / losses attributable to minority interest		4.4	–	–	–
Profit attributable to equity holders of the parent		134.3	119.6	72.4	33.6
Earnings per share		cents	cents		
Basic earnings per share	7	24.92	22.71		
Diluted earnings per share	7	23.91	22.69		

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

Balance Sheet

As at 30 June 2006	Notes	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m
Assets					
Cash and cash equivalents	8	425.5	490.7	0.3	–
Receivables	9	503.3	158.3	331.8	250.6
Derivative assets	27	6.7	2.7	–	–
Financial assets fair valued through income statement	10	903.6	–	–	–
Investment assets	10	–	1,013.2	–	–
Available-for-sale assets	10	318.5	–	–	–
Infrastructure investments	10	183.1	344.4	–	–
Other financial assets	10	10.9	0.3	–	–
Investment properties	11	1,800.7	1,683.3	–	–
Plant and equipment	12	281.5	10.9	–	–
Securitised assets	21	19,667.9	16,937.1	–	–
Deferred tax assets	5	14.3	10.9	18.8	7.7
Investment in associates	36	6.3	2.8	–	–
Investments in controlled entities	34	–	–	938.0	931.5
Goodwill	13	1,583.1	562.2	–	–
Other intangible assets	13	17.1	18.2	–	–
Other assets	15	172.2	156.9	–	–
Total assets		25,894.7	21,391.9	1,288.9	1,189.8
Liabilities					
Payables	16	390.0	260.1	185.2	39.1
Current tax payable		–	2.8	–	–
Derivative liabilities	27	74.9	1.3	–	–
Financial liabilities fair valued through income statement	17	18.4	–	–	–
Interest bearing liabilities	18	1,770.7	600.7	–	–
Provisions	19	64.8	67.0	–	–
Securitised liabilities	21	19,680.2	16,937.1	–	–
Deferred tax liabilities	5	147.1	94.1	–	92.5
Life insurance contract liabilities	20	91.1	–	–	–
Life investment contract liabilities	20	2,047.3	–	–	–
Life policy liability	20	–	2,271.9	–	–
Total liabilities		24,284.5	20,235.0	185.2	131.6
Net assets		1,610.2	1,156.9	1,103.7	1,058.2
Equity					
Contributed equity	22	1,244.0	1,235.1	1,244.0	1,235.1
Reserves	23	96.1	71.1	78.6	71.1
Retained (loss)	24	(93.0)	(149.3)	(218.9)	(248.0)
Total equity attributable to equity holders of the parent		1,247.1	1,156.9	1,103.7	1,058.2
Cash flow hedge reserve – Special Purpose Vehicles	21	(12.3)	–	–	–
Minority interests	25	375.4	–	–	–
Total equity		1,610.2	1,156.9	1,103.7	1,058.2

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

Statement of Changes in Equity

For the year ended 30 June 2006		Attributable to equity holders of the parent		
Consolidated $m	**Issued capital**	**Treasury shares**	**Retained earnings/ (losses)**	**Equity option premium reserve**
As at 1 July 2005	1,363.9	(128.8)	(149.3)	61.7
Effect of change in accounting policy	–	–	(34.6)	–
As at 1 July 2005 – restated	1,363.9	(128.8)	(183.9)	61.7
Currency translation differences	–	–	–	–
Net changes in available for sale assets, net of tax	–	–	–	–
Net change in cash flow hedges, net of tax	–	–	–	–
Total income and expenses for the period recognised directly in equity	–	–	–	–
Profit for the period	–	–	134.3	–
Total recognised income/expense for the period	–	–	134.3	–
Movements in share capital net of transaction costs	–	–	–	–
Share issue costs	–	–	–	–
Shares redeemed	–	4.9	–	–
Cost of share based payments	45.1	(44.5)	–	–
Equity dividends/distributions	3.4	–	(43.4)	–
As at 30 June 2006	1,412.4	(168.4)	(93.0)	61.7

The above statement of changes in equity should be read in conjunction with the accompanying notes.

Attributable to equity holders of the parent (cont.)					Cash flow hedge within SPV	Minority interest	Total equity
Share based payments premium reserve	Foreign currency translation reserve	Available-for-sale securities revaluation reserve	Cash flow hedge reserve	Total			
9.4	–	–	–	1,156.9	–	–	1,156.9
–	–	–	(0.3)	(34.9)	(10.0)	–	(44.9)
9.4	–	–	(0.3)	1,122.0	(10.0)	–	1,112.0
–	11.6	–	–	11.6	–	9.8	21.4
–	–	4.6	–	4.6	–	4.0	8.6
–	–	–	1.6	1.6	(2.3)	2.9	2.2
–	11.6	4.6	1.6	17.8	(2.3)	16.7	32.2
–	–	–	–	134.3	–	(4.4)	129.9
–	11.6	4.6	1.6	152.1	(2.3)	12.3	162.1
–	–	–	–	–	–	387.3	387.3
–	–	–	–	–	–	(8.5)	(8.5)
–	–	–	–	4.9	–	–	4.9
7.5	–	–	–	8.1	–	–	8.1
–	–	–	–	(40.0)	–	(15.7)	(55.7)
16.9	11.6	4.6	1.3	1,247.1	(12.3)	375.4	1,610.2

Statement of Changes in Equity (continued)

For the year ended 30 June 2005	Attributable to equity holders of the parent							Minority interest	Total equity
Consolidated $m	Issued capital	Treasury shares	Retained earnings/ (losses)	Equity option premium reserve	Share based payments premium reserve	Foreign currency translation Reserve	Total		
As at 1 July 2004	1,258.7	(118.2)	(268.9)	61.7	5.3	–	938.6	–	938.6
Currency translation differences	–	–	–	–	–	–	–	–	–
Total income and expenses for the period recognised directly in equity	–	–	–	–	–	–	–	–	–
Profit for the period	–	–	119.6	–	–	–	119.6	–	119.6
Total recognised income/ expense for the period	–	–	119.6	–	–	–	119.6	–	119.6
Purchase of Associated Planners Group Ltd net of transaction costs	90.1	–	–	–	–	–	90.1	–	90.1
Share issue costs	15.1	(15.1)	–	–	–	–	–	–	–
Shares redeemed	–	4.5	–	–	–	–	4.5	–	4.5
Cost of share based payments	–	–	–	–	4.1	–	4.1	–	4.1
As at 30 June 2005	1,363.9	(128.8)	(149.3)	61.7	9.4	–	1,156.9	–	1,156.9

For the year ended 30 June 2006	Attributable to equity holders of the parent					
Parent $m	Issued capital	Treasury shares	Retained earnings/ (losses)	Equity option premium reserve	Share based payments premium reserve	Total
As at 1 July 2005	1,363.9	(128.8)	(248.0)	61.7	9.4	1,058.2
Profit for the period	–	–	72.4	–	–	72.4
Total recognised income/ expense for the period	–	–	72.4	–	–	72.4
Shares redeemed	–	4.9	–	–	–	4.9
Cost of share based payments	45.1	(44.5)	–	–	7.5	8.1
Equity dividends/distributions	3.4	–	(43.4)	–	–	(40.0)
As at 30 June 2006	1,412.4	(168.4)	(218.9)	61.7	16.9	1,103.7

For the year ended 30 June 2005	Attributable to equity holders of the parent					
Parent $m	Issued Capital	Treasury shares	Retained earnings/ (losses)	Equity option premium reserve	Share based payments premium reserve	Total
As at 1 July 2004	1,258.7	(118.2)	(281.6)	61.7	5.3	925.9
Profit for the period	–	–	33.6	–	–	33.6
Total recognised income/ expense for the period	–	–	**33.6**	–	–	33.6
Purchase of Associated Planners Group Ltd net of transaction costs	90.1	–	–	–	–	90.1
Share issue costs	15.1	(15.1)	–	–	–	–
Shares redeemed	–	4.5	–	–	–	4.5
Cost of share based payments	–	–	–	–	4.1	4.1
As at 30 June 2005	**1,363.9**	**(128.8)**	**(248.0)**	**61.7**	**9.4**	1,058.2

Statement of Cash Flows

For the year ended 30 June 2006	Notes	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m
Cash flows from operating activities					
Receipts from customers (inclusive of GST)		569.3	649.9	–	–
Premiums received		365.4	716.3	–	–
Payments to suppliers and employees (inclusive of GST)		(277.1)	(511.9)	–	–
Claim payments		(624.2)	(639.3)	–	–
Dividends received		33.9	26.6	65.0	33.0
Interest received		90.8	158.4	–	–
Interest paid		(109.5)	(155.8)	–	–
Income tax paid		(35.0)	(5.7)	–	–
Net cash (outflow)/inflow from operating activities	31	13.6	238.5	65.0	33.0
Cash flows from investing activities					
Purchase of investments		(547.3)	(695.8)	–	–
Proceeds from disposal of investments		186.4	1,841.9	–	–
Acquisition of controlled entities, net of cash acquired		(814.4)	(8.7)	–	–
Purchase of property, plant and equipment		(45.2)	(14.7)	–	–
Restructure costs		(5.8)	(9.9)	–	–
Net cash (outflow)/inflow from investing activities		(1,226.3)	1,112.8	–	–
Cash flows from financing activities					
Proceeds from borrowings		1,390.4	7.3	–	–
Repayment of borrowings		(220.4)	(1,494.3)	–	–
Proceeds from issue of shares		8.9	–	–	–
Dividend paid		(43.4)	–	(43.4)	–
Advances to controlled entities		–	–	(21.3)	(33.0)
Net cash inflow/(outflow) from financing activities		1,135.5	(1,487.0)	(64.7)	(33.0)
Net increase/(decrease) in cash and cash equivalents		(77.2)	(135.7)	0.3	–
Cash and cash equivalents at the beginning of period		490.7	626.4	–	–
Cash acquired on acquisition		12.0	–	–	–
Effects of exchange rate fluctuations on cash held		–	–	–	–
Cash and cash equivalents at the end of period	8	425.5	490.7	0.3	–

The statement of cash flows should be read in conjunction with the accompanying notes. This cash flow statement does not include the special purpose vehicles (SPVs) which have their own separate cash flow detailed in note 21.

Notes to the Financial Statements

Note 1. Summary of Significant Accounting Policies

The financial report of Challenger Financial Services Group Limited ('the Company') for the year ended 30 June 2006 was authorised for issue in accordance with a resolution of the Directors on 25 August 2006.

The consolidated financial report of the Company for the financial year ended 30 June 2006 comprise the Company and its subsidiaries (together referred to as 'the Group') and the Group's interest in associates.

(a) Basis of preparation

The financial report is a general purpose financial report which has been prepared in accordance with the requirements of the Corporations Act 2001 and Australian Accounting Standards. The financial report has been prepared on a historical cost basis, except for investment properties, derivative financial instruments, available for sale financial assets and assets supporting the life insurance business, which have been measured at fair value.

(b) Statement of compliance

The financial report complies with Australian Accounting Standards, which include Australian equivalents to International Financial Reporting Standards (AIFRS). The adoption of AIFRS ensures that the financial report, comprising the financial statements and notes thereto, is in compliance with International Financial Reporting Standards (IFRS).

This is the first annual financial report prepared based on AIFRS and comparatives for the year ended 30 June 2005 have been restated accordingly. The Company has adopted the exemption under AASB 1: *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* from having to apply AASB 132 and AASB 139 to the comparative period. Reconciliations of AIFRS equity and profit for 30 June 2005 to the balances reported in the 30 June 2005 financial report and at transition to AIFRS are detailed in note 39.

The following amendments are not applicable to the Group and therefore have no impact.

AASB amendment	Affected standard(s)
2005-1	AASB 139: *Financial Instruments: Recognition and Measurement*
2005-2	AASB 1023: *General Insurance Contracts*
2005-3	AASB 119: *Employee Benefits*
2005-4	AASB 139: *Financial Instruments: Recognition and Measurement*, AASB 132: *Financial Instruments: Disclosure and Presentation*, AASB 1: *First-time Adoption of AIFRS*, AASB 1023: *General Insurance Contracts*, AASB 1028: *Life Insurance Contracts*
2005-5	AASB 139: *Financial Instruments: Recognition and Measurement*, AASB 1: *First-time Adoption of AIFRS*
2005-6	AASB 3: *Business Combinations*
2005-9	AASB 4: *Insurance Contracts*, AASB 1023: *General Insurance Contracts*, AASB 139: *Financial Instruments: Recognition and Measurement*, AASB 132: *Financial Instruments: Disclosure and Presentation*
2005-12	AASB 1023: *General Insurance Contracts*, AASB 1038: *Life Insurance Contracts*
2005-13	AASB 25: *Financial Reporting by Superannuation Plans*
2006-1	AASB 121: *The Effects of Changes in Foreign Exchange Rates*
2006-2	AASB 1: *First-time Adoption of AIFRS*

The following standards and amendments were available for early adoption but have not been applied by the Group in these financial statements:

- AASB 7: *Financial Instruments: Disclosure* replacing the presentation requirements of financial instruments under AASB 132: *Financial Instruments: Disclosure and Presentation*. AASB 7 is applicable for annual reporting periods beginning on or after 1 January 2007.
- AASB 2005-10: *Amendments to Australian Accounting Standards* makes consequential amendments to AASB 132: *Financial Instruments: Disclosure and Presentation*, AASB 101: *Presentation of Financial Statements*, AASB 114: *Segment Reporting*, AASB 117: *Leases*, AASB 133: *Earnings Per Share*, AASB 139: *Financial Instruments: Recognition and Measurement*, AASB 1: *First-time Adoption of AIFRS*, AASB 4: *Insurance Contracts*, AASB 1023: *General Insurance Contracts* and AASB 1028: *Life Insurance Contracts*, arising from the release of AASB 7. AASB 2005-10 is applicable for annual reporting periods beginning on or after 1 January 2007.

The Group plans to adopt AASB 7 and AASB 2005-10 in the year ended 30 June 2008. The initial application of AASB 7 and AASB 2005-10 is not expected to have an impact on the financial results of the Company and the Group as the standard and the amendment are concerned only with disclosures.

A summary of the significant accounting policies of the Group under AIFRS are disclosed below.

(c) Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company, its subsidiaries and certain special purpose entities as at 30 June 2006. The financial statements of subsidiaries and special purpose entities are prepared for the same reporting period as the Company, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

All intercompany balances and transactions, including unrealised profits arising from intra-group transactions, have been eliminated in full. Unrealised losses are eliminated unless costs cannot be recovered.

Subsidiaries and Special Purpose Vehicles are consolidated from the date on which control is transferred to the Company and cease to be consolidated from the date on which control is transferred out of the Company. Where there is a loss of control of a subsidiary or special purpose entity, the consolidated financial statements include the results for the part of the reporting year during which the Company had control.

Refer to note 33 acquisition and disposal of controlled entities for details of acquisitions during the year ended 30 June 2006.

Minority interest in the results and equity of controlled entities where the Group owns less than 100% of the issued capital, are shown separately in the consolidated income statement and balance sheet.

Both the shareholders' and policy owners' interests in the life insurance funds of Challenger Life No. 2 Limited are consolidated.

Where controlled entities other than Challenger Life No. 2 Limited are consolidated, the excess of the purchase price over the fair value of net assets of controlled entities is treated as goodwill and is subject to impairment testing as described in note 1(s).

Funds under management

Within the economic entity, certain controlled entities act as the single responsible entity/manager for a number of registered schemes and property syndicates. Registered schemes and property syndicates have not been consolidated in the financial statements as individual entities within the economic entity do not have control of the schemes and syndicates.

Investment in associates

The Group's investment in associates are accounted for under the equity method of accounting in the consolidated financial statements. These are entities which the Group has significant influence but not control over the financial and operating policies. The financial statements of the associates are used by the Group to apply the equity method. The reporting dates of the associates and the Group are consistent and both use consistent accounting policies. After application of the equity method, the Group determines whether it is necessary to recognise any additional impairment loss with respect to the Group's net investment in the associates.

The investments in associates are carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associate, less any impairment in value. The consolidated income statement reflects the share of the results of operations of the associate. Where there has been a change recognised directly in the associate's equity, the Group recognises its share of any changes and discloses this in the consolidated statement of changes in equity.

(d) Life insurance financial reporting

The Asset Management business includes the selling and administration of contracts through Challenger Life No. 2 Limited. These contracts are governed under the Life Insurance Act 1995 (Life Act). For purposes of the financial statements these are classified as either life insurance contracts or life investment contracts.

Life insurance contracts involve the acceptance of significant insurance risk. Insurance risk is defined as significant if and only if an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e. have no discernible effect on the economics of the transaction).

The Asset Management business is conducted within separate statutory funds as required by the Life Insurance Act 1995 and are reported in aggregate in the income statement and balance sheet of the Group. The activities of the statutory funds are reported in aggregate with the shareholders fund in the financial report of the Group.

Life investment contracts are contracts regulated under the Life Act but which do not meet the definition of life insurance contracts under AASB 1038: *Life Insurance Contracts* and similar contracts issued by entities operating outside of Australia.

The life insurance operations consist of both investment-linked and non-investment-linked business. Investment-linked business is business where the Group issues a contract where the benefit amount is directly linked to the market value of the investments held in the fund. While the underlying assets are registered in the name of a controlled entity and the policy owner has no direct access to the specific assets, the contractual arrangements are such that the policy owner bears the risks and rewards of the fund's investment performance. The Group derives fee income from the administration of the investment-linked funds.

Non-investment-linked business is business which issues a contract where the benefit amount is not directly linked to the market value of the investments held in the fund. Policy contracts that include both investment-linked elements and non-investment-linked elements are separated into these two elements and reported accordingly.

(e) Income tax

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

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Deferred income tax is provided on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences except:

- when the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or
- when the taxable temporary difference is associated with investments in subsidiaries and associates and the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax assets and unused tax losses can be utilised except:

- when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; or
- when the deductible temporary difference is associated with investments in subsidiaries and associates, in which case deferred tax assets are only recognised to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Income taxes relating to items recognised directly in equity are recognised in equity and not in profit or loss.

Deferred tax assets and liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities related to the same taxable entity and the same taxation authority.

Tax consolidation

Challenger Financial Services Group Limited and its 100% owned Australian resident subsidiaries have formed a tax consolidated group with effect from 1 July 2002 and are therefore taxed as a single entity from that date. Challenger Financial Services Group Limited is the head entity of the tax consolidated group.

Tax effect accounting by members of the tax group

Members of the tax consolidated group have applied tax funding principles under which Challenger Financial Services Group Limited and each of the members of the tax consolidated group agree to pay tax equivalent payments to or from the head entity, based on the current tax liability or current tax asset of the member. Such amounts are reflected in the amounts receivable from or payable to each member and the head entity.

The group allocation approach is applied in determining the appropriate amount of current tax liability or current tax asset to allocate to members of the tax consolidated group. Deferred taxes are allocated to members of the tax consolidated group in accordance with the principles of AASB 112.

(f) Foreign currency

(i) Transactions

Transactions in foreign currencies are translated into presentation currency, Australian dollars, at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into Australian dollars at the foreign exchange rate ruling at the balance sheet date.

Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the transaction. Non-monetary items measured at fair value in a foreign currency shall be translated to Australian dollars using the exchange rates ruling at the date when the fair value was determined.

(ii) Foreign controlled entities
As at the reporting date, the assets and liabilities of foreign subsidiaries, whose functional currency differs from the presentation currency, are translated into Australian dollars at the rate of exchange ruling at the balance sheet date and their income statements are translated at the weighted average exchange rate for the year.

Foreign exchange differences arising on the retranslation are taken directly to the foreign currency translation reserve in equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

(g) Revenue recognition
Revenue is recognised to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. Revenues and expenses are generally recognised on an accrual basis.

Revenue from fees income is derived from the provision of investment management services to the Company's managed investment products and fee and distribution income from managed loan securitisation trusts. Revenue is recognised when the services are deemed to have been earned using an effective interest rate method over the life of the contract.

Revenue from premiums in the asset management business is separated into revenue and liability components. Premium amounts received, which are akin to deposits, are recognised as an increase in policy liabilities. For the investment-linked and annuity business, all premiums are recognised as an increase in policy liabilities.

Interest income is recognised as it accrues using an effective interest rate, taking into account the effective yield of the financial asset.

Revenue received relating to financial planning in the form of brokerage from life companies and fund managers is recognised on an accrual basis using the effective interest method.

Dividends are recognised as income on the date the share is quoted ex-dividend. Dividends from unlisted companies are recognised when the dividend is received.

Operating lease rental income is earned on a straight line basis over the life of the contract.

(h) Finance costs
Finance establishment costs in respect of debt that is not fair valued are deferred and amortised over the life of the underlying facility.

(i) Cash and cash equivalents
Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

For the purpose of the cash flow statement, cash and cash equivalents consist of cash and short-term deposits as defined above, net of outstanding bank overdrafts.

(j) Receivables
Trade and other receivables are stated at their amortised cost less impairment losses. Trade and other receivables are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

Bills of exchange have been purchased in the market at a discount to face value. The bills are carried at an amount representing cost and a portion of the discount recognised as income on an effective yield basis. The discount brought to account each period is accounted for as interest income.

(k) Derivative financial instruments
1 July 2004 to 30 June 2005
The Group is exposed to changes in interest rates and foreign exchange rates and may use interest rate swaps, forward foreign exchange contracts and futures to hedge these risks. Derivative financial instruments are held for risk management purposes and not for the purpose of speculation. The Group does not hold a derivative trading portfolio.

Other than in the Asset Management business, costs arising at the time of entering into hedge transactions are brought to account in the income statement over the lives of the hedge contracts. For the asset management company and its controlled entities, costs arising at the time of entering into hedge transactions are recognised in the income statement in the period in which the costs are incurred.

Derivative financial instruments designated as hedges are accounted for on a fair value basis and changes in value are recorded in the income statement in the period in which they arise. Where futures contracts are a hedge of interest rate risk, the gain or loss on those contracts is deferred and recognised in the period for which the underlying interest rate risk has been hedged.

1 July 2005 onwards
The Group uses derivative financial instruments such as foreign currency contracts and interest rate swaps to hedge its risks associated with interest rate and foreign currency fluctuations. The Group does not hold derivative financial instruments for trading purposes. However, for derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement for the year.

All derivative financial instruments are stated at fair value. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swap contracts is determined by reference to market values for similar instruments.

All derivative financial instruments held within Challenger Life No. 2 Limited are stated at fair value with any gains or losses arising from changes in fair value being taken directly to the income statement for the year.

For all entities, for the purpose of hedge accounting, hedges are classified as either fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability; or cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecasted transaction. On entering into a hedging relationship, the Group formally designates and documents the hedge relationship and the risk management objective and strategy for undertaking the hedge.

Fair value hedges
In relation to fair value hedges which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument at fair value is recognised immediately in the income statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the income statement. Where the adjustment is to the carrying amount of a hedged interest bearing financial instrument, the adjustment is amortised to the net profit and loss such that it is fully amortised by maturity.

Cash flow hedges
In relation to cash flow hedges to hedge firm commitments which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion is recognised in the income statement.

When the hedged firm commitment results in the recognition of an asset or a liability the associated gains or losses that had previously been recognised in equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same year in which the hedged firm commitment affects the net profit and loss, e.g. when interest income or expense is recognised.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement for the year.

(l) Financial assets (2005: Investments)
From 1 July 2004 to 30 June 2005
Investments within the Asset Management segment were accounted for at net market value. Investments held elsewhere in the Group were brought to account at the lower of cost or net realisable value. Controlled entities and associates were accounted for in the consolidated financial statements as set out in note 1(c).

From 1 July 2005
The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss, receivables or available-for-sale investments. The classification depends on the definition and the purpose for which the investments were acquired. The classification of investments are determined at initial recognition and evaluated at each reporting date.

Purchases and sales of investments are recognised on the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

(i) Financial assets at fair value through profit or loss
Financial assets classified in this category are assets held for the purposes of trading. Assets in this category are classified as debt or equity securities. They are carried at fair value and unrealised gains and losses are recognised through the income statement.

(ii) Receivables
Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are carried at amortised cost, calculated by taking into account any discount or premium on acquisition over the period to maturity.

(iii) Available-for-sale financial assets
Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are carried at fair value and unrealised gains and losses are recognised in available-for-sale asset reserve in equity. If the asset is derecognised or determined to be impaired, the cumulative gain or loss previously reported in equity is recognised in the income statement.

The fair values of quoted investments are based on quoted bid prices at the balance sheet date. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other assets that are substantially the same, discounted cash flow analysis, and option pricing models refined to reflect the issuer's specific circumstances.

(m) Investment properties
Investment properties are measured initially at cost including transaction costs. Subsequent to initial recognition, investment properties are stated at fair value, which reflect market conditions at the balance sheet date. Independent valuations for all investment properties are conducted annually and the Directors make reference to these independent valuations when determining fair value. Gains or losses arising from changes in the fair values of investment properties are included in the income statement in the period in which they arise.

Investment properties are derecognised when they have either been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gains or losses on the derecognition of an investment property are recognised in the income statement in the period of derecognition.

(n) Infrastructure fixed assets
Infrastructure fixed assets are stated at cost and amortised on a straight line basis over their estimated useful life of 40 years. This is done on a project by project basis with amortisation commencing when the Company starts receiving transportation income from the project.

The carrying values of infrastructure fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Impairment losses are recognised in the income statement.

(o) Plant and equipment
Items of plant and equipment are stated at cost or deemed cost less accumulated depreciation and impairment losses.

Depreciation is calculated on a straight line basis to write off the net cost of each class of fixed assets over its expected useful life. Estimates of remaining useful lives are made on a regular basis for all assets, with annual reassessments for major items. The expected useful lives are as follows:

- Plant and equipment – three to five years.

(p) Leased assets
Leases are classified as either operating leases or finance leases at the date of inception of the lease.

A distinction is made between finance leases which effectively transfer from the lessor to the lessee substantially all of the risks and benefits incident to ownership of leased assets, and operating leases under which the lessor effectively retains substantially all such risks and benefits.

Finance leases are capitalised. A lease asset and liability are established at the present value of minimum lease payments. Lease payments are allocated between the principal component of the lease liability and the interest expense.

The lease asset is amortised on a straight line basis over the term of the lease, or where it is likely that the Group will obtain ownership of the asset, the life of the asset. Lease assets held at the reporting date are being amortised over periods ranging from three to five years.

Incentives received on entering into operating leases are recognised as liabilities and are amortised over the life of the lease.

Other operating lease payments are charged to the income statement in the periods in which they are incurred.

Surplus lease space
The present value of future payments for surplus leased space under non-cancellable operating leases is recognised as a liability, net of sub-leasing revenue, in the period in which it is determined that the leased space will be of no future benefit to the Group.

(q) Deferred portfolio and origination costs

Deferred portfolio costs

Portfolio costs represent the costs associated with establishing securitised mortgage backed pools of funds which are funded via the issue of residential mortgage backed securities (RMBS) to investors. When incurred these costs are recognised as an asset and subsequently amortised over the life of the future economic benefits expected to be received.

The amortisation policy is to match the portfolio costs with the expected repayment profile of each securitised pool so that the amortisation charge as a proportion of the outstanding securitisation pool is consistent over the life of the securitisation, creating an effective yield. The amortisation rate is determined based on the forecast prepayment rate of the loans underlying the RMBS. This is calculated on a trust by trust basis, thereby matching each pool of relevant costs with the forecast prepayment rate of the 'issue' they relate to.

Deferred origination costs

Deferred origination costs are costs associated with origination of loans including commissions paid to mortgage originators and Lenders Mortgage Insurance (LMI) premiums. Deferred origination costs incurred are recognised as an asset and subsequently amortised over the life of the future economic benefits expected to be received.

The amortisation policy is to match the amortisation of the origination costs with the average repayment profile of a loan so that the amortisation charge as a proportion of the outstanding loan balance is consistent over the life of a loan, creating an effective yield. The basis of amortisation is determined by the amortisation of the loan book or Cumulative Prepayment Rates (CPR) curve (excluding discharges). Any origination costs (remaining written down value) associated with a loan which has discharged during the period is written off immediately. This policy ensures that total deferred origination costs are not carried at an amount above their recoverable amount

(r) Goodwill and other intangible assets

(i) Goodwill

Goodwill acquired in a business combination is initially measured at cost where the cost of the business combination exceeds the net fair value of the identifiable assets, liabilities and contingent liabilities acquired. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill on acquisitions is not amortised but is tested for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

As at the acquisition date any goodwill acquired is allocated to each of the cash-generating units expected to benefit from the combination's synergies. Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

(ii) Other intangible assets

Other intangible assets acquired are recorded at cost less accumulated amortisation and impairment losses. The cost of an intangible asset acquired in a business combination is its fair value as at the date of acquisition.

Certain internal and external software costs directly incurred in acquiring and developing certain software have been capitalised and are being amortised on a straight line basis over their useful life, usually for a period of five years. Useful lives are examined on an annual basis and where applicable, adjustments are made on a prospective basis. Costs incurred on software maintenance are expensed as incurred.

(s) Impairment of assets

At each reporting date, the Group assesses whether there is any indication that an asset may be impaired. If any such indication exists, the Group makes a formal estimation of the asset's recoverable amount.

An asset's recoverable amount is the greater of the fair value less costs to sell and its value in use. It is determined for an individual asset, unless the asset's value in use cannot be estimated to be close to its fair value less costs to sell and it does not generate cash flows that are largely independent of those from other assets or groups of assets. In such cases, the asset is tested for impairment as part of the cash-generating unit to which it belongs. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset.

When the carrying amount of an asset or cash-generating unit exceeds its recoverable amount, the asset or cash-generating unit is considered impaired and is written down to its recoverable amount.

Impairment losses are recognised in the income statement, unless an asset has previously been revalued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through the income statement. Impairment losses recognised in respect of cash generating units are allocated first to reduce the carrying amount of any goodwill allocated to cash-generating units, then to reduce the carrying amount of the other assets in the unit on a pro rata basis.

An assessment is also made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A reversal of the impairment loss may only increase the asset's value up to its carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement unless the asset is carried at revalued amount, in which case it is treated as a revaluation increase.

(t) Payables
These amounts represent unsecured liabilities for goods and services provided to the Group prior to the end of the financial year and short-term financing of deferred origination costs by managed warehouse trusts. Payables are stated at amortised costs.

(u) Interest bearing liabilities
All loans and borrowings are initially recognised at fair value of the consideration received less directly attributable transaction costs. Interest is accrued over the period it becomes due and is recorded as part of payables. After initial recognition, interest bearing loans and borrowings are measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

(v) Employee benefits
(i) Defined contribution superannuation funds
Obligations for contributions to defined contribution superannuation funds are recognised as an expense in the income statement as incurred.

(ii) Wages, salaries, annual leave, sick leave and non-monetary benefits
Liabilities for wages and salaries, including non-monetary benefits, annual leave and accumulating sick leave expected to be settled within 12 months of the reporting date are recognised in other payables in respect of employees' services up to the reporting date. They are measured at the amounts expected to be paid when the liabilities are settled.

(iii) Long service leave
Liability for long service leave is recognised in the provision for employee benefits and measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using interest rates on national government guaranteed securities with terms to maturity that match, as closely as possible, the estimated future cash outflow.

(w) Provisions
A provision is recognised in the balance sheet when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

Where the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognised as a separate asset only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement.

If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

(x) Contributed equity
Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new share or options are shown in equity as a deduction, net of tax, from the proceeds.

Treasury shares are ordinary shares in the Company held by the employee share trust. These shares are issued in respect of the LTIP. Refer note 1(z) for further details.

(y) Earnings per share
Basic earnings per share is calculated by dividing net profit for the year attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the financial period. The number of ordinary shares outstanding includes any shares granted under the employee share incentive plan which have vested and settled.

Diluted earnings per share is calculated by dividing the net profit attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the year (adjusted for the effects of dilutive options and any shares granted under the employee share incentive plan). The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share.

(z) Share based payment transactions

(i) Long Term Equity Based Incentive Plan

The Group has an employee share incentive plan and an employee share trust for the granting of non-transferable options to executives and senior employees. Shares in the Company held by the employee share trust are classified as treasury shares and presented in the balance sheet as a deduction from equity.

Employees of the Group receive remuneration in the form of share based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions).

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined using an option pricing model. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company (market conditions).

In accordance with AIFRS, the cost of equity-settled transactions is recognised in the consolidated accounts, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (vesting date). At the parent entity level, the cost of the equity shares are recognised as an equity distribution, whereby the investment in subsidiary is increased with a corresponding increase in the share based equity reserve.

The cumulative expense or investment recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the number of awards that, in the opinion of the directors of the Group at that date, based on the best available estimate of the number of equity instruments that will ultimately vest.

No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled during the vesting period (other than a grant cancelled forfeiture when the investing conditions are not satisfied), it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

(ii) Employee Incentive Equity Scheme (EIES)

Challenger Connections Ltd (a controlled entity) provides benefits to Inexus employees in the form of share based payment transactions, whereby employees render services in exchange for shares or rights over shares within Inexus. There is currently one plan in place to provide these benefits to designated senior executives (EIES). Under EIES, the employees have an option to receive their vested shares paid as cash. As such, EIES is treated as a cash settled share based scheme.

The liability is measured, initially and at each reporting date until settled, at the fair value of the share appreciation rights, by applying an option pricing model, and the extent to which the employees have rendered services to date. Changes in fair value are recognised in the income statement.

(aa) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of the GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of the acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the Australian Taxation Office (ATO) is included as an asset or liability in the statement of financial position.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the ATO are classified as operating cash flows.

(ab) Restrictions on assets

Investments held in Challenger Life No. 2 Limited can only be used within the restrictions imposed under the Life Insurance Act 1995. The main restrictions are that the assets in a Fund can only be used to meet the liabilities and expenses of that Fund, to acquire investments to further the business of the Fund or as distributions when solvency and capital adequacy requirements are met. Participating policyholders can receive a distribution when solvency requirements are met, whilst shareholders can only receive a distribution when the higher level of capital adequacy requirements are met.

(ac) Significant accounting judgements, estimates and assumptions

The carrying amount of certain assets and liabilities are often determined based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of certain assets and liabilities within the next annual reporting period are:

Impairment of goodwill

The Group assesses whether goodwill is impaired at least annually in accordance with the accounting policy in note 14. These calculations involve an estimation of the recoverable amount of the cash-generating units to which the goodwill is allocated.

Share based payments

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the ordinary shares at the date at which they are granted. The fair value is determined using the Black-Scholes formula taking into account the terms and conditions upon which the equity instruments were granted, as discussed in note 30.

Policy liabilities

Policy liabilities are measured at net present values of estimated future cash flows or, where the result would not be materially different, as the accumulated benefits available to policyholders. Changes in policy liabilities for non-deposit business are recognised in the income statement as revenues or expenses in the financial year in which the changes occur.

Property valuations

Investment properties are stated at fair value, which has been determined based on valuations performed by independent valuers during the year ended 30 June 2006.

The Valuer or Valuation Practice are authorised to practise as a Valuer under the law of the relevant jurisdiction where the valuation takes place. The Valuer performing the valuation has at least five years of continuous experience in the valuation of property of a similar type to the property being valued. Neither the Valuer nor Valuation Practice has a pecuniary interest that could conflict with the valuation of the property. The Valuer and Valuation Practice comply with the Australian Property Institute (API) Code of Ethics and Rules of Conduct.

Valuations are prepared on the basis of Market Value as defined by The International Assets Valuation Standards Committee (TIAVSC) and endorsed by the API.

Market value is the estimated amount for which an asset could exchange on the date of valuation between a willing buyer and willing seller in an arm's length transaction wherein the parties had each acted knowledgeably, prudently and without compulsion.

In determining Market Value, Valuers have examined available market evidence and applied this analysis to both the traditional capitalisation approach and discounted cash flow approach.

Note 2. Revenue

	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m
Revenue				
Rental income	150.5	176.4	–	–
Management fee income	525.7	410.4	–	–
Interest income	90.8	121.4	–	–
Dividend income	33.9	26.6	–	–
Dividend income from controlled entities	–	–	65.0	33.0
Fair value adjustments of:				
– investment property (net of exchange fluctuations)	51.7	82.8	–	–
– infrastructure investments (net of exchange fluctuations)	12.8	36.7	–	–
Net realised gain/(loss) on:				
– properties	24.3	45.8	–	–
– investments and subsidiaries	19.5	50.4	–	–
– foreign exchange	(2.8)	(1.5)	–	–
Unrealised gain/(loss) on/from:				
– trading securities	(1.5)	(1.1)	–	–
– interest rate derivative assets and liabilities	6.2	–	–	–
– FX forward derivative assets and liabilities[1]	(13.7)	(56.2)	–	–
Other income	21.1	7.7	4.4	0.8
	918.5	899.4	69.4	33.8
SPV revenue				
Interest and fee income	1,367.9	1,171.5	–	–
	1,367.9	1,171.5	–	–
Inexus revenue				
Inexus transportation revenue	50.1	–	–	–
Unrealised loss on interest rate swaps[1]	(3.4)	–	–	–
	46.7	–	–	–
Total revenue	2,333.1	2,070.9	69.4	33.8

[1] This includes a $13.7 million loss in 2006 on revaluation of economic hedges in relation to CIF earnings.

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 3. Expenses

Expenses				
Increase in investment contract liability	80.5	–	–	–
Increase in insurance contract liability	5.6	–	–	–
Increase in policy liability	–	139.2	–	–
Property management expenses	15.9	28.7	–	–
Restructure costs	–	10.8	–	–
Intangibles amortisation expense	4.4	2.5	–	–
Amortisation of deferred portfolio and origination costs	74.7	62.1	–	–
Depreciation expense[1]	4.1	4.3	–	–
Employee expenses	172.5	132.3	–	–
Commission expenses	196.0	176.4	–	–
Occupancy expense – operating lease	8.3	8.4	–	–
Occupancy expense – relocation[1]	12.4	–	–	–
Professional fees	13.6	11.7	–	–
Communications	4.7	5.5	–	–
Other expenses	52.9	44.6	1.3	–
	645.6	626.5	1.3	–
SPV expenses				
Interest expenses and distributions	1,367.9	1,171.5	–	–
	1,367.9	1,171.5	–	–
Inexus expenses				
Depreciation expense	9.2	–	–	–
Overheads	19.9	–	–	–
	29.1	–	–	–
Total expenses	2,042.6	1,798.0	1.3	–

[1] The 2006 balances include $13.1 million of expenses associated with the relocation to the Hilton building in Sydney.

Note 4. Finance Costs

Interest expense incurred by property trusts controlled by asset management subsidiaries	22.9	81.2	–	–
Interest expense incurred by Challenger Infrastructure Fund (CIF)	55.0	–	–	–
Interest expense incurred by other entities	24.3	26.9	–	–
Provision discount adjustment	1.0	–	–	–
Other finance costs (CIF)	3.5	–	–	–
Other finance costs	2.8	2.4	–	–
Finance costs	109.5	110.5	–	–

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 5. Income Tax

Major components of income tax expense are:

Income statement				
Current *income* tax				
Current income tax charge	11.2	2.8	(4.3)	0.2
Deferred income tax				
Relating to the origination and reversal of temporary differences	39.9	42.1	–	–
Income tax expense/(benefit) reported in income statement	51.1	44.9	(4.3)	0.2
Statement of equity				
Deferred income tax related to items charged or credited directly to equity				
Gain on sale of forfeited LTIP shares	0.4	–	0.4	–
Income tax benefit reported in equity	0.4	–	0.4	–

A reconciliation between tax expense and the product of accounting profit before income tax multiplied by the Group's applicable income tax rate is as follows:

Net profit before tax	181.0	164.5	68.1	33.8
Add loss relating to minority interest	4.4	–	–	–
Accounting profit before tax	185.4	164.5	68.1	33.8
At the statutory income tax rate of 30% (2005: 30%)	55.6	49.4	20.4	10.1
Recoupment of previously unrecognised tax losses	(5.5)	(19.4)	(5.5)	–
Expenditure not allowable for income tax purposes	8.9	2.7	0.2	–
Provision for potential overseas tax on sale of properties	–	8.8	–	–
Non-assessable items	(2.6)	(3.9)	(19.4)	(9.9)
Other	(5.3)	7.3	–	–
Income tax expense reported in income statement	51.1	44.9	(4.3)	0.2

Deferred income tax

Deferred income tax at 30 June relates to the following:

Consolidated	**Balance sheet**		**Income statement**	
	2006 $m	2005 $m	**2006 $m**	2005 $m
Deferred income tax liabilities				
Unrealised gains on interests in investment property	(104.4)	(44.1)	60.3	15.6
Other	(42.7)	(50.0)	(17.0)	29.9
	(147.1)	(94.1)		

Consolidated	Balance sheet		Income statement	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 5. Income Tax (continued)

Deferred income tax assets				
Provision for transaction costs	–	0.7	0.7	(0.7)
Surplus lease space provision	7.0	5.0	(2.0)	(1.1)
Restructure provision	0.3	–	(0.3)	1.0
Provision for doubtful debts	4.6	1.7	(2.9)	(0.6)
Employee entitlements	2.4	2.4	–	(0.9)
Other	–	1.1	1.1	(1.1)
	14.3	10.9		
Deferred tax income/(expense)			39.9	42.1
Parent				
Deferred income tax liabilities				
Unrealised gains on interests in investment property		(45.5)	–	–
Other	–	(47.0)	–	–
	–	(92.5)	–	–
Deferred income tax assets				
Other	18.8	7.7	–	–
	18.8	7.7		
Deferred tax income/(expense)			–	–

The Group has tax losses arising in Australia of $44.0 million (2005: $49.5 million) that are available for offset against future taxable profits of companies in the tax consolidated group.

Tax consolidation
Challenger Financial Services Group Limited and its 100% owned Australian resident subsidiaries have formed a tax consolidated group with effect from 1 July 2002 and are therefore taxed as a single entity from that date. Challenger Financial Services Group Limited is the head entity of the tax consolidated group.

Tax effect accounting by members of the tax group
Members of the tax consolidated group have applied tax funding principles under which Challenger Financial Services Group Limited and each of the members of the tax consolidated group agree to pay tax equivalent payments to or from the head entity, based on the current tax liability or current tax asset of the member. Such amounts are reflected in the amounts receivable from or payable to each member and the head entity.

The group allocation approach is applied in determining the appropriate amount of current tax liability or current tax asset to allocate to members of the tax consolidated group. Deferred taxes are allocated to members of the tax consolidated group in accordance with the principles of AASB 112.

	2006 $m	2005 $m
Total increase/(reduction) to tax expense of the Company	–	–
Total increase/(reduction) to inter-company assets of the Company	**(178.8)**	34.7
Total increase/(reduction) to equity accounts of the Company	–	–

Note 6. Dividends Paid and Proposed

	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m
(a) Declared and paid during the year				
Final fully franked dividend for the financial year 30 June 2005: 5 cents (2004: nil)	28.8	–	28.8	–
Interim fully franked dividend for the financial year 30 June 2006: 2.5 cents (2005: nil)	14.6	–	14.6	–
	43.4	–	43.4	–
(b) Proposed for approval at the AGM (not recognised as a liability as at 30 June)				
Final fully franked dividend for the financial year 30 June 2006: 5 cents (2005: 5 cents)	29.6	–	29.6	–
Franking credit balance				
The amount of franking credits available for the subsequent financial year are:				
– franking account balance as at the end of the financial year at 30%			59.6	36.7
– franking credits that will arise from the payment of income tax payable as at the end of the financial year			(35.2)	–
			24.4	36.7
– impact on the franking account of dividends proposed or declared before the financial report was authorised for issue but not recognised as a distribution to equity holders during the period			(12.7)	–
			11.7	36.7

The tax rate at which paid dividends have been franked is 30% (2005: 30%).

Dividend proposed will be franked at the rate of 30% (2005: 30%).

	Consolidated 2006 cents	Consolidated 2005 cents

Note 7. Earnings Per Share

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	2006 cents	2005 cents
Basic earnings per share	24.92	22.71
Diluted earnings per share	23.91	22.69
	$m	$m
Net profit attributable to ordinary shareholders for basic earnings per share	134.3	119.6
Net profit attributable to ordinary shareholders for diluted earnings per share	131.6	119.6
	Number	Number
Weighted average number of ordinary shares for basic earnings per share	538,890,140	524,638,103
Effect of dilution:		
– Share options	11,361,710	1,891,821
Adjusted weighted average number of ordinary shares for diluted earnings per share	550,251,850	526,529,924

There have been no other transactions involving ordinary shares or potential ordinary shares since the reporting date and before the completion of these financial statements.

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 8. Cash and Cash Equivalents

	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m
Cash at bank and on hand (excluding CIF)	236.2	221.3	0.3	–
Cash at bank and on hand (CIF)	36.6	–	–	–
Deposits at call	152.7	269.4	–	–
	425.5	490.7	0.3	–

Note 9. Receivables

	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m
Secured loans	62.4	10.6	–	–
Trade debtors	71.7	43.9	–	–
Bills of exchange	9.9	11.9	–	–
Amounts recoverable from managed trusts	16.6	13.8	–	–
Dividends receivable	1.0	1.1	–	–
Interest receivable	10.9	4.8	–	–
Other debtors	67.6	72.2	–	–
Receivables (CIF)[1]	211.8	–	–	–
Tax refunds receivable	51.4	–	51.4	–
Amount receivable from controlled entities	–	–	280.4	250.6
	503.3	158.3	331.8	250.6

[1] This includes $193.6 million related to the second instalment on the CIF security due from minorities.

Note 10. Financial Assets Fair Valued Through Income Statement and Available-for-Sale Assets

	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m
(i) Financial asset fair valued through income statement (2005: Investment assets)				
Debt securities held for trading				
Fixed interest notes	148.6	232.9	–	–
Floating rate notes	217.3	70.2	–	–
Preference shares	92.2	173.2	–	–
Bonds	179.9	170.0	–	–
Other	52.0	96.4	–	–
	690.0	742.7	–	–
Equity securities held for trading				
Shares in listed corporations	4.7	119.0	–	–
Unit trusts and managed funds	58.4	51.7	–	–
Shares in listed corporations held in relation to endowment warrants	94.8	86.3	–	–
Other	5.0	13.5	–	–
	162.9	270.5	–	–
Securities elected to be fair valued through income statement				
Investment in Five Oceans World Fund	50.7	–	–	–
	50.7	–	–	–
Total	903.6	1,013.2	–	–
(ii) Available-for-sale assets	318.5	–	–	–
	318.5	–	–	–
(iii) Infrastructure investments	183.1	344.4	–	–
	183.1	344.4	–	–
(iv) Other financial assets (at fair value)	10.9	0.3	–	–
	10.9	0.3	–	–

	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m

Note 11. Investment Properties

	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m
Indirect property investment at fair value	142.5	12.5	–	–
Land and buildings at fair value	1,658.2	1,670.8	–	–
	1,800.7	1,683.3	–	–
Reconciliation – indirect property investment				
Opening balance	12.5	11.4	–	–
Reclassify prior year indirect property from equity securities	19.4	–	–	–
Acquisition	123.0	–	–	–
Sale of properties	(7.1)	–	–	–
FX gain	2.5	–	–	–
Net revaluation	(7.8)	1.1	–	–
Closing balance	142.5	12.5	–	–
Reconciliation – land and buildings				
Opening balance	1,670.8	2,528.8	–	–
Acquisition	55.8	24.0	–	–
Sale of properties	(137.6)	(946.4)	–	–
Capital expenditure	9.7	9.7	–	–
Net revaluation	59.5	54.7	–	–
Closing balance	1,658.2	1,670.8	–	–
Total closing balance	1,800.7	1,683.3	–	–

Note 11. Investment Properties (continued)

Consolidated entity	Acquisition date	Acquisition price $m	Total cost including additions $m	Carrying value 2006 $m	Valuer	Date of latest valuation	Carrying value 2005 $m
Australian Properties							
Cinema/Retail							
Century City Walk, VIC	4-Jul-00	24.1	22.6	23.5	JLL	30-Jun-06	25.0
Innaloo Cinema Centre, WA	17-Dec-01	20.3	23.4	29.0	KF	30-Jun-06	27.5
Jam Factory, VIC	4-Jul-00	74.9	91.5	105.0	JLL	30-Jun-06	110.3
Rivoli, VIC – SOLD	4-Jul-00	12.7	–	–	JLL	30-Jun-06	21.0
George Street Cinemas, NSW	4-Jul-00	68.5	72.8	83.0	JLL	30-Jun-06	81.0
Sub-sector Cinema/Retail Total		200.5	210.3	240.5			264.8
Retail							
Chapel Street Air Rights, VIC – SOLD	15-May-01	6.0	–	–	JLL	30-Jun-05	14.5
Kings Langley, NSW	29-Jul-01	14.1	14.7	17.6	CBRE	30-Jun-06	16.6
Sub-sector Retail Total		20.1	14.7	17.6			31.1
Social Infrastructure							
County Court, VIC	30-Jun-00	153.6	186.4	248.1	URBIS	30-Jun-06	234.0
Industrial Hi-Tech							
CSIRO, NSW	27-Jun-01	137.0	150.9	162.8	CBRE	31-Dec-05	160.0
Globe, Port Melbourne, VIC	13-Nov-02	17.3	18.5	21.1	Colliers	30-Jun-06	19.0
Goodman Fielder, North Ryde, NSW	23-Feb-01	35.2	35.4	46.5	CBRE	30-Jun-06	45.4
Heidelberg, Waterloo, NSW	7-Jan-00	12.9	13.7	16.0	CBRE	30-Jun-06	15.0
Kraft, Port Melbourne, VIC	28-Jun-02	24.1	25.8	27.5	Colliers	30-Jun-06	26.5
Rexel, North Ryde, NSW	18-Dec-99	15.1	16.5	22.9	CBRE	30-Jun-06	20.6
Sub-sector Industrial Hi-Tech Total		241.6	260.8	296.8			286.5
Industrial Distribution Centre							
Toll Drive, Altona North, VIC	31-Jan-01	18.9	20.1	23.0	Colliers	30-Jun-06	22.5
API, Richlands, QLD	29-Dec-99	10.5	11.1	12.5	Colliers	30-Jun-06	11.1
Auto Group, Enfield, NSW	17-Feb-99	15.6	16.7	24.0	CBRE	30-Jun-06	21.2
Spotlight, Laverton North, VIC	11-May-00	12.1	12.9	15.7	Colliers	30-Jun-06	15.0
Tetra Pak, Fairfield, NSW	15-May-02	17.4	18.5	20.4	CBRE	30-Jun-06	19.8
Sub-sector Industrial Distribution Centre Total		74.5	79.3	95.6			89.6

Consolidated entity	Acquisition date	Acquisition price $m	Total cost including additions $m	Carrying value 2006 $m	Valuer	Date of latest valuation	Carrying value 2005 $m

Note 11. Investment Properties (continued)

Consolidated entity	Acquisition date	Acquisition price $m	Total cost including additions $m	Carrying value 2006 $m	Valuer	Date of latest valuation	Carrying value 2005 $m
Office							
ABS Building, ACT	1-Jan-00	35.2	79.2	134.0	FPD Savills	30-Jun-06	123.9
DIMIA Building, ACT	1-Dec-01	43.4	92.8	101.5	FPD Savills	30-Jun-06	92.0
Discovery House, ACT	28-Apr-98	30.6	36.2	36.5	FPD Savills	30-Jun-06	36.6
Elders House, SA	21-Jun-02	40.2	42.7	48.0	Colliers	30-Jun-06	45.7
Executive Building, Hobart, TAS	30-Mar-01	20.6	21.7	27.1	Colliers	30-Jun-06	25.5
Makerston, QLD	14-Dec-00	38.0	42.0	55.9	Colliers	30-Jun-06	49.0
417 St Kilda Rd, Melbourne, VIC	27-Jun-02	73.0	78.2	64.0	CBRE	30-Jun-06	67.6
Taylors Institute, Waterloo, NSW	16-May-01	35.0	37.4	41.8	CBRE	30-Jun-06	41.2
The Forum, Cisco, NSW	5-Jan-01	96.0	101.6	115.4	Colliers	30-Jun-06	108.1
The Forum, UUNet, NSW	5-Jan-01	61.0	65.8	76.0	Colliers	30-Jun-06	69.0
Sub-sector Office Total		473.0	597.6	700.2			658.6
Land							
Duriff Holdings Pty Ltd[1]	20-Apr-05	24.0	4.0	4.0	N/A	N/A	24.0
Hotel							
Rendezvous Hotels	8-Dec-05	52.0	55.8	55.4	Directors	30-Jun-06	–
Total Australia		1,239.3	1,408.9	1,658.2			1,588.6
United States – Office							
Invesco, Denver, USA – SOLD	31-Dec-02	83.1	–	–	N/A	N/A	82.2
Grand Total Direct Property		1,322.4	1,408.9	1,658.2			1,670.8
CPI Braeside, VIC (JV) – SOLD	29-Dec-99	6.4	–	–	Colliers	30-Jun-05	7.1
CPI Wetherill Park, NSW (JV)	29-Dec-99	4.5	4.5	5.9	CBRE	30-Jun-06	5.4
Property Trust Investments	N/A	141.7	141.7	136.6	N/A	N/A	–
Grand Total Indirect Property		152.6	146.2	142.5			12.5
Grand Total Property		1,475.0	1,555.1	1,800.7			1,683.3

[1] The reduction in carrying value is due to partial sale of land in April 2006 and June 2006 following sub-division.

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 12. Plant and Equipment and Infrastructure Assets

Plant and equipment – at cost	26.3	24.7	–	–
Less: accumulated depreciation	(17.9)	(13.8)	–	–
	8.4	10.9	–	–
Fixed assets under finance lease – at cost	4.1	4.1	–	–
Less: accumulated depreciation	(4.1)	(4.1)	–	–
	–	–	–	–
CIF infrastructure assets and plant and equipment – at cost	282.3	–	–	–
Less: accumulated depreciation	(9.2)	–	–	–
Total infrastructure assets	273.1	–	–	–
Total plant and equipment	281.5	10.9	–	–

Reconciliations

2006	**Plant and equipment $m**	**Fixed assets under finance lease $m**	**CIF infrastructure and plant and equipment $m**	**Total $m**
Consolidated				
Opening balance (net of accumulated depreciation) 1 July 2005	10.9	–	–	10.9
Acquisition of subsidiaries	–	–	241.2	241.2
Additions	3.3	–	30.4	33.7
Disposals	(1.7)	–	–	(1.7)
Depreciation expense	(4.1)	–	(9.2)	(13.3)
Exchange gains/(losses) arising on the translation of foreign PPE	–	–	10.7	10.7
Closing balance (net of accumulated depreciation) 30 June 2006	8.4	–	273.1	281.5

2005	**Plant and equipment $m**	**Fixed assets under finance lease $m**	**CIF infrastructure and plant and equipment $m**	**Total $m**
Consolidated				
Opening balance (net of accumulated depreciation) 1 July 2004	6.0	0.7	–	6.7
Acquisition of subsidiaries	0.6	–	–	0.6
Additions	8.7	–	–	8.7
Disposals	(0.7)	–	–	(0.7)
Depreciation expense	(3.7)	(0.7)	–	(4.4)
Closing balance (net of accumulated depreciation) 30 June 2005	10.9	–	–	10.9

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 13. Goodwill and Other Intangible Assets

Goodwill				
Cost (excluding CIF)	832.8	842.2	–	–
Cost (CIF)	1,030.3	–	–	–
Less: accumulated impairment	(280.0)	(280.0)	–	–
Total goodwill	1,583.1	562.2	–	–
Other intangible assets				
Trade mark – at cost	0.6	–	–	–
Less: accumulated amortisation	(0.1)	–	–	–
	0.5	–	–	–
Software – at cost	26.5	23.7	–	–
Less: accumulated amortisation	(9.9)	(5.5)	–	–
	16.6	18.2	–	–
Total other intangible assets	17.1	18.2	–	–

Consolidated	Goodwill		Software	
	2006 $m	2005 $m	**2006 $m**	2005 $m
Opening balance (net of accumulated amortisation and impairment)	562.2	256.0	18.2	15.2
Acquisitions through business combinations	992.4	104.0	–	–
Additions	–	–	2.8	5.5
Goodwill attributed to sale of acquired businesses	(2.6)	–	–	–
Increase or decrease in goodwill translation to closing rate[1]	37.9	–	–	–
Amortisation expense	–	–	(4.4)	(2.5)
Re-appraisal of fair value of net assets acquired	–	(2.9)	–	–
Restatement of goodwill on internal restructure	–	199.4	–	–
Deferred acquisition costs	(6.8)	5.7	–	–
Closing balance (net of accumulated amortisation and impairment)	1,583.1	562.2	16.6	18.2

[1] In accordance with AASB 121, any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus they shall be expressed in the functional currency of the foreign operation and shall be translated into the presentation currency of the acquirer at the closing rate, with a resultant movement in goodwill reflected in a foreign currency translation reserve.

Note 14. Impairment Testing of Goodwill

Goodwill acquired through business combinations has been allocated to the following cash-generating units for impairment testing as follows:

- Mortgage Management
- Financial Planning
- Funds Management
- Asset Management (excluding CIF)
- CIF

The recoverable amount of goodwill for each cash-generating unit has been determined based on a value in use calculation.

To calculate this, cash flow projections are based on financial budgets approved by senior management covering an appropriate horizon for each cash-generating unit.

The discount rates applied to cash flow projections are set out below and are the same as the long-term average growth rate for the industry in which the unit operates.

Cash-generating unit	2006 Discount rate %	2005 Discount rate %	Cash flow horizon
Mortgage Management	11	11	10[1]
Financial Planning	11	11	5
Funds Management	11	11	5
Asset Management	11	11	5

[1] The 10 year period has been used because this business has a proven history of mortgage market growth which allows easier determination of longer term cash flow assumptions. Further, the business' financial budgets and forecasts are modelled from 10 year forecasts.

The recoverable amount of the CIF cash-generating unit has been determined based on a value in use calculation.

To calculate this, cash flow projections are based on financial budgets approved by senior management covering a 30 year period. A 30 year period has been used given the long-term predictable cash flow characteristics of the asset and the matching of the time periods against the derivative instruments in place. Further, the business' financial budgets and forecasts are modelled from 30 year forecasts.

A discount rate has been applied to cash flow projections which has been provided as a mid point within a range completed by an independent external valuer. The factors considered in calculating the discount rate are the risk free rate, market equity risk premium and company specific adjustments.

Carrying amount of goodwill

	Consolidated												Parent	
	Mortgage Management		Financial Planning		Funds Management		Asset Management		CIF		Total		Total	
$m	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Carrying amount of goodwill	260.0	266.8	126.3	126.3	79.0	81.6	87.5	87.5	1,030.3	–	1,583.1	562.2	–	–

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

- Budgeted gross margins – the basis used to determine the value assigned to the budgeted gross margins is the average gross margins achieved in the year end immediately before the budgeted year, adjusted for expected impact of competitive pressure on margins and any expected efficiency improvements.
- Bond rates – the yield on a government bond rate at the beginning of the budgeted year is utilised and the value assigned to the key assumption is consistent with external information sources. Values assigned to key assumptions reflect past experiences, except for efficiency improvements.
- Growth rates – the growth rates used are consistent with long-term trends in the industry segments in which we operate.

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 15. Other Assets

Deferred portfolio and origination costs	138.8	116.1	–	–
Other	33.4	40.8	–	–
	172.2	156.9	–	–

Note 16. Payables

Trade creditors and accruals	182.6	144.1	–	–
Unsettled trades payable	0.7	1.7	–	–
Warrant liability[1]	96.1	87.5	–	–
Funded expenses[2]	24.1	6.7	–	–
Other creditors	86.5	20.1	–	–
Amounts payable to controlled entities	–	–	185.2	39.1
	390.0	260.1	185.2	39.1

[1] Does not represent an in substance liability of the Company, refer note 34(b) for additional information.

[2] Funded expenses represent loan origination fees initially funded by residential lending trusts managed by the Company. The liabilities are non-interest bearing and are repayable by the Company to the Trusts on terms as agreed between the parties. The expenses are capitalised in the Company and amortised over the life of the loans.

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 17. Financial Liabilities Fair Valued Through Income Statement

Equity securities	18.4	–	–	–
	18.4	–	–	–

	2006			2005		
	Outstanding $m	**Facility $m**	**Unused $m**	Outstanding $m	Facility $m	Unused $m

Note 18. Interest Bearing Liabilities

Bank loans						
CIF Bridge Debt[1]	284.3	320.8	36.5	–	–	–
CIF Senior Bank Debt[1]	679.0	1,095.4	416.4	–	–	–
CIF Junior Bank Debt[1]	87.1	87.1	–	–	–	–
Less Capitalised Line Fees[1]	(7.0)	–	–	–	–	–
Corporate	120.0	350.0	230.0	70.0	350.0	280.0
Controlled property trusts	285.5	285.5	–	348.7	348.7	–
Total bank loans	1,448.9	2,138.8	682.9	418.7	698.7	280.0
Non-bank loans						
Loan Notes to Inexus minority shareholders[1]	14.7	–	–	–	–	–
Inexus preference shares[1]	77.0	–	–	–	–	–
Corporate	230.0	230.0	–	–	180.0	180.0
Total non-bank loans	321.7	230.0	–	–	180.0	180.0
Lease liabilities	0.1	–	–	–	2.0	–
Total interest bearing liabilities	1,770.7	2,368.8	682.9	600.7	878.7	280.0

[1] Relates to interest bearing liabilities of the consolidated Challenger Infrastructure Fund (CIF) which have been incorporated into the Group's balance sheet.

Bridge Debt

Bridge Debt Facilities amounting to $320,819,206 which are secured by a guarantor relationship with Challenger Listed Investments Limited as Responsible Entity for CIF 1 and CIF 2. Any outstanding liability can be enforced against the Guarantor only to the extent to which it can be satisfied out of Trust Property of CIF 1 or CIF 2 out of which it is actually indemnified for the liability.

All amounts owing under the Senior Facilities must be repaid on 28 August 2006 (Termination Date) from the proceeds from the Challenger Investment Fund Second Instalment.

Senior and Junior Bank Debt

The Senior Bank Debt Facility amounting to £440,000,000 and the Junior Bank Debt Facility amounting to £35,000,000 are secured by fixed and floating charges granted by Challenger Connections Company Limited, Challenger Connections Mid Company Limited, Inexus Group (Holdings) Limited and its material subsidiaries over all assets (excluding relevant assets in regulated subsidiaries).

Corporate

The corporate bank facility amounting to $350,000,000 is secured by fixed and floating charges granted by Challenger Group Holdings Limited and Challenger Life Holdings Pty Limited; a fixed charge over the rights of Challenger Managed Investments Limited and Challenger Commercial Lending Limited in the Howard Mortgage Trust; and an Equitable Mortgage of Shares from Challenger Group Holdings Limited over all its shares in Challenger Commercial Lending Limited. In addition, there are cross guarantees in place between certain Group companies.

Controlled property trusts

Bank loans and non-bank loans in the controlled property trusts are secured solely by first mortgages over properties.

Non-bank loans (Corporate)

Working capital was raised via a Net Interest Margin Bond securitisation through the NIM Master Trust Series 2004-A2, 2004-A3 and 2006-A1. The facility is limited in its recourse to the manager to the extent of $1 and holds security over the residual incomes of all Australian securitised trusts. The NIM represents a long-term financing alternative. It is anticipated total outstanding principal will be repaid within four years from June 2006. Interest is fixed and is payable monthly.

Lease liabilities

Lease liabilities are effectively secured as the rights to the leased asset revert to the lessor in the event of default.

	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m

Note 19. Provisions

	2006 $m	2005 $m	2006 $m	2005 $m
Restructuring provision	9.1	11.8	–	–
Surplus lease provision[1]	25.4	18.7	–	–
Relocation provision[1]	5.1	–	–	–
Deferred acquisition consideration	14.5	21.2	–	–
Employee entitlements (note 30)	7.5	7.0	–	–
Other provisions	3.2	8.3	–	–
	64.8	67.0	–	–

Consolidated	Restructuring on acquisition $m	Surplus lease provision $m	Relocation provision $m
Opening balance at 1 July 2005	11.8	18.7	–
Arising during the year	3.1	7.5	5.1
Provision discount adjustment	–	1.0	–
Amounts utilised	(5.8)	(1.8)	–
Restatement in provision	–	–	–
Closing balance at 30 June 2006	9.1	25.4	5.1

Consolidated	Deferred acquisition consideration $m	Employee entitlements $m	Other $m
Opening balance at 1 July 2005	21.2	7.0	8.3
Arising during the year	–	3.4	2.2
Provision discount adjustment	–	–	–
Amounts utilised	–	(2.9)	(7.3)
Restatement in provision	(6.7)	–	–
Closing balance at 30 June 2006	14.5	7.5	3.2

[1] The movement in the surplus lease provision and the relocation provision includes $12.4 million related to the relocation to the Hilton building in Sydney.

Restructuring provision includes provisions for corporate entity restructuring and employee termination benefits. Employee entitlements exclude termination benefits. The restructuring is expected to be completed within the next three years.

Surplus lease provision represents the Group's net rental expense obligation on floors within the Aurora Place building in Sydney. The Group's lease obligation on these floors expires in 2015.

Provision for deferred acquisition consideration is in respect of the acquisition of Interstar Securities Holdings Pty Limited and its controlled entities ('Interstar') which was acquired as part of the acquisition of Zed Capital Markets Australia Structured Finance Pty Limited and its controlled entities on 29 September 2003.

The consideration payable in respect of this acquisition is contingent upon the future performance of Interstar.

The contingent consideration payable in respect of this acquisition is outlined as follows:

- a one-off performance payment calculated by reference to the profitability of the business and loan portfolio as at 30 June 2006; and
- earnings based payments to be made through to 31 December 2011.

This consideration is revised annually by reference to the above noted variables.

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 20. Life Business

	2006 $m	2005 $m	**2006 $m**	2005 $m
(i) Life contract liabilities				
Life investment contract liabilities – at fair value[1]	1,997.3	–	–	–
Life investment contract liabilities – limited recourse secured notes	50.0	–	–	–
Total investment contract liabilities	2,047.3			
Life insurance contract liabilities – at MOS value	91.1	2,271.9	–	–
Total	2,138.4	2,271.9	–	–

[1] In accordance with AASB 1038: *Life Insurance Contracts*, policy liabilities are required to be classified as Life insurance contracts or Life investment contracts. Accordingly, on implementation of AIFRS, certain policy liabilities have been reclassified from Life insurance contracts to Life investment contracts. The Company has elected to adopt the transitional exemption allowed by AASB 1: *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* and has not applied AASB 139 to its comparative information. AIFRS does not permit the disclosure of comparative information in respect of this item, accordingly no comparative information for Life investment contracts has been provided.

Limited recourse secured notes

Limited recourse secured notes are issued by Challenger Capital Markets Limited, a wholly owned subsidiary of Challenger Life No. 2. Challenger Capital Markets Limited is a bankruptcy remote special purpose vehicle (SPV).

The notes issued by the SPV are secured by and restricted in their recourse to a Life investment contract annuity issued by Statutory Fund No. 2 of CL2. The Life investment contract annuity issued by CL2 to the SPV meets the definition of a Life Policy for the purposes of the Life Act and CL2's liability under the policy ranks equally with other policy owners of the Statutory Fund No. 2.

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m
(ii) Life insurance contract liabilities				
(a) Analysis of life insurance contract premium and related revenue				
Total life insurance contract premiums received and receivable	–	714.5	–	–
Inwards reinsurance premiums	–	3.9	–	–
Life insurance contract premium revenue	–	718.4	–	–
Less: component recognised as a change in life insurance contract liabilities	–	(718.4)	–	–
Total life insurance contract premium and related revenue	–	–	–	–
(b) Analysis of life insurance contract claims and related expenses				
Total life insurance contract claims paid and payable				
Inwards reinsurance claims	6.8	601.7	–	–
	0.1	35.9	–	–
Life insurance contract claims expense	6.9	637.6	–	–
Less: component recognised as a change in life insurance contract liabilities	(6.9)	(637.6)	–	–
Total life insurance contract claims and related expenses	–	–	–	–

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 20. Life Business (continued)

(c) Analysis of life insurance contract operating expenses				
Life insurance contract acquisition expenses				
– Commission	–	14.5	–	–
– Other	–	8.8	–	–
Life insurance contract maintenance expenses				
– Commission	0.3	6.7	–	–
– Other	0.1	35.9	–	–
(d) Life insurance contract liabilities				
Life insurance contract liabilities				
Best estimate liability				
– Value of future life insurance contract benefits	81.6	2,057.8	–	–
– Value of future expenses	9.5	138.2	–	–
– Value of future premiums	–	–	–	–
Total best estimate liability	91.1	2,196.0	–	–
Value of future profits				
Shareholders' profit margins	–	75.9	–	–
(e) Reconciliation of changes in life insurance contract liabilities				
Total life insurance contract liabilities at the beginning of the period	92.5	2,052.0	–	–
Change in life insurance contract liabilities recognised in the income statement	5.5	139.2	–	–
Premiums recognised as an increase in life insurance contract liabilities	–	718.4	–	–
Claims recognised as a decrease in life insurance contract liabilities	(6.9)	(637.6)	–	–
Total life insurance contract liabilities at the end of the period	91.1	2,272.0	–	–

(f) Assumptions and methodology applied in the valuation of life insurance contract liabilities

Life insurance contract liabilities, and hence the net profit from life insurance contracts have been calculated using the Margin on Services (MoS) method in accordance with the requirements of Actuarial Standard 1.03: *Valuation of Policy Liabilities* under section 114 of the Life Insurance Act 1995. The Actuarial Standard requires the life insurance contracts to be calculated in a manner that allows for the systematic release of planned margins on services as services are provided to policyholders and premiums are received.

Note 20. Life Business (continued)

The methods and profit carriers used to calculate life insurance contract liabilities for particular policy types are as follows:

Business type	Method	Profit carrier(s)
Individual		
Annuity	Projection	Annuity payments

Key assumptions used in the calculation of life insurance liabilities are:

i. Investment earnings/discount rate
Discount rates are determined based on the current observable, objective rates that relate to the nature, structure and term of the future liability cash flows.

ii. Maintenance expenses
The assumption is based on budgeted maintenance expenses for the year ending 30 June 2007. These expenses are converted to a per policy unit cost or percentage of account balance, depending on their nature, based on an expense analysis for the funds.

iii. Inflation
The assumption is based on long-term expectations of inflation and is reviewed annually for changes in the market environment. The current assumption is 3.42% per annum (2005: 2.5% per annum).

iv. Shareholder tax
The corporate tax rate of 30% has been used. There have been no changes to the bases during the year (or the prior year) which would materially affect the valuation results.

v. Voluntary discontinuances
The assumption is based on past experience investigations. The current assumption range is 0.15% to 1.0% (2005: 0.15% to 1.5%).

vi. Surrender values
Current and future values have been calculated using the surrender bases under the products.

vii. Mortality – annuity products
The mortality assumption is based on IM/IF90 (mortality tables developed by the Institute of Actuaries and the Faculty of Actuaries based on United Kingdom annuitant lives experience from 1990 to 1992) and adjusted for future mortality improvements.

viii. Impact of changes in assumptions
Under MoS, for life insurance contracts valuations using the projection method, changes in actuarial assumptions are generally recognised by adjusting the value of future profit margins in life insurance contract liabilities. Future profit margins are released over future periods.

Changes in actuarial assumptions do not include market related changes in discount rates such as changes in benchmark market yields caused by changes in investment markets and economic conditions. These are reflected in both life insurance contract liabilities and asset values at the balance sheet date.

There was a nil impact on future profit margins of changes in actuarial assumption from 30 June 2005 to 30 June 2006 in respect of life insurance contracts (excluding new business contracts which are measured using assumptions at balance sheet date).

(g) Insurance risk sensitivity analysis – life insurance contracts
For life insurance contracts which are accounted for under MoS, amounts of liabilities, income or expense recognised in the period are unlikely to be sensitive to changes in variables even if those changes may have an impact on future profit margins.

Note 20. Life Business (continued)

The table below reports the sensitivity of life insurance contract liabilities, current shareholder period profit after income tax, and equity, to changes in assumptions relating to insurance risk.

		Change in life insurance contract liabilities		Changes in shareholder profit after income tax, and equity	
Variable		**Gross of reinsurance $m**	**Net of reinsurance $m**	**Gross of reinsurance $m**	**Net of reinsurance $m**
Annuitant mortality	50% increase in the rate of mortality improvement	1.1	–	(0.8)	–
Discontinuance rates	10% increase in discontinuance rates	–	–	–	–
Maintenance expenses	10% increase in maintenance expenses	0.9	0.9	(0.7)	(0.7)

(h) Life insurance risk

The sole life insurance risk of CL2 is annuitant mortality rates. CL2 mitigates the majority of any adverse financial impact arising from annuitant mortality rates by reinsuring (ceding) this risk with a specialist reinsurance company.

(iii) Other life insurance and investment contracts disclosure

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m
(a) Analysis of life insurance and investment contract profit				
Components of profit related to life insurance and investment contract liabilities:				
– Planned margins of revenues over expenses released	–	8.4	–	–
– Profits (losses) arising from difference between actual and assumed experience	25.0	118.0	–	–
Profit related to life insurance and investment contract liabilities				
Attributable to:				
– Life insurance contracts	1.0	126.4	–	–
– Investment contracts	24.0	–	–	–
Investment earnings on assets in excess of life insurance and investment contract liabilities	81.7	123.7	–	–

(b) Restrictions on assets

Investments held in the CL2 Funds can only be used within the restrictions imposed under the Life Insurance Act 1995. The main restrictions are that the assets in a Fund can only be used to meet the liabilities and expenses of that Fund, to acquire investments to further the business of the Fund or as distributions when solvency and capital adequacy requirements are met.

(c) Actuarial information

Mr A Bofinger FIAA, as the Appointed Actuary of CL2, is satisfied as to the accuracy of the data used in the valuations of policy liabilities and solvency reserves in the Financial Report and in the tables in this note. The policy liabilities and solvency reserves have been determined at the reporting date in accordance with the Life Insurance Act 1995.

Investment assets of the life statutory funds comprising cash, equity securities, debt securities, property securities, other financial assets and investment property are held to back investment contract liabilities amounting to $2,047.3 million (2005: nil) and life insurance contract liabilities amounting to $91.1 million (2005: $2,271.9 million). Investment assets are traded on a regular basis taking into account the movements in liabilities as well as incoming cash flows.

For the majority of investment contract and life insurance contract liabilities, there is a fixed settlement date. Based on CL2 assumptions as to likely withdrawal patterns in the various product groups, it is estimated that approximately $136.2 million (2005: $192.4 million) may be settled within 12 months of the reporting date.

Note 21. Consolidation of Special Purpose Vehicles

The Mortgage Management business establishes and services Special Purpose Vehicles which fund pools of residential mortgage loans via the issuance of residential mortgage backed securities in its normal course of business. While Mortgage Management does not provide funding to the Special Purpose Vehicles and all borrowings are limited in recourse to the assets of securitised trusts, it is the residual beneficiary of the fund loans via a nominal investment.

AIFRS requires the Group to consolidate all securitisation Special Purpose Vehicles that were not previously consolidated under AGAAP. The consolidation rules impact both existing and new securitisation arrangements involving the Group's assets and those of its customers. This results in a gross up of assets and liabilities, separately disclosed as they are not considered part of the Group's assets and liabilities from management's perspective. There is also a gross up of revenue and expenses which is separately disclosed in the income statement. There is no impact on total equity, other than for amounts reflected in a cash flow hedge reserve explained hereunder, which has also been separately disclosed.

AASB 139: *Financial Instruments: Recognition and Measurement* requires all derivatives to be recognised on the balance sheet and measured at fair value. Gains and losses arising from changes in fair value will be recognised in the income statement, unless hedge accounting is applied. Where cash flow hedge accounting requirements are met, the carrying value of the hedged item is not adjusted, and the fair value changes on the related hedging instrument (to the extent that the hedge is effective) are deferred in the cash flow hedge reserve. This amount will then be transferred to the income statement at the time the hedged item affects the income statement. Hedge ineffectiveness is recognised in the income statement immediately.

The Special Purpose Vehicles in the Mortgage Management business hedge exposure to interest rate and exchange rate risk using derivative financial instruments. All derivatives in these Special Purpose Vehicles are designated as cash flow hedges, thereby protecting the income statement from significant volatility.

The consolidated balance sheet and cash flow statement for the securitised Special Purpose Vehicles is contained below.

Balance sheet

	Consolidated Special Purpose Vehicles	
	2006 $m	2005 $m
Assets – securitised		
Cash and cash equivalents	1,162.4	709.4
Receivables	18,495.8	16,221.2
Other assets	9.7	6.5
Total assets	19,667.9	16,937.1
Liabilities – securitised		
Payables	91.5	49.0
Derivative liability	15.3	–
Interest bearing liabilities	19,573.4	16,888.1
Total liabilities	19,680.2	16,937.1
Net liabilities	(12.3)	–
Equity		
Cash Flow Hedge Reserve – Special Purpose Vehicles	(12.3)	–
Total equity	(12.3)	–

Note 21. Consolidation of Special Purpose Vehicles (continued)

Statement of cash flows for securitised Special Purpose Vehicles

	Consolidated	
	2006 $m	2005 $m
Cash flows from operating activities		
Receipts from customers (inclusive of GST)	1,364.2	1,169.5
Payments to suppliers and employees (inclusive of GST)	(1,107.4)	(944.8)
Net cash inflow from operating activities	256.8	224.7
Cash flows from investing activities		
Mortgage loans – advanced and purchased	(14,075.8)	(11,245.4)
Mortgage loans repaid and sold	11,773.6	9,139.9
Net cash outflows from investing activities	(2,302.2)	(2,105.5)
Cash flows from financing activities		
Proceeds from borrowings	18,382.2	14,744.0
Repayment of borrowings	(15,883.9)	(12,649.9)
Net cash inflow from financing activities	2,498.3	2,094.1
Net increase in cash and cash equivalents held	453.0	213.1
Cash and cash equivalents at the beginning of the period	709.4	496.1
Effects of exchange rates on cash	–	–
Cash and cash equivalents at the end of the financial period	1,162.4	709.2
Reconciliation of reserves		
SPV reserves		
Cash flow hedge reserve	(12.3)	–
	(12.3)	–
Movements in reserves		
Cash flow hedge reserve		
Opening balance	–	–
AIFRS transition adjustments	(10.0)	–
Net gains/(losses) from changes in fair value	(2.3)	–
	(12.3)	–

	Consolidated and Parent			
	2006		2005	
	No. of shares	**$m**	No. of shares	$m

Note 22. Contributed Equity

	No. of shares 2006	**$m 2006**	No. of shares 2005	$m 2005
(a) Shares on issue				
Ordinary shares	592,303,540	1,412.4	578,231,048	1,363.9
LTIP shares held in trust and treated as treasury shares	(59,360,000)	(168.4)	(48,340,000)	(128.8)
	532,943,540	1,244.0	529,891,048	1,235.1
(b) Movement in shares on issue				
Ordinary shares				
Opening balance	529,891,048	1,235.1	2,439,035,735	1,140.5
Purchase of Associated Planners Group Limited	–	–	203,146,130	91.4
Share consolidation[1]	–	–	(2,113,740,817)	–
Less transaction costs	–	–	–	(1.3)
Balance after share consolidation	529,891,048	1,235	528,441,048	1,230.6
Sale and cancellation of forfeited shares issued under share based payment plan	2,150,000	5.5	1,450,000	4.5
Issuance under dividend reinvestment plan	902,492	3.4	–	–
Less transaction costs	–	–	–	–
Closing balance[2]	532,943,540	1,244.0	529,891,048	1,235.1
LTIP				
Opening balance	48,340,000	128.8	224,400,000	118.2
Share consolidation[1]	–	–	(179,520,000)	–
Shares issued and held on trust	13,600,000	47.4	4,910,000	15.1
Redeem shares forfeited by leavers	(1,790,000)	(4.9)	(1,450,000)	(4.5)
Vested shares transferred to ordinary shares	(790,000)	(2.9)	–	–
Closing balance[2]	59,360,000	168.4	48,340,000	128.8

[1] Effective 25 November 2004, the share capital of the Company was consolidated by converting every five Challenger shares on issue into one Challenger share. Where the consolidation of the Company's share capital resulted in a shareholder having a fractional entitlement to a Challenger share, the Company rounded up any such fractional entitlement to the next whole number.

[2] The shares on issue exclude vested shares under the executive share based payments scheme (LTIP), which have not yet been settled. This can be represented as follows:

	2006 No. of shares	2005 No. of shares
Ordinary shares		
Issued	544,767,540	534,269,048
LTIP vested but not settled	(11,824,000)	(4,378,000)
	532,943,540	529,891,048
LTIP		
Unvested	47,536,000	43,962,000
LTIP vested but not settled	11,824,000	4,378,000
	59,360,000	48,340,000

Note 22. Contributed Equity (continued)

(c) Terms and conditions of shares

Ordinary shares

A holder of a share is entitled to certain rights, including rights:

- to receive dividends as declared;
- to be provided with copies of annual reports and other information in respect of the Company;
- to receive notice of, and vote at, meetings of holders of shares, either in person or by proxy;
- after liquidation of the Company, to receive the distribution of the net proceeds of Company assets according to the number of shares registered at termination; and
- to transfer shares and on death, to pass the shares to a surviving joint holder, or by will or otherwise to the holder's estate.

A holder of a share is entitled to one vote on a show of hands and on a poll, each shareholder will have one vote for each fully paid share, determined from the sale of such shares on the ASX on the trading day immediately before the day on which the poll is taken.

Shares issued under LTIP

The terms and conditions of shares issued under the LTIP are disclosed in note 30 of the financial report.

Note 23. Reserves

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m
Non-CIF reserves				
Equity option premium reserve	61.7	61.7	61.7	61.7
Share based payments premium reserve	16.9	9.4	16.9	9.4
Cash flow hedge reserve	(2.0)	–	–	–
	76.6	71.1	78.6	71.1
CIF reserves				
Available-for-sale securities revaluation reserve	4.6	–	–	–
Cash flow hedge reserve	3.3	–	–	–
Foreign currency translation reserve	11.6	–	–	–
	19.5	–	–	–
Total reserves	96.1	71.1	78.6	71.1
Movements in reserves				
Equity option premium reserve				
Opening balance	61.7	61.7	61.7	61.7
Issue of options to previous option holders of the Company	–	–	–	–
	61.7	61.7	61.7	61.7
Share based payments premium reserve				
Opening balance	9.4	5.3	9.4	5.3
Share based payments for the year	7.5	4.1	7.5	4.1
	16.9	9.4	16.9	9.4
Cash flow hedge reserve – non-CIF				
Opening balance	–	–	–	–
AIFRS transition adjustments	(0.3)	–	–	–
Net gains/(losses) from changes in fair value	(1.7)	–	–	–
	(2.0)	–	–	–

Note 23. Reserves (continued)

	Consolidated 2006 $m	Consolidated 2005 $m	Parent 2006 $m	Parent 2005 $m
Available-for-sale investment revaluation reserve – CIF				
Opening balance	–	–	–	–
Net gains/(losses) from changes in fair value	4.6	–	–	–
	4.6	–	–	–
Cash flow hedge reserve – CIF				
Opening balance	–	–	–	–
Net gains/(losses) from changes in fair value	3.3	–	–	–
	3.3	–	–	–
Foreign currency translation reserve – CIF				
Opening balance	–	–	–	–
Foreign currency translation adjustments	11.6	–	–	–
	11.6	–	–	–

Nature and purpose of reserves

Equity option premium reserve

This reserve represents the valuation assigned to options that were issued to previous option holders of Challenger Financial Services Group and Consolidated Press Holdings Limited as a result of the equity restructure of the parent entity.

Share based payments premium reserve

Under AIFRS (AASB 2) an expense is recognised over the vesting period of share options granted to employees as part of the Long Term Incentive Plan. This expense is based on the valuation of the options granted determined at the grant date. When an instrument is granted, and an expense incurred, there is a corresponding increase in the share based payments reserve recognised as a separate component of equity. The total of this reserve is net of any gain or loss realised on the disposal of forfeited shares held within the scheme.

Cash flow hedge reserve

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Available-for-sale investment revaluation reserve

This reserve includes the cumulative net change in the fair value of available-for-sale investments until the investment is derecognised or sold.

Foreign currency translation reserve

This reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations where their functional currency is different to the presentation currency of the Company.

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 24. Retained Profits/(Losses)

Opening balance[1]	**(183.9)**	(268.9)	**(248.0)**	(281.6)
Net profit for the period	**134.3**	119.6	**72.4**	33.6
Dividends declared	**(43.4)**	–	**(43.4)**	–
Closing balance	**(93.0)**	(149.3)	**(218.9)**	(248.0)

[1] The 30 June 2005 retained loss is impacted by AIFRS, refer to note 39(c) for further details.

	Consolidated 30 June 2006	
	% holding 46.11%	**Minority Interest $m**

Note 25. Total Minority Interests

Challenger Infrastructure Fund (CIF)		
Share capital		387.3
Share issue expenses		(8.5)
Foreign exchange gains and losses		9.8
Distributions provided to security holders		(15.7)
Available for sale securities revaluation reserve		4.0
Cash flow hedge reserve		2.9
Loss after tax for the period attributable to minority interests		(4.4)
		375.4

The Group acquired a 53.89% interest in Challenger Infrastructure Fund through two share allotments on 19 August 2005 (50%) and 24 November 2005 (3.89%). The Challenger Infrastructure Fund on 1 September 2005 acquired a majority interest in Inexus Group (Holdings) Ltd.

Note 26. Segment Information

Business segments
The primary business units of the Group have been identified as follows:

$m	Mortgage Management 2006	Mortgage Management 2005	Special Purpose Vehicles [5] 2006	Special Purpose Vehicles [5] 2005	Financial Planning 2006	Financial Planning 2005
Revenue from external customers	273.2	228.7	1,367.9	1,171.5	144.7	120.9
Intersegment revenue	9.1	7.2	–	–	–	–
Share of net profits of associates	–	–	–	–	0.2	0.1
Total segment revenue	282.3	235.9	1,367.9	1,171.5	144.9	121.0
Expenses						
Depreciation and amortisation	(2.3)	(3.1)	–	–	(0.5)	(0.3)
Other expenses	(202.2)	(171.4)	(1,367.9)	(1,171.5)	(137.1)	(115.3)
Total segment expenses	(204.5)	(174.5)	(1,367.9)	(1,171.5)	(137.6)	(115.6)
Net profit/(loss) before tax	77.8	61.4	–	–	7.3	5.4
Income tax expense						
Net profit after tax						
Segment assets	545.2	448.3	19,668.0	16,942.0	162.6	160.6
Segment liabilities	(132.6)	(82.4)	(19,680.0)	(16,942.0)	(16.7)	(14.4)
Net assets	412.6	365.9	(12.0)	–	145.9	146.2
Acquisition of non-current assets	–	0.1	–	–	–	–

[1] Excludes CIF's consolidated earnings and net assets and includes CIF on a investment accounting basis recognising $18.4 million in distribution income and $14.4 million in transaction fee income derived from CIF. These income amounts are reversed in the eliminations column.

[2] Represents 100% of CIF's earnings and net assets (including CL2's investment in CIF).

[3] Corporate segment includes non-core activities of the Group. (The 2005 balance includes businesses to be restructured or sold as previously announced to the Australian Stock Exchange). Corporate expenses consist of costs that fall outside the day-to-day operations of Asset Management, Mortgage Management, Financial Planning and Funds Management. These costs include the costs of the Group CEO and CFO, shared services across the Company, Directors' fees, corporate borrowings and associated borrowing costs and shareholder registry services for the Group.

[4] Reverses Asset Management's investment in CIF (53.89%).

[5] Special Purpose Vehicles is part of the Mortgage Management segment. It is being separately disclosed to provide greater transparency.

Funds Management		Asset Management[1]		CIF[2]		Corporate[3]		Eliminations[4]		Total Consolidated	
2006	2005	**2006**	2005	**2006**	2005	**2006**	2005	**2006**	2005	**2006**	2005
115.9	73.5	390.6	468.9	64.6	–	6.6	7.4	(30.4)	–	2,333.1	2,070.9
6.4	4.3	(4.3)	0.8	(4.0)	–	–	–	(7.2)	(12.3)	–	–
(0.2)	–	–	2.0	–	–	–	–	–	–	–	2.1
122.1	77.8	386.3	471.7	60.6	–	6.6	7.4	(37.6)	(12.3)	2,333.1	2,073.0
–	–	–	(0.7)	(9.2)	–	(5.6)	(2.7)	–	–	(17.6)	(6.8)
(97.6)	(86.8)	(189.0)	(316.3)	(77.4)	–	(100.9)	(52.7)	37.6	12.3	(2,134.5)	(1,901.7)
(97.6)	(86.8)	(189.0)	(317.0)	(86.6)	–	(106.5)	(55.4)	37.6	12.3	(2,152.1)	(1,908.5)
24.5	(9.0)	197.3	154.7	(26.0)	–	(99.9)	(48.0)	–	–	181.0	164.5
							(51.1)	(44.9)			
							129.9	119.6			
153.8	139.3	3,744.8	3,399.9	2,045.0	–	254.3	301.8	(679.0)	–	25,894.7	21,391.9
(19.0)	(20.9)	(2,861.7)	(2,714.3)	(1,242.1)	–	(558.7)	(461.0)	226.3	–	(24,284.5)	(20,235.0)
134.8	118.4	883.1	685.6	802.9	–	(304.4)	(159.2)	(452.7)	–	1,610.2	1,156.9
–	1.5	–	–	30.4	–	–	–	–	–	30.4	1.6

Note 26. Segment Information (continued)

Geographical segments
The following tables present revenue, expenditure and certain asset information regarding geographical segments:

	Australia		United Kingdom		Total Consolidated	
$m	**2006**	2005	**2006**	2005	**2006**	2005
Revenue						
Revenue from external customers	2,268.5	2,070.9	64.6	–	2,333.1	2,070.9
Intersegment revenue	4.0	–	(4.0)	–	–	–
Share of net profits of associates	–	2.1		–	–	2.1
Total segment revenue	2,272.5	2,073.0	60.6	–	2,333.1	2,073.0
Expenses						
Depreciation and amortisation	(8.4)	(6.8)	(9.2)	–	(17.6)	(6.8)
Other expenses	(2,057.1)	(1,901.7)	(77.4)	–	(2,134.5)	(1,901.7)
Total segment expenses	(2,065.5)	(1,908.5)	(86.6)	–	(2,152.1)	(1,908.5)
Net profit/(loss) before tax	207.0	164.5	(26.0)	–	181.0	164.5
Income tax expense					(51.1)	(44.9)
Net profit after tax					129.9	119.6
Segment assets	23,849.7	21,391.9	2,045.0	–	25,894.7	21,391.9
Segment liabilities	(23,042.4)	(20,235.0)	(1,242.1)	–	(24,284.5)	(20,235.0)
Net assets	807.3	1,156.9	802.9	–	1,610.2	1,156.9
Acquisition of non-current assets	–	1.6	30.4	–	30.4	1.6

Note 27. Financial Instruments

(a) Financial risk management objectives and policies
The Group's principal financial instruments, other than derivatives, comprise cash and cash equivalents, receivables, payables, interest bearing liabilities, available-for-sale assets and financial assets and liabilities fair valued through income statement.

The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as receivables and payables, which arise directly from its operations.

Exposure to credit, interest rate and currency risks arises in the normal course of the Group's business. Derivative financial instruments are used to hedge exposures to fluctuations in foreign exchange rates and interest rates. Instruments used include interest rate futures contracts, forward foreign exchange contracts, cross currency swaps and interest rate swap contracts.

All derivative financial instruments held within *Challenger Life No. 2 Limited (CL2)* are stated at fair value with any gains or losses arising from changes in fair value being taken directly to the income statement for the year. CL2 has elected not to undertake the hedge accounting treatment available under AASB 139 for its derivative financial instruments as the business' underlying assets and liabilities are predominantly fair valued through the income statement.

For all other entities, for the purpose of hedge accounting, hedges are classified as either fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability; or cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecasted transaction. For those that do not qualify for hedge accounting under the requirements of AASB 139, the derivative instruments are stated at fair value with any gains or losses arising from changes in fair value being taken directly to the income statement.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial instruments are disclosed in note 1.

Note 27. Financial Instruments (continued)

(b) Interest rate risk

The principle of using derivative financial instruments is to minimise financial risk from movements in interest rates. The Group's exposure to interest rate risk arises predominantly from assets and liabilities bearing variable interest rates.

Hedging activity is performed using interest rate swaps and futures. A swap transaction obliges the two parties to the contract to exchange a series of cash flows at specified intervals known as payment or settlement dates. A futures contract obliges its owner to buy a specific underlying commodity or financial instrument at a specified price on the contract maturity date (or to settle the value for cash). Futures contracts are exchange traded.

Some Asset Management controlled entities have entered into interest rate derivatives as part of their policy to protect certain borrowings from exposure to movements in interest rates. The contracts require settlement of net interest receivable or payable between 30–120 days. These derivative instruments are fair valued with changes in value directed to the income statement.

The Special Purpose Vehicles in Mortgage Management controlled entities hedge exposure to interest rates arising from funding fixed rate loans with floating rate mortgage backed securities using interest rate swaps. All derivatives in these Special Purpose Vehicles are designated as cash flow hedges. Mortgage Management uses futures contracts to hedge the interest rate basis risk between variable rate loans, which reprice with changes in official interest rates, and issued mortgage backed securities issued which reprice with changes in 30 day and 90 day BBSW. These derivative instruments are designated as cash flow hedges.

The Group hedges a portion of its variable interest rate exposures arising from corporate interest bearing liabilities using an interest rate swap. The change in fair value of the interest rate swap is taken directly to the income statement.

The interest rate swaps' notional and fair values for 2006 and 2005 are presented in the table below:

Description $m	Year	Asset Management	SPV	Corporate	Consolidated Total
Notional contract value	30 June 2006	1,223.2	731.8	50.0	2005.0
	30 June 2005	117.2	669.3	50.0	836.5
Net fair value	30 June 2006	(51.5)	(4.7)	0.3	(55.9)
	30 June 2005	2.1	(1.0)	0.1	1.2
Net fair value (assets)	30 June 2006	6.4	–	0.3	6.7
	30 June 2005	2.1	–	0.1	2.2
Net fair value (liabilities)	30 June 2006	(57.9)	(4.7)	–	(62.6)
	30 June 2005	–	(1.0)	–	(1.0)

The interest rate futures' notional and fair values for 2006 and 2005 are presented in the table below:

Description $m	Year	Asset Management	SPV	Mortgage Management	Consolidated Total
Notional contract value	30 June 2006	505.1	–	7,620.0	8,125.1
	30 June 2005	528.3	–	900.0	1,428.3
Net fair value	30 June 2006	(2.0)	–	(2.6)	(4.6)
	30 June 2005	(1.2)	–	0.1	(1.1)

Note 27. Financial Instruments (continued)

The following table sets out the carrying amount, by maturity, of the financial instruments exposed to interest rate risk:

		Weighted average effective interest rate		1 year or less	
Consolidated	Notes	**2006**	2005	**2006**	2005
$m		**%**	%		
Financial assets					
Fixed rate					
Debt securities	10	6.7	6.7	59.2	137.9
Receivables	9	5.5	4.0%	9.9	3.1
Available-for-sale securities	10	13.0	–	–	–
Securitised receivables	21	7.5	7.4	17.1	14.3
Floating rate					
Cash and cash equivalents	8	5.4	5.1	425.5	490.7
Securitised cash and equivalents	21	5.3	5.3	1,162.4	709.4
Debt securities	10	7.4	6.7	23.4	425.0
Receivables	9	9.2	5.3	1.5	10.6
Available-for-sale securities	10	10.7	–	–	–
Securitised receivables	21	7.6	7.6	–	31.2
				1,699.0	1,822.2
Financial liabilities					
Fixed rate					
Interest bearing liabilities	18	6.9	6.5	–	2.0
Floating rate					
Interest bearing liabilities	18	5.6	6.5	403.5	70.0
Life investment contract liabilities	20	6.2	–	149.1	–
Securitised interest bearing liabilities	21	6.2	6.1	7,612.8	7,637.7
				8,165.4	7,709.7
Net financial assets (liabilities)				**(6,466.4)**	(5,887.5)

The entity has financial assets and liabilities that are subject to a right of set off. The interest rate for both counterparties' financial assets and liabilities are matched and fixed for the term of the deals. Accordingly, they do not give rise to interest rate risk.

		Weighted average effective interest rate		1 year or less	
Parent	Notes	**2006**	2005	**2006**	2005
$m		**%**	%		
Financial assets					
Floating rate					
Cash and cash equivalents	8	5.4	–	0.3	–
Total financial assets				**0.3**	–

Between 1 to 5 years 2006	2005	More than 5 years 2006	2005	Non interest bearing 2006	2005	Total 2006	2005
115.3	134.6	92.7	45.2	–	–	267.2	317.7
13.3	10.7	–	–	375.0	133.9	398.2	147.7
–	–	49.8	–	247.9	–	297.7	–
128.3	143.8	5.2	–	–	–	150.6	158.1
–	–	–	–	–	–	425.5	490.7
–	–	–	–	–	–	1,162.4	709.4
135.6	–	263.8	–	–	–	422.8	425.0
2.0	–	50.2	–	–	–	53.7	10.6
–	–	20.8	–	–	–	20.8	–
–	148.9	18,345.2	15,883.0	–	–	18,345.2	16,063.1
394.5	438.0	18,827.7	15,928.2	622.9	133.9	21,544.1	18,322.3
230.0	180.1	223.1	348.6	–	–	453.1	530.7
759.0	–	155.1	–	–	–	1,317.6	70.0
316.2	–	1,582.0	–	–	–	2,047.3	–
11,400.9	8,833.5	559.7	416.9	–	–	19,573.4	16,888.1
12,706.1	9,013.6	2,519.9	765.5	–	–	23,391.4	17,488.8
(12,311.6)	(8,575.6)	16,307.8	15,162.7	622.9	133.9	(1,847.3)	833.5

Between 1 to 5 years 2006	2005	More than 5 years 2006	2005	Non-interest bearing 2006	2005	Total 2006	2005
–	–	–	–	–	–	0.3	–
–	–	–	–	–	–	0.3	–

Note 27. Financial Instruments (continued)

(c) Credit risk
The Group trades only with recognised, creditworthy third parties. Bills of exchange which have been purchased at a discount to face value are carried on the balance sheet at an amount less than the amount realisable at maturity. The total credit risk exposure of the Group could also be considered to include the difference between the carrying amount and the realisable amount.

At balance date, there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet.

(d) Liquidity risk
Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet cash commitments associated with financial instruments. This may result from either the inability to sell financial assets at their face values; or a counterparty failing on repayment of a contractual obligation; or the inability to generate cash inflows as anticipated. The Group's objective is to manage a balance between continuity of funds and flexibility through the use of various facilities.

(e) Foreign currency risk
CL2 owns investments in Europe, New Zealand and the United States. The currencies giving rise to this risk are primarily British pounds, Euro and US dollars. In order to protect against exchange rate movements the asset management business has entered into forward foreign exchange contracts. The contracts are timed to mature when major cash flows from the investments are scheduled to be paid. The Asset Management business states forward foreign exchange contracts at fair value with movements in fair value being posted against income statement.

The Special Purpose Vehicles in Mortgage Management controlled entities hedge exposure to foreign currency risk arising from issuing mortgage backed securities in foreign currency using cross currency swaps. All derivatives in these Special Purpose Vehicles are designated as cash flow hedges.

The forward foreign exchange contracts' and cross currency swaps' notional and fair values for 2006 and 2005 are presented in the table below:

Description $m	**Year**	**Asset Management**	**SPV**	**Corporate**	**Consolidated Total**
Notional contract value	30 June 2006	826.5	10,920.9	12.1	11,759.5
	30 June 2005	514.0	8,777.5	–	9,291.5
Net fair value	30 June 2006	(12.3)	(10.7)	–	(23.0)
	30 June 2005	2.2	(14.4)	–	(12.2)

The details of the outstanding contracts are as follows:

	Consolidated		**Consolidated**	
	Buy/(sell) australian dollars 2006 $m	**Average exchange rate $m**	Buy Australian dollars 2005 $m	Average exchange rate 2005
Sell GBP Sterling				
Less than 1 year	661.7	0.3965	220.4	0.4188
1–2 years	127.9	0.4062	25.5	0.4127
2–3 years	149.6	0.4223	28.1	0.4127
3–4 years	133.8	0.3853	43.3	0.4127
4–5 years	79.9	0.4718	35.4	0.4127
Greater than 5 years	–	–	3.4	0.4127
	1,152.9		356.1	

Note 27. Financial Instruments (continued)

	Consolidated		Consolidated	
	Buy/(sell) Australian Dollars 2006 $m	**Average Exchange Rate 2006**	Buy Australian dollars 2005 $m	Average exchange rate 2005
Sell US dollars				
Less than 1 year	54.8	0.7393	85.8	0.7554
1–2 years	–	–	4.3	0.5525
2–3 years	–	–	2.7	0.5489
3–4 years	–	–	3.4	0.5466
4–5 years	–	–	3.1	0.5454
Greater than 5 years	14.7	0.7074	23.5	0.5509
	69.5		122.8	
Sell EURO				
Less than 1 year	166.7	0.5826	28.6	0.6111
	166.7		28.6	
Sell SE krona				
Less than 1 year	5.8	5.3264	6.4	5.8957
	5.8		6.4	
Sell NZ dollars				
Less than 1 year	13.2	1.2302	–	–
	13.2		–	
Buy GBP sterling				
Less than 1 year	(340.6)	0.3918	–	–
1–2 years	(64.4)	0.4037	–	–
2–3 years	(72.4)	0.4362	–	–
3–4 years	(70.9)	0.3639	–	–
4–5 years	(34.0)	0.5542	–	–
	(582.2)		–	
Buy US dollars				
Less than 1 year	(5.8)	0.7383	–	–
	(5.8)		–	
Buy EURO				
Less than 1 year	(2.7)	0.5840	–	–
	(2.7)		–	
Buy Japanese yen				
	(2.0)	84.4000	–	–
	(2.0)		–	
Buy Hong Kong dollars				
Less than 1 year	(0.9)	5.6920	–	–
	(0.9)		–	

Note 27. Financial Instruments (continued)

(f) Fair values
The fair values of the Company and Group's financial instruments together with the carrying amounts shown in the balance sheet are as follows:

Consolidated	Carrying amount 2006 $m	Fair value 2005 $m	Carrying amount 2006 $m	Fair value 2005 $m
Cash and cash equivalents	425.5	425.5	490.7	490.7
Receivables	503.3	503.3	158.3	158.3
Investments	–	–	1,013.2	1,013.2
Financial assets fair valued through income statement:				
Debt investments	690.0	690.0	742.7	742.7
Equity investments	162.9	162.9	270.5	270.5
Securities elected to be fair valued through income statement	50.7	50.7	–	–
Available-for-sale assets	318.5	318.5	–	–
Other financial assets	10.9	10.9	0.3	0.3
Derivative assets	6.7	6.7	2.7	4.4
Payables	(390.0)	(390.0)	(260.1)	(260.1)
Financial liabilities fair valued through income statement	(18.4)	(18.4)	–	–
Derivative liabilities	(74.9)	(74.9)	(1.3)	(1.2)
Interest bearing liabilities:				
Finance lease	(0.1)	(0.1)	(2.0)	(2.0)
Bank loans	(1,448.9)	(1,448.9)	(418.7)	(418.7)
Non-bank loans	(321.7)	(321.7)	(180.0)	(180.0)
Life insurance policy liabilities	(2,047.3)	(2,047.3)	–	–
	(2,132.8)	(2,132.8)	1,816.3	1,818.1

Parent	Carrying amount 2006 $m	Fair value 2005 $m	Carrying amount 2006 $m	Fair value 2005 $m
Cash and cash equivalents	0.3	0.3	–	–
Receivables	331.8	331.8	250.6	250.6
Payables	185.2	185.2	(39.1)	(39.1)
	517.3	517.3	211.5	211.5

Market values have been used to determine the fair value of listed available-for-sale and held for trading assets. The fair values of derivatives and interest bearing liabilities have been calculated by discounting the expected future cash flows at prevailing interest rates. The fair value of receivables and payables with a remaining life of less than one year is deemed to be the notional amount.

Note 28. Commitments for Expenditure

Finance leases

The Group has entered into finance leases on certain motor vehicles where it is not in the best interests of the Group to purchase these assets. These leases have an average life of between three and five years with renewal terms included in the contracts. Renewals are at the specific option of the entity that holds the lease. There are no restrictions placed on the lessee by entering into these leases.

Operating leases

The Group has entered into commercial operating leases for the rental of properties where it is not in the best interests of the Group to purchase these properties. These leases have an average life of between 1 and 10 years with renewal terms included in the contracts. Renewals are at the specific option of the entity that holds the lease. Surplus lease space under non-cancellable operating leases has been sub-leased, and the revenue from these leases calculated on a straight line basis is offset against operating lease rentals.

In 2006, the Group has entered into operating leases for the rental of new premises in Sydney. This represents the significant increase in operating lease commitments noted for 30 June 2006. The Group's plans to relocate Sydney staff to the new premises in January 2007.

Details of the relevant commitments are contained below:

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m
Lease commitments				
Commitments payable in relation to leases contracted for at the reporting date but not recognised as liabilities:				
Not later than one year	7.5	7.6	–	–
Later than one year but not later than two years	7.6	7.2	–	–
Later than two years but not later than five years	22.5	17.0	–	–
Later than five years	42.0	19.0	–	–
	79.6	50.8	–	–
Representing:				
Non-cancellable operating leases	79.6	50.7	–	–
Future finance charges on finance leases	–	0.1	–	–
	79.6	50.8	–	–
Operating leases				
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:				
Not later than one year	9.5	8.7	–	–
Later than one year but not later than two years	9.6	8.3	–	–
Later than two years but not later than five years	29.0	20.5	–	–
Later than five years	55.0	25.2	–	–
Less: Liability recognised for surplus lease space and estimate of sub lease liabilities on relocation	(23.5)	(12.0)	–	–
Commitments not recognised in the financial statements	79.6	50.7	–	–

Note 28. Commitments for Expenditure (continued)

Finance leases

Commitments in relation to finance leases are payable as follows:

	Consolidated		Parent	
	Minimum lease payments 2006 $m	Present value of lease payments 2005 $m	**Minimum lease payments 2006 $m**	Present value of lease payments 2005 $m
Consolidated				
Not later than one year	–	–	2.1	2.1
Later than one year but not later than five years	–	–	0.1	0.1
Later than five years	–	–	–	–
Minimum lease payments	–	–	2.2	2.2
Less: Future finance charges	–	–	(0.1)	(0.1)
Total finance lease liabilities	–	–	2.0	2.0

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m
Capital expenditure commitments				
Commitments payable in relation to capital expenditure commitments contracted for at the reporting date but not recognised as liabilities:				
Not later than one year	84.1	54.0	–	–
Later than one year but not later than five years	82.7	–	–	–
Later than five years	45.0	–	–	–
	211.8	54.0	–	–
Remuneration commitments				
Commitments payable for the payment of salaries and other remuneration under long-term employment contracts in existence at the reporting date but not recognised as liabilities:				
Not later than one year	–	–	–	–
Later than one year but not later than five years[1]	2.5	2.5	–	–
Later than five years	–	–	–	–
	2.5	2.5	–	–

[1] Amounts disclosed as remuneration commitments include commitments arising from the service contracts (retention bonus, termination payment) of key management personnel referred to in Executive Service Agreements of the remuneration report that are not recorded.

Note 29. Related Parties

Key management personnel for the year ended 30 June 2006
The key management personnel of Challenger Financial Services Group Limited at any time during the financial year are as follows:

Directors

Peter Leith Polson	Chairman
Graham Allan Cubbin	Non-Executive Director
Russell Richard Roberts Hooper	Non-Executive Director
Ashok Peter Jacob	Non-Executive Director
James Douglas Packer	Non-Executive Director
James Glen Service	Non-Executive Director
Brenda Mary Shanahan	Non-Executive Director

Executive Director

Michael Tilley	Chief Executive Officer

Executives
Current

Mr Robert Woods	Chief Executive, Asset Management
Mr Brian Benari	Chief Executive, Mortgage Management
Mr Chris Cuffe	Ex-Chief Executive, Funds Management and Financial Planning
Mr Dominic Stevens	Deputy Managing Director
Mr Paul Rogan	Chief Financial Officer (from 13 March 2006 to 30 June 2006)
Mr Rob Adams	Chief Executive, Funds Management
Mr Raymond Miles	Managing Director, Financial Planning[1]

Former

Mr Tim Foster	Ex-Chief Financial Officer (from 1 July 2005 to 12 March 2006)

[1] Mr Gregory Kirk commenced in the role of Managing Director, Financial Planning on 26 June 2006. Mr Raymond Miles has taken on the role of Managing Director, Member Firm Relations and Acquisitions.

Transactions with related parties in the wholly owned group
Transactions with related parties (except otherwise disclosed) are conducted on an arm's length basis under normal commercial terms and conditions. Amounts payable and receivable in respect of transactions between entities in the Group are disclosed in notes 9 and 16.

Ultimate parent entity
Challenger Financial Services Group Limited is the ultimate parent entity.

Key management personnel compensation for the year ended 30 June 2006

	Year	Short-term employee benefits $	Post employment $	Share based payments $	Total $
Directors	2006	914,223	24,232	–	938,455
	2005	698,443	26,065	–	724,508
Executive Directors	2006	2,328,421	12,139	2,340,564	4,681,124
	2005	799,930	11,585	52,103	863,618
Executives	2006	9,999,273	90,031	2,193,857	12,283,161
	2005	5,122,642	77,233	2,285,528	7,485,403

The Company has taken advantage of the relief provided by ASIC Class Order 06/50 and has transferred the detailed remuneration disclosures to the Directors' Report. The relevant information can be found in the remuneration report at Section 13 of the Directors' Report.

Note 29. Related Parties (continued)

Shareholdings in Challenger Financial Services Group Limited of Directors and senior Executives

Details of the Directors and senior Executives' shareholdings in the Company as at 30 June 2006 and their affiliates are set out below:

For the year ended 30 June 2006 — **Movement during the year**

Shares held in Challenger Financial Services Group Limited	Held at 1 July 2005	Granted remuneration during 2006	Forfeited during 2006	Net change other during 2006	Held at 30 June 2006 (vested and unvested)	Vested during 2006
	Number	Number	Number	Number	Number	Number
Directors						
P Polson	82,000	–	–	–	82,000	–
G Cubbin	177,702	–	–	–	177,702	–
R Hooper	60,000	–	–	65,000	125,000	–
A Jacob	20,000	–	–	–	20,000	–
J Packer	800,000	–	–	121,988,278	122,788,278	–
J Service	50,001	–	–	–	50,001	–
B Shanahan	1,150,854	–	–	–	1,150,854	–
Executive Directors						
M Tilley	2,022,999	3,000,000	–	–	5,022,999	–
Executives						
R Woods	3,000,000	500,000	–	85,000	3,585,000	600,000
B Benari	3,000,000	500,000	–	–	3,500,000	600,000
C Cuffe	3,205,000	–	–	–	3,205,000	500,000
D Stevens	5,500,000	–	–	–	5,500,000	1,100,000
P Rogan	–	1,000,000	–	–	1,000,000	–
R Adams	3,000,000	–	–	–	3,000,000	600,000
R Miles	600,000	–	–	–	600,000	–
T Foster	1,600,000	–	(1,360,000)	(240,000)	–	–
Total	24,268,556	5,000,000	(1,360,000)	121,898,278	149,806,834	3,400,000

For the year ended 30 June 2005 — **Movement during the year**

Shares held in Challenger Financial Services Group Limited	Held at 1 July 2004	Granted remuneration during 2005	Forfeited during 2005	Net change other during 2005	Held at 30 June 2005 (vested and unvested)	Vested during 2005
	Number	Number	Number	Number	Number	Number
Directors						
P Polson	22,000	–	–	60,000	82,000	–
G Cubbin	177,702	–	–	–	177,702	–
R Hooper	60,000	–	–	–	60,000	–
A Jacob	20,000	–	–	–	20,000	–
J Packer		–	–	800,000	800,000	–
J Service	36,543	–	–	13,458	50,001	–
B Shanahan	1,150,854	–	–	–	1,150,854	–
Executive Directors						
M Tilley	22,999	1,000,000	–	1,000,000	2,022,999	–
Executives						
R Woods	3,000,000	–	–	–	3,000,000	–
B Benari	3,000,000	–	–	–	3,000,000	600,000
C Cuffe	8,200,000	–	–	(4,995,000)	3,205,000	1,600,000
D Stevens	5,500,000	–	–	–	5,500,000	–
P Rogan		–	–	–	–	–
R Adams	3,000,000	–	–	–	3,000,000	–
R Miles		600,000	–	–	600,000	–
T Foster	1,200,000	400,000	–	–	1,600,000	240,000
Total	25,390,098	2,000,000	–	(3,121,542)	24,268,556	2,440,000

Note 29. Related Parties (continued)

Terms and conditions of loan funded share allocations for the year ended 30 June 2006

Executive	Granted number	Grant date	Grant price $	Fair value at grant $	First vest date	Last vest date
M Tilley	3,000,000	19/12/05	2.65	1.32	02/08/06	02/08/09
R Woods	500,000	15/09/05	3.77	0.51	15/09/07	15/09/10
B Benari	500,000	15/09/05	3.77	0.51	15/09/07	15/09/10
P Rogan	1,000,000	15/03/06	3.67	0.50	15/03/08	15/03/11

Shareholdings of Directors at 30 June 2006 were acquired at arm's length prices. There were no dividends paid or payable to the Directors and their affiliates.

Loans to Directors and senior Executives
There were no loans made to Directors and specified Executives as at 30 June 2006. Non-recourse loans to buy shares are treated as options and are not to be included as loans for the purpose of AASB 124. In 2005 and 2006, there were no loans to individuals that exceeded $100,000 at any time.

Mr Tilley is entitled to a $500,000 interest free loan for the purpose of investing in Challenger investment products, other than Challenger shares. Mr Tilley has not utilised this facility.

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m

Note 30. Employee Entitlements

Employee entitlements	7.5	7.0	–	–

Employees of the Group totalled 958 (2005: 901) at balance date.

Long Term Equity Based Incentive Plan (LTIP) – Loan Funded Share Plan
The LTIP was approved by unitholders as part of the equity restructure resolutions of Challenger as part of the corporatisation of Challenger. These resolutions were approved at a meeting of unitholders of CFSG on 22 December 2003.

'Under the terms of the LTIP, eligible employees may acquire Challenger shares, with the cost being financed by a non-recourse, interest bearing loan from Challenger which is repayable on the earlier of the sixth anniversary of the reference date and the date when the participating shares are sold. The reference date is the date of issue of the participating shares, a date determined by the Board not being earlier than 10 April 2003.'

Dividends received on shares that have been issued under the LTIP must be paid to the Company as interest on the associated non-recourse loans. All grants of shares during the period were issued and placed on Trust on behalf of the employee.

There are two types of participants of Challenger's LTIP:

- Participants; and
- Initial Participants.

The performance hurdles in respect of Participants are summarised as follows:

- with the exception of Mr Cuffe, subject to performance hurdles being met, 20% of the participating shares issued to Participants will be released on each of the second, third and fourth anniversaries of the date the shares are issued with the remaining 40% balance released on the fifth anniversary;

Note 30. Employee Entitlements (continued)

- Mr Cuffe has voluntarily reduced his participating share entitlement on two occasions, upon stepping down as CEO on 2 August 2004 (4.4 million reduction in post share consolidation shares) and subsequently in March 2005 (395,000 reduction in post share consolidation shares). Therefore Mr Cuffe has an interest in 3,205,000 participating shares, subject to performance hurdles being met, these shares will be released as follows:
  - 1,600,000 released on 10 April 2005
  - 500,000 released on 10 April 2006
  - 500,000 to be released on 10 April 2007
  - 605,000 to be released on 10 April 2008;
- the performance hurdle is 15% per annum compounded annually, based on total shareholder return (TSR). The TSR is determined by reference to the 20 day volume weighted average share price (VWAP) for Challenger shares adjusted for capital restructures and distributions (dividends, capital returns and other distributions excluding franking credits);
- if the TSR for a period equals or exceeds the performance hurdle for that period, the relevant proportion of participating shares will be immediately released. This may include participating shares that have not been released in an earlier period because the TSR for that earlier period was not achieved; and
- unreleased participating shares are forfeited upon the resignation of Participants except in the case of Mr Cuffe who would maintain his LTIP shares if he leaves by his choice on or after 30 June 2006.

On the release of participating shares (once vesting and performance hurdles have been met) Participants may, but are not obliged to sell the shares.

The Board has identified a number of Initial Participants for whom special conditions apply, having regard to:

- the improvement in the share price since the relevant senior Executives were recruited;
- the significant efforts made to date by the relevant senior Executives in restructuring the Company business to prepare for future growth; and
- the fact that the Company continues to be in a significant development phase for the next few years and the Board wishes to ensure that absolute performance hurdles do not drive short-term behaviour at the expense of long-term planning and decision-making.

The special conditions to apply to Initial Participants are as follows:

- the release dates of shares will be calculated from a reference date which is nominated by the Board (rather than the date of issue of shares), being no earlier than April 2003;
- the issue price for the initial participating shares to be allocated to the Initial Participants was $2.65 (as adjusted for the share consolidation on 25 November 2004) rather than the market price at the date of issue;
- no performance hurdle was required to be met for the initial 20% of the participating shares which were released after two years from the reference date; and
- a 15% per annum compound TSR performance hurdle will be required to be met for the release of shares after the third, fourth and fifth anniversaries from the reference date, with the starting price for that calculation being $2.65 (post share consolidation) and the starting date for that calculation being the second anniversary of the reference date.

Any unreleased participating LTIP shares will be sold by the Custodian to reduce any outstanding loan, bought back under the LTIP or cancelled by Challenger, subject to compliance with the law.

Under the terms of the LTIP, Participants and Initial Participants are not entitled to voting rights until the shares have vested and the associated loan has been repaid to the Company.

Note 30. Employee Entitlements (continued)

Details of the movement and fair value of employee shares under the LTIP are detailed in the following table:

Grant date	Opening balance 01-Jul-05 Number	Granted Number	Issue price[1] $	Vested Number	Forfeited/ Modified[2] Number	Balance at 30-Jun-06 Number	FV at grant date[3] $
Initial Participants							
22-Jan-04	1,605,000	–	2.65	(500,000)	–	1,105,000	0.43
23-Feb-04	26,582,000	–	2.65	(6,676,000)	(1,930,000)	17,976,000	0.41
01-Apr-04	320,000	–	2.65	(80,000)	–	240,000	0.38
15-Mar-05	1,100,000	–	3.19	–	(600,000)	500,000	0.42
Participants							
03-Mar-04	4,550,000	–	2.50	(870,000)	–	3,680,000	0.33
01-Apr-04	550,000	–	2.50	(110,000)	(200,000)	240,000	0.32
15-Sep-04	4,650,000	–	2.24	–	–	4,650,000	0.28
15-Mar-05	1,805,000	–	3.19	–	–	1,805,000	0.42
26-Apr-05	1,800,000	–	3.20	–	(230,000)	1,570,000	0.41
15-Sep-05	–	5,700,000	3.77	–	(250,000)	5,450,000	0.51
15-Mar-06	–	4,900,000	3.67	–	–	4,900,000	0.50
CEO – Initial Participant							
23-Dec-04	1,000,000	–	2.65	–	–	1,000,000	0.19
19-Dec-05	–	3,000,000	2.65	–	–	3,000,000	1.32
Total	43,962,000	13,600,000	–	(8,236,000)	(3,210,000)	46,116,000	–

[1] The issue price of grants in respect of participating shares is the VWAP of the shares over the five trading days up to and including the date of issue of that participating share.

[2] Mr Cuffe voluntarily reduced his participating share entitlement on two occasions, upon stepping down as CEO on 2 August 2004 (4.4 million reduction in post share consolidation shares) and subsequently in March 2005 (395,000 reduction in post share consolidation shares).

[3] Grant fair value represents the fair value of the shares issued at grant date calculated after taking into account all relevant factors including vesting timeframes, performance hurdles, share price volatility, dividend rates and interest rates.

CEO remuneration

Mr Tilley is not entitled to participate in the Challenger LTIP. However, following shareholder approval at the Company Annual General Meeting on 23 November 2004 Mr Tilley was allocated 1,000,000 restricted post share consolidation Challenger shares, funded via limited recourse loan and issued at $2.65. He was subsequently issued 3,000,000 subject to the same conditions. These shares were issued substantially on the same terms as the long-term incentive plan limited recourse loan and escrow conditions, with a reference date of 2 August 2004, the date Mr Tilley became CEO.

Employee option plans

No options were granted to employees of the Group during the year ended 30 June 2006. No options were exercised during the year ended 30 June 2006.

Note 31. Statement of Cash Flows

	Consolidated		Parent	
	2006 $m	2005 $m	**2006 $m**	2005 $m
Reconciliation of profit after income tax to net cash flows from operating activities				
Profit after tax	134.3	119.6	72.4	33.6
Adjustments for:				
(Profit)/loss on sale of investments	(41.6)	(94.7)	–	–
Net unrealised losses on investments	(52.2)	(62.3)	–	–
Profit from minority interest	(4.4)	–	–	
Share of associates' net (profits) and losses	–	(2.1)	–	–
Amortisation and depreciation	92.4	68.9	–	–
Other	64.5	153.5	(7.4)	–
Change in assets and liabilities, net of effects from purchase of controlled entity:				
Decrease/(increase) in receivables	(85.6)	138.5	–	–
Decrease/(increase) in other assets	(15.5)	(13.3)	–	(0.8)
Increase/(decrease) in payables	(75.9)	(187.6)	–	–
Increase/(decrease) in provisions and employee benefits	2.3	39.5	–	–
Increase/(decrease) in current tax liability	(54.3)	44.9	–	–
Increase/(decrease) in deferred tax assets/liabilities	49.6	33.6	–	0.2
Net cash inflow from operating activities	13.6	238.5	65.0	33.0

Note 32. Remuneration of Auditors

	$	$	**$**	$
Amounts received or due and receivable by Ernst & Young for:				
Audit or review of the financial report of the entity and any other entities in the Group.				
Full year audit	1,116,000	929,000	–	–
Half year review	233,000	172,000		
Other audit services – audit of trusts and funds	988,000	787,000	–	–
Other services in relation to the entity and any other entity in the Group				
Taxation services	1,553,000	990,000	–	–
Due diligence services	2,219,000	390,000	–	–
Actuarial	–	44,000	–	–
Other assurance services	473,000	438,000	–	–
	6,582,000	3,750,000	–	–
Amounts received or due and receivable by auditors other than Ernst & Young for:				
Audit or review of the financial report of subsidiary entities	–	15,000	–	–
	–	15,000	–	–

Auditors' remuneration for the Group is paid by Challenger Group Services Limited, a wholly owned subsidiary of the Company.

Note 33. Acquisition and Disposal of Controlled Entities

(a) Acquisition of Challenger Infrastructure Fund
The Group acquired a 53.89% interest in Challenger Infrastructure Fund through two share allotments on 19 August 2005 (50%) and 24 November 2005 (3.89%). The total consideration paid amounted to $226,326,000.

(b) Acquisition of Inexus Group (Holdings) Limited
On 1 September 2005, the Challenger Infrastructure Fund acquired a majority interest in a foreign subsidiary Inexus Group (Holdings) Limited, from STAR Capital Partners Limited for a purchase price of $1,116,883,000.

The goodwill acquired together with any fair value adjustments is accounted for in accordance with AASB 121: *The Effects of Changes in Foreign Exchange Rates* which requires that any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate.

The goodwill recorded in pounds sterling at the date of transition amounted to £414,845,000. The goodwill is thus subject to exchange fluctuations.

In the period to 30 June 2006, Inexus contributed a net loss of $23.9 million to the consolidated net profit for the year.

The fair value of the identifiable assets and liabilities of Inexus as at the date of the acquisition are:

	Consolidated 2006 $m
Consideration	
Cash and other consideration	1,116.9
Acquisition costs	43.9
	1,160.8
Net assets acquired	
Cash and other assets	12.0
Receivables	14.3
Infrastructure assets	232.1
Work in progress	9.8
Payables	(98.6)
Provisions	(1.2)
	168.4
Goodwill	992.4

(c) Disposals of controlled entities
During the 2006 financial year, the Group disposed of its entire interest in the wholly owned entity, Challenger Funds Management Limited on 19 April 2006.

Details of the disposals are as follows:

	Consolidated 2006 $m Challenger Funds Management Limited
Consideration[1]	7.4
Net assets disposed	6.1
Profit on disposal	1.3

[1] Consideration is disclosed net of debt repayments, settlement of swap break costs and associated selling costs.

The operating results of the controlled entities to the date of disposal have been included in the consolidated operating profit.

Note 34. Investments in Controlled Entities

(a) Controlled entities

Name of entity	Country of incorporation	Class of shares	Equity holding 2006 %	Equity holding 2005 %
Directly controlled by Challenger Financial Services Group Limited:				
Challenger Financial Services Group	Australia	Ordinary	100	100
CFSG Holdings No.2 Victoria Pty Limited	Australia	Ordinary	100	100
Directly controlled by FXF Holdings Pty Limited:				
FXF Investments Pty Limited	Australia	Ordinary	50	50
FXF Finance Pty Limited	Australia	Ordinary	100	100
Directly controlled by FXF Finance Pty Limited:				
FXF Investments Pty Limited	Australia	Ordinary	50	50
Directly controlled by CFSG Holdings No.2 Victoria Pty Limited:				
Challenger Group Holdings Limited	Australia	Ordinary	100	100
FXF Holdings Pty Limited	Australia	Ordinary	100	100
Directly controlled by Challenger Group Holdings Limited:				
Challenger Group Services Pty Limited	Australia	Ordinary	100	100
Challenger Property Capital Limited	Australia	Ordinary	100	100
Challenger International Nominees Limited	Australia	Ordinary	100	100
Challenger Superannuation Pty Limited	Australia	Ordinary	100	100
Challenger Equity Lending Limited	Australia	Ordinary	100	100
Challenger Treasury Limited	Australia	Ordinary	100	100
Challenger Commercial Lending Limited *(formerly Challenger Mortgage Management Limited)*	Australia	Ordinary	100	100
Challenger Group Pty Limited (i)	Australia	Ordinary	100	100
Endowment Warrants Limited *(formerly Challenger Equities Limited) (i)*	Australia	Ordinary	100	100
Challenger Portfolio Management Limited	Australia	Ordinary	100	100
Challenger Wholesale Finance Holdings Pty Limited *(formerly Challenger Mortgage Finance Pty Limited)*	Australia	Ordinary	100	100
Beston Pacific Vineyard Management Limited	Australia	Ordinary	100	100
Challenger Strategic Capital Pty Limited	Australia	Ordinary	100	
Challenger Life Holdings Pty Limited *(formerly IROKA Pty Limited)*	Australia	Ordinary	100	100
Challenger Wealth Management Pty Limited *(formerly CFSG Holdings No.1 Victoria) Pty Limited)*	Australia	Ordinary	100	100
Challenger International (New Zealand) Limited (vi)	New Zealand	Ordinary	100	100
Directly controlled by Challenger Group Services Pty Limited:				
Challenger Group Services (UK) Limited	UK	Ordinary	100	100
Directly controlled by Challenger Group Pty Limited:				
Challenger Freeholds Limited	Australia	Ordinary	100	100
Challenger Hedging Limited	Australia	Ordinary	100	100
Directly controlled by Challenger Hedging Limited:				
Challenger Lending No. 1 Pty Limited	Australia	Ordinary	100	100
Directly controlled by Challenger Treasury Limited:				
Challenger Property Finance Limited	Australia	Ordinary	100	100

Note 34. Investments in Controlled Entities (continued)

(a) Controlled entities (continued)

Name of entity	**Country of incorporation**	**Class of shares**	**Equity holding 2006 %**	Equity holding 2005 %
Directly controlled by Challenger Wholesale Finance Holdings Pty Limited:				
ZCM Australia Asset Holdings Limited	Bermuda	Ordinary	100	100
Interstar Non-Conforming Finance Management Pty Limited *(formerly TMA Management Pty Limited)*	Australia	Ordinary	100	100
Interstar Non-Conforming Finance Pty Limited *(formerly The Mortgage Alternative Pty Limited)*	Australia	Ordinary	100	100
Interstar Special Servicing Pty Limited *(formerly TMA Special Servicing Pty Limited)*	Australia	Ordinary	100	100
Challenger Inventory Finance Servicing Pty Limited *(formerly The Mortgage Alternative Holdings Pty Limited)*	Australia	Ordinary	100	100
Directly controlled by Challenger Inventory Finance Servicing Pty Limited:				
TMA C Warehouse C Trust	Australia	Ordinary	100	100
Directly controlled by Interstar Non-Conforming Finance Pty Limited:				
INC C Warehouse C Trust	Australia	Ordinary	100	100
Interstar Titanium Series 2004-1 Trust	Australia	Ordinary	100	100
Interstar Titanium Series 2005-1 Trust	Australia	Ordinary	100	100
Directly controlled by ZCM Australia Asset Holdings Limited:				
Interstar Wholesale Finance Holdings Pty Ltd *(formerly Interstar Securities Holdings Pty Limited)*	Australia	Ordinary	100	100
Directly controlled by Interstar Wholesale Finance Holdings Pty Ltd:				
Interstar Wholesale Finance Pty Limited *(formerly Interstar Securities (Australia) Pty Limited)*	Australia	Ordinary	100	100
Interstar Securities (International) Pty Limited	Australia	Ordinary	100	100
Interstar Securities (NZ) Pty Limited	Australia	Ordinary	100	100
Directly controlled by Interstar Wholesale Finance Pty Limited:				
Interstar Home Loan Corporation Pty Limited	Australia	Ordinary	100	100
Interstar Securitisation Management Pty Limited	Australia	Ordinary	100	100
Interstar Millennium Series 2001-1C Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-1E Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-2 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-3 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2002-1G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2002-2 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-1G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-2 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-3G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-4 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-5G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-1E Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-2G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-3P Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-4E Trust	Australia	Ordinary	100	100

Note 34. Investments in Controlled Entities (continued)

(a) Controlled entities (continued)

Name of entity	Country of incorporation	Class of shares	Equity holding 2006 %	Equity holding 2005 %
Interstar Millennium Series 2004-5 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2005-1G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2005-2L Trust	Australia	Ordinary	100	–
Interstar Millennium Series 2005-3E Trust	Australia	Ordinary	100	–
Interstar Millennium Series 2006-1 Trust	Australia	Ordinary	100	–
Interstar Millennium Series 2006-2G Trust	Australia	Ordinary	100	–
NIM Master Trust Series	Australia	Ordinary	100	100
Interstar Millennium Series Ware Mill A Trust	Australia	Ordinary	100	100
Interstar Millennium Series Ware Mill B Trust	Australia	Ordinary	100	100
Interstar Millennium Series Ware Mill D Trust	Australia	Ordinary	100	100
Interstar Millennium Series Ware Mill J Trust	Australia	Ordinary	100	100
Interstar Millennium Series Ware Mill N Trust	Australia	Ordinary	100	100
Interstar Millennium Series Ware Mill R Trust	Australia	Ordinary	100	100
Interstar Millennium Series Ware Mill S Trust	Australia	Ordinary	100	100
Interstar Millennium Series Ware Mill G Trust	Australia	Ordinary	100	–
Interstar Millennium Series Ware Mill U Trust	Australia	Ordinary	100	–
Interstar Millennium Series Ware Mill V Trust	Australia	Ordinary	100	–
Interstar NZ Millennium Warehouse W Trust	New Zealand	Ordinary	100	100
Interstar NZ Millennium Series 2004-A Trust	New Zealand	Ordinary	100	100
Directly controlled by Interstar Securities (NZ) Pty Limited:				
Interstar Home Loan Corporation NZ Limited	New Zealand	Ordinary	100	100
Interstar Wholesale Finance NZ Limited	New Zealand	Ordinary	100	100
Interstar Mortgage Management Pty Limited	Australia	Ordinary	100	100
Directly controlled by Challenger Life Holdings Pty Limited:				
Challenger Life Pty Limited *(formerly Challenger Life Limited)*	Australia	Ordinary	100	100
Challenger Listed Investments Limited *(formerly Challenger Beston Limited)*	Australia	Ordinary	100	100
Challenger Property Funds Management Limited	Australia	Ordinary	100	100
Challenger Property Asset Management Pty Limited	Australia	Ordinary	100	100
Challenger Management Services Limited *(formerly Challenger Biotech Management Limited)*	Australia	Ordinary	100	100
Directly controlled by Challenger Life Pty Limited:				
Challenger Life No. 2 Limited	Australia	Ordinary	100	100
Directly controlled by Challenger Life No. 2 Limited:				
Challenger Corporate Superannuation Pty Limited	Australia	Ordinary	100	100
e-Financial Capital Limited	Australia	Ordinary	100	100
Challenger Property Nominees Pty Limited	Australia	Ordinary	100	100
Challenger Capital Markets Limited	Australia	Ordinary	100	100
Challenger Life (UK) Limited	United Kingdom	Ordinary	100	100
CPHIC Investments Pty Limited	Australia	Ordinary	100	100
Challenger Inventory Finance Pty Limited *(formerly CPHIC Financial Services Pty Limited)*	Australia	Ordinary	100	100
Allfine Holdings Pty Limited	Australia	Ordinary	100	100
Bluezen Pty Limited	Australia	Ordinary	100	100

Note 34. Investments in Controlled Entities (continued)

(a) Controlled entities (continued)

Name of entity	Country of incorporation	Class of shares	Equity holding 2006 %	Equity holding 2005 %
Directly controlled by Challenger Listed Investments Limited:				
Challenger US Infrastructure Holdings Pty Limited	Australia	Ordinary	100	–
Inexus Asutralian Holding Company Pty Limited	Australia	Ordinary	100	–
CSPP1 Investment Company 1 Pty Limited	Australia	Ordinary	100	–
Beston Financial Management Pty Limited	Australia	Ordinary	100	100
Directly controlled by Challenger International (New Zealand) Limited:				
Challenger Securities (New Zealand) Limited	New Zealand	Ordinary	100	100
Directly controlled by Challenger Commercial Lending Limited:				
Howard Pacific Pty Limited	Australia	Ordinary	100	100
HFH Staff Pty Limited	Australia	Ordinary	100	100
Directly controlled by Challenger Wealth Management Pty Limited:				
Garrisons Pty Limited (ii)	Australia	Ordinary	100	100
Challenger Managed Investments Limited (iii)	Australia	Ordinary	100	100
Synergy Capital Management Limited (iv)	Australia	Ordinary	100	100
Genesys Group Limited *(formerly Associated Planners Group Limited)* (ii)	Australia	Ordinary	100	100
Challenger Funds Management (Nominees) Pty Limited (v)	Australia	Ordinary	100	100
Challenger Margin Lending Limited (ii)	Australia	Ordinary	100	100
Directly controlled by Challenger Margin Lending Limited:				
Challenger ML Nominees Pty Limited	Australia	Ordinary	100	100
Directly controlled by Challenger Property Nominees Pty Limited:				
Sabrand Limited	Cyprus	Ordinary	100	100
Mawbury Pty Limited	Australia	Ordinary	100	100
TLG Services Pty Limited	Australia	Ordinary	100	100
TLGH Pty Limited	Australia	Ordinary	100	100
Talaverra Herring Pty Limited	Australia	Ordinary	100	100
Directly controlled by TLGH Pty Limited:				
The Liberty Group Consortium Pty Limited	Australia	Ordinary	100	100
Directly controlled by Mawbury Pty Limited:				
Cescade Pty Limited	Australia	Ordinary	100	100
Directly controlled by Sabrand Limited:				
Challenger Hungary International Capital Investment and Management Limited	Hungary	Ordinary	100	100
Directly controlled by Challenger Hungary International Capital Investment and Management Limited:				
Challenger South Monaco LLC (US)	USA	Ordinary	100	100
Directly controlled by Garrisons Pty Limited:				
Northstar Lending Pty Limited	Australia	Ordinary	100	100
Foundation Wealth Advisers Pty Limited	Australia	Ordinary	100	100
Directly controlled by Synergy Capital Management Limited:				
Galaxy Investment Wrap Pty Ltd	Australia	Ordinary	100	100

Note 34. Investments in Controlled Entities (continued)

(a) Controlled entities (continued)

Name of entity	Country of incorporation	Class of shares	Equity holding 2006 %	Equity holding 2005 %
Directly controlled by Genesys Group Limited:				
Genesys Wealth Advisers Limited *(formerly Associated Planners Financial Services Limited)*	Australia	Ordinary	100	100
AP Adviser Strategies Pty Limited	Australia	Ordinary	100	100
AP Strategic Finance (WA) Pty Limited	Australia	Ordinary	100	100
Associated Planners Strategic Finance Pty Limited	Australia	Ordinary	100	100
Solar Risk Pty Limited	Australia	Ordinary	100	100
Bain Financial Group Pty Limited	Australia	Ordinary	100	100
Associated Planners Asia Pty Limited	Australia	Ordinary	100	90

(i) These controlled entities have been granted relief from the necessity to prepare financial reports in accordance with Class Order 98/1418 issued by the Australian Securities & Investments Commission. For further information see note 35.
(ii) As at 30 June 2005, these entities were 100% controlled by Challenger Group Holdings Limited.
(iii) As at 30 June 2005, this entity was 100% controlled by Challenger Commercial Lending Limited.
(iv) As at 30 June 2005, this entity was 100% controlled by Garrisons Pty Limited.
(v) As at 30 June 2005, this entity was 100% controlled by Challenger Funds Management Limited.
(vi) As at 30 June 2005, this entity was 100% controlled by Challenger Portfolio Management Limited.

(b) Assignment of warrants business

In an agreement dated 30 April 2004, Challenger entered into a Deed of Assignment with Westpac Banking Corporation (WBC) whereby all legal and beneficial rights, title and interests in respect of the following assets and liabilities were assigned to WBC.

	Consolidated 2006 $m	Consolidated 2005 $m
Shares in listed corporations held in relation to endowment warrants	94.9	86.3
Dividends receivable	1.2	1.2
Warrant liability	(96.1)	(87.5)
	–	–

Note 35. Deed of Cross Guarantee

The following wholly owned companies are parties to a Deed of Cross Guarantee under which each company guarantees the debts of the others. By entering in the deed, the wholly owned companies have been relieved from the requirement to prepare a financial report and directors' report under Class Order 98/1418 (as amended by Class Order 98/2017 and 00/0321) issued by the Australian Securities & Investments Commission:

- Challenger Group Pty Limited
- Endowment Warrants Limited

The above companies represent a 'Closed Group' for the purposes of the Class Order, and as there are no other parties to the Deed of Cross Guarantee that are controlled by the Company, they also represent the 'Extended Closed Group. The following companies were released from their obligations under the Deed by executing Revocation deeds in February 2006:

- Challenger International Nominees
- Venture Link Australia Limited
- Challenger Freeholds Limited.

Set out below is a consolidated income statement of the Closed Group for the year ended 30 June 2006.

	2006 $m	2005 $m
Revenue	1.2	–
Other expenses	(0.4)	–
Profit/(Loss) before income tax expense	0.8	–
Income tax expense	–	0.4
Total changes in equity other than these resulting from transactions with owners as owners	0.8	(0.4)

Set out below is a summary of the movements in consolidated retained profits for the year ended 30 June 2006.

	2006 $m	2005 $m
Retained earnings/(losses) at the beginning of the financial period	(1.6)	(17.6)
Profit from ordinary activities after income tax expense	0.8	(0.4)
Retained earnings/(losses) at the end of the financial period	(0.8)	(18.0)

Reconciliation of closing and opening retained losses is set out below:

	Opening retained as @ 1/7/2005 $m	Closing losses as @ 30/6/2005 $m
Challenger Group Pty Ltd	(2.8)	(2.8)
Endowment Warrants Limited (formerly Challenger Equities Limited)	1.2	1.2
Challenger International Nominees Ltd (Revoked in February 2006)	–	(16.4)
Total	(1.6)	(18.0)

Note 35. Deed of Cross Guarantee (continued)

Set out below is a consolidated balance sheet of the Closed Group as at 30 June 2006.

	2006 $m	2005 $m
Assets		
Cash and cash equivalents	–	0.1
Receivables	4.6	3.6
Equity securities	94.9	86.5
Total assets	99.5	90.2
Liabilities		
Payables	56.7	62.5
Interest bearing liabilities	39.4	41.2
Provisions	–	0.3
Total liabilities	96.1	104.0
Net assets	3.4	(13.8)
Equity		
Contributed equity	4.1	4.2
Retained losses	(0.7)	(18.0)
Total equity	3.4	(13.8)

Note 36. Investment in Associates

			Ownership interest		Consolidated	
	Principal activity	Country of incorporation	2006 %	2005 %	2006 $m	2005 $m
Garrisons (Toowong) Pty Ltd	Financial Planning	Australia	40	40	0.3	0.3
Carter Bax	Financial Planning	Australia	40	40	–	–
Garrisons (Burnie) Pty Ltd	Financial Planning	Australia	–	49	–	0.2
Its Your Money Pty Limited	Financial Planning	Australia	40	40	0.5	0.5
DVG Pty Limited	Financial Planning	Australia	50	50	1.4	1.4
Pension Transfers Direct Pty Ltd	Pension Transfers Business	Australia	25	25	0.3	0.2
PowerState Financial Services Pty Ltd	Financial Planning	Australia	25	25	0.1	0.1
Synergy Consolidated Pty Ltd	Financial Planning Dealer	Australia	–	46	–	0.4
Five Oceans World Fund	Financial Planning	Australia	25	–	4.0	–
Less: provision for diminution in value					(0.3)	(0.3)
					6.3	2.8

Note 36. Investment in Associates (continued)

Movements in carrying amount of investments in associates	Consolidated 2006 $m	2005 $m
Carrying amount at the beginning of the financial year	2.8	17.8
Investment in associates acquired on acquisition of Five Oceans World Fund	4.2	0.8
Sale of interest in associates	(0.7)	(17.8)
Share of associates' net profit	–	2.1
Carrying amount at the end of the financial year	6.3	2.8
Share of the associates' profit or loss:		
Profits before related income tax	–	3.0
Income tax expense	–	(0.9)
Profits after related income tax expense	–	2.1
Retained profits attributable to associates at the beginning of the financial year	3.5	1.4
Adjustment to retained profits attributable to associates sold in current year	(3.5)	–
Retained profits attributable to associates at the end of the financial year	–	3.5
Share of the associates' balance sheet:		
Assets	1.9	1.6
Liabilities	(0.3)	(0.8)
Net assets	1.6	0.8

There were no commitments or contingent liabilities relating to the associates.

Note 37. Subsequent Events

Challenger Life No. 2 Limited, a wholly owned subsidiary of the Group, paid $226.3 million in respect of the second instalment on its investment in the Challenger Infrastructure Fund (a controlled entity of the Group).

The Group intends to explore market interest in an initiative to launch a listed Australian Real Estate Investment Trust which will be announced on 28 August 2006. If the initiative proceeds, it is anticipated that no less than $500 million in directly held real estate investment properties will be released from the Group's balance sheet. If this proposed transaction proceeds the Directors do not expect any material impact on the profit and loss of the Group, as all real estate investment properties were independently valued as at balance date as disclosed in note 11.

No other matter or circumstance has arisen that has affected or may significantly affect:

(a) the Group's operations in future financial years; or

(b) the results of those operations in future financial years; or

(c) the Group's state of affairs in future financial years.

Note 38. Contingent Liabilities

During the previous financial year a claim for fees relating to the 13 August 2004 acquisition of Associated Planners was lodged against Challenger Financial Services Limited. The Company has denied liability and during the current financial year commenced proceedings in the NSW Supreme Court seeking a declaration that the claim is invalid. The Directors remain of the view that no material loss will be incurred.

At balance date a controlled entity, Challenger Life No. 2 Limited had received certain warranty claims in connection with the sale of a subsidiary. Under the terms of the sale agreement the Company's maximum financial exposure for warranty claims cannot exceed $5 million.

In addition the Group has over the course of its corporate rationalisation activity, given warranties to the purchasers on several agreements which are still outstanding at 30 June 2006. At the date of this report no material claims against these warranties have been received by the Group.

The ATO released GST Ruling 2004/4 on the Assignment of Payment Streams including under a Securitisation Arrangement. The ruling describes the ATO's view of how a securitisation works and the application of GST in relation to a number of areas specifically affecting the securitisation, which could impact on Challenger Wholesale Finance subsidiary Interstar Securities (Australia) Pty Limited. In particular the ruling now prescribes that taxpayers are not able to claim a reduced input tax credit (RITC) for servicing fees, contrary to previous draft rulings. Previous accepted practice has been to claim a RITC for servicing fees. The ruling applies from 1 July 2000 for all taxpayers. In response to the release of GSTR 2004/4, there has been significant lobbying by the securitisation industry and as a result the ATO has agreed to consult further with industry on GSTR 2004/4 before taking steps to implement the approach adopted by the ATO ruling. At the date of this report significant uncertainty surrounds the applicability of the treatments described in the ATO ruling due to:

- Interstar's method of arranging financing of mortgages via securitisation differing from that described in the ruling;
- uncertainty over whether the courts would allow the ruling to have retrospective effect given certain contrary draft rulings; and
- potential aspects of the ruling being amended as a result of continued industry interaction with the ATO and Treasury.

At balance date the Company was in discussions with the ATO in relation to the appropriate application of GST to certain transactions entered into at the time of the corporatisation in December 2003. At the date of signing the annual financial statements, resolution of this matter had not been reached with the ATO. The amount of GST involved is not considered to be material by the Directors.

In the normal course of business, the Group enters into various types of business contracts that could give rise to contingent liabilities in relation to performance obligations under those contracts by certain members of the Group.

The information usually required by AASB 137: *Provisions, Contingent Liabilities and Contingent Assets*, is not disclosed on the grounds that it may seriously prejudice the outcome of the claims. At the date of this report significant uncertainty exists regarding any potential liability under these claims, however, the Directors are of the opinion that no material loss will be incurred.

Note 39. Impact of Transition to AIFRS

(a) Explanation of transition to AIFRS

These financial statements are the Group's first consolidated financial statements prepared in accordance with AIFRS. The policies set out in the significant accounting policies section of this report have been applied in preparing the financial statements for the financial year ended 30 June 2006, the comparative information presented in these financial statements for the financial year ended 30 June 2005 and in the preparation of an opening AIFRS balance sheet as at 1 July 2004 (the Group's date of transition).

The adoption of AIFRS has a material effect on the Group's reported financial position. However, the implementation of AIFRS has had no impact on Challenger's economic strength, risk management practices or cash flows of the underlying business.

Two types of adjustments arise from the transition to AIFRS:

- those concerning recognition and measurement of items in the financial statements; and
- those concerning presentation and disclosure of items in the financial statements.

Recognition and measurement adjustments that arise as a result of the transition process are recognised in either retained earnings or an appropriate equity reserve at the date of transition (1 July 2004). They may affect reported profit or equity for periods after that date.

Presentation and disclosure adjustments do not impact total equity or retained earnings.

The transition to AIFRS changes a number of the Group's accounting policies. Based on AIFRS as currently issued, the areas of most significant impact and the transitional adjustments arising from application of AIFRS are summarised below.

Note 39. Impact of Transition to AIFRS (continued)

Future AIFRS changes are expected that the Group will need to address, including Phase II of the IASB's insurance project. The Group continues to monitor these and other developments, including emerging industry practice, additional guidance relating to the application of AIFRS and interpretations subject to international debate. These developments may require future changes to the Group's accounting policies. These changes may be reflected in the Group's 30 June 2007 financial report, or a later financial report as appropriate.

The quantified cumulative impacts of the application of relevant AIFRS on total equity and profit as detailed below have been presented in tables which form part of this note. All adjustments have been presented on a pre-tax basis, the tax effects where applicable are disclosed separately in the tables. Adjustments arising from AIFRS standards applicable from 1 July 2004 have been segregated from those arising from standards applicable from 1 July 2005.

The Group has made its election in relation to the transitional exemptions allowed by AASB 1: *First time adoption of Australian Equivalents to International Financial Reporting Standards* as follows:

- **Business combinations**
  AASB 3: *Business Combinations* was not applied retrospectively to past business combinations (i.e. to business combinations that occurred before the date of transition to AIFRS).
- **Designation of previously recognised financial instruments**
  Financial instruments were designated as financial assets or liabilities at fair value through profit or loss or as available for sale at the date of transition to AIFRS.
- **Exemption from the requirement to restate comparative information – AASB 132, AASB 139 and AASB 4**
  The Group has elected to adopt this exemption and has not applied AASB 132: *Financial Instruments: Presentation and Disclosure*, AASB 139: *Financial Instruments: Recognition and Measurement* and AASB 4: *Insurance contracts* to its comparative information.

There are no material differences between the statement of cash flows presented under AIFRS and under its previous basis of accounting (AGAAP).

Note 39. Impact of Transition to AIFRS (continued)

Reconciliation of total equity as presented under AGAAP to that under AIFRS

		Consolidated		Parent	
	Ref	30-Jun-05 $m	1-Jul-04 $m	30-Jun-05 $m	1-Jul-04 $m
Total equity as reported under Australian GAAP		1,300.8	1,084.9	1,177.6	1,038.8
Effects of transition to AIFRS on total equity:					
Impacts on retained earnings					
Derecognition of EMVONA	1	(25.0)	(25.0)	–	–
Transfer to share based payments reserve	2	(9.4)	(5.3)	–	–
Reversal of goodwill amortisation	3	23.3	–	–	–
Reversal of internally generated profit	4	(3.6)	–	–	–
Reversal of transaction costs	5	2.8	2.8	–	–
Recognition of restructure costs	6	(10.8)	–	–	–
Changes in provision discount rate	7	(4.8)	(4.5)	–	–
Relocation provision	9	(1.9)	(1.9)		
Tax effect of transitional adjustments		4.9	0.5	–	–
Impacts on contributed equity					
Derecognition of share based payment schemes	8	(128.8)	(118.2)	(128.8)	(118.2)
Impact on reserves					
Transfer from retained earnings to share based payments reserve	2	9.4	5.3	9.4	5.3
Total adjustments to equity		(143.9)	(146.2)	(119.4)	(112.9)
Total equity measured under AIFRS		1,156.9	938.6	1,058.2	925.9

Explanation of adjustments

1. Excess of market value over net assets (EMVONA)
Under AIFRS, any EMVONA balances arising from increases in internal valuation since the acquisition or establishment of the controlled entity can no longer be recognised. Further, the consolidated financial statements are required to reflect the values recognised in the underlying net assets of the controlled entity. The opening retained earnings adjustment reflects the derecognition of the EMVONA balance at 30 June 2004, the date of transition. The EMVONA adjustment relates entirely to internally generated goodwill. There is no tax impact from the EMVONA adjustments.

2. Share based payments
Under Australian GAAP, the Group recognised on its balance sheet shares issued to employees under the Challenger Long Term Incentive Plan (LTIP) and an associated LTIP loan receivable. No expense was recognised for equity based compensation. Under AIFRS, an expense is recognised over the vesting period of the instruments based on a valuation of the instrument determined at grant date. When an instrument is granted, and an expense incurred, there is a corresponding increase in the share based payments reserve. The opening retained earnings adjustment reflects the recognition of the share based payment expense up to date of transition, and correspondingly an amount recognised as a separate component of equity as a share based payments reserve. The retained earnings adjustment at 30 June 2005 reflects the allocation of the cumulative share based payments expense to each prior reporting period. There is no tax impact from share based payments.

3. Reversal of goodwill amortisation
Under AGAAP, goodwill was required to be amortised over the period benefits were expected to be received but no greater than 20 years. Under AIFRS, goodwill is not subject to amortisation, although it is subject to impairment testing. The amortised value of goodwill at the date of transition has been set as the initial carrying amount for AIFRS. Therefore, there is no opening retained earnings impact at date of transition. The retained earnings adjustment at 30 June 2005 reflects the reversal of the cumulative goodwill amortisation previously expensed under AGAAP in each period. There is no tax impact on amortisation of goodwill.

4. Internally generated profit
The consolidation of Special Purpose Vehicles under AIFRS has resulted in distributions of internally generated profit to Group companies from Special Purpose Vehicles arising from the sale of non-conforming loans, which have been removed.

Note 39. Impact of Transition to AIFRS (continued)

5. Reversal of transaction costs
Under AIFRS the carrying value of investment properties is no longer reduced by transaction costs (NSW vendor duty), however where management has an intention to sell a property, we have a constructive obligation which is required to be provided for. This adjustment is the net difference between the reversal of the transaction costs and the amount provided for.

6. Recognition of restructure costs on acquisition
Certain restructure costs previously recognised in goodwill under Australian GAAP, no longer satisfy the more stringent requirements for recognition under AASB 3: *Business Combinations* and are required to be expensed through the income statement.

7. Change in provision discount rate
Under AIFRS provisions are now required to be discounted by a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

8. Derecognition of share based payment LTIP shares
The LTIP shares do not meet the definition of Equity under AIFRS and have thus been removed from the Group financial statements along with the non-recourse loan used to acquire the LTIP shares.

9. Relocation provision
The lease contract for Aurora Place requires the Group to make good the premises at the end of the lease. Under AGAAP, the Group had not provided for make good costs. Under AIFRS, a provision is required to be raised as the Group has a present legal obligation as a result of a past event to incur the make good costs at the end of the lease. The provision for make good costs has been calculated and discounted using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(b) Reconciliation of net profit after income tax attributable to shareholders under AGAAP to that under IFRS

		Consolidated	Parent
	Ref	30-Jun-05 $m	30-Jun-05 $m
Net profit after income tax as reported under Australian GAAP		110.6	33.6
Effects of transition to AIFRS on net profit:			
Share based payment expenses	1	(4.1)	–
Reversal of goodwill amortisation	2	23.3	–
Reversal of internally generated profit	3	(3.6)	–
Recognition of restructure costs	4	(10.8)	–
Changes in provision discount rate	5	(0.3)	–
Tax effect of AIFRS adjustments	6	4.4	–
Total AIFRS adjustment to net profit		8.9	–
Net profit after income tax measured under AIFRS		119.6	33.6

Explanation of adjustments

1. Share based payments
Under AASB 2: *Share based Payments'* an expense is recognised for the long-term share based incentive plan over the vesting period of the instruments, based on a valuation of the instruments determined at grant date. This expense has resulted in a decrease in previously reported AGAAP profit.

2. Goodwill amortisation
Under AIFRS goodwill is no longer amortised but is subject to annual impairment testing. This has resulted in the removal of the goodwill amortisation charge with a resultant increase in profit.

3. Internally generated profit
The consolidation of special purpose vehicles under AIFRS has resulted in distributions of internally generated profit to Group companies from Special Purpose Vehicles arising from the sale of non-conforming loans, which have been removed.

4. Recognition of restructure costs on acquisition
Certain restructure costs previously recognised in goodwill under Australian GAAP, no longer satisfy the more stringent requirements for recognition under AASB 3: *Business Combinations* and are required to be expensed through the income statement.

5. Change in provision discount rate
Under AIFRS provisions are now required to be discounted by a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Note 39. Impact of Transition to AIFRS (continued)

6. Tax effect of AIFRS adjustments
In accordance with AASB 112: *Income Taxes* all AIFRS adjustments are tax affected, and any adjustments that may arise as a result, are taken to the income statement unless specifically required to be accounted for as a separate component of equity in accordance with AASB 112.

Exemption from the requirements to restate comparative information
The Group elected to apply the exemptions provided in AASB 1 which permits entities not to apply the requirements of AASB 132: *Financial Instruments: Disclosure and Presentation*, AASB 139: *Financial Instruments: Recognition and Measurement* and AASB 4: *Insurance Contracts* with respect to the comparative information. As a result, the Group has chosen not to present its comparative information in accordance with the above standards in its first year of transition. The Group has chosen to apply previous AGAAP in its comparative information, disclose the basis used to prepare this information, and disclose the nature and effect of the main adjustments under note 39(c) below. The adjustments reflect the cumulative effect these standards would have on total equity at 1 July 2005, if they had been applied from the beginning.

(c) Reconciliation of total equity as at 1 July 2005

		Consolidated	Parent
	Ref	$m	$m
Total equity measured under AIFRS at 30 June 2005		1,156.9	1,058.2
AIFRS adjustments to retained earnings:			
Revenue recognition – effective yield	1	(6.9)	–
Valuation of financial instruments using bid and offer price gross of transaction costs	2	(2.0)	–
Adjustment to policy holders' liabilities	3	(39.1)	–
Tax effect of the above transitional adjustments		13.4	–
AIFRS adjustments to reserves:			–
Recognition of cash flow hedge derivatives	4	(0.5)	–
Tax effect of the above transitional adjustment		0.2	–
Cash flow hedge reserve SPVs	4	(10.0)	
Total adjustments to equity as at 1 July 2005		(44.9)	–
Total equity measured under AIFRS as at 1 July 2005		1,112.0	1,058.2

1. Revenue recognition – effective yield
AASB 118: *Revenue* requires certain upfront financial service fees to be recognised as either fees integral to the effective interest rate of a loan or spread over the period of the service. Fees that are integral to the effective interest rate of a loan must be recognised using the effective interest method outlined in AASB 139: *Financial Instruments: Recognition and Measurement*. Fees deemed as service fees are to be amortised over the period of service. AIFRS also requires deferral of related costs where these are both direct and incremental to the origination of the contract.

The use of the effective interest rate method has resulted in a reduction of retained earnings. The Group took advantage of the exemption granted in AASB 1: *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* and chose not to restate its comparatives.

2. Valuation of financial instruments using bid and offer prices and the removal of transaction costs
AASB 139: *Financial Instruments: Recognition and Measurement* requires that in valuing financial instruments at fair value, the appropriate quoted market price to be used is the bid or offer price. Under AGAAP all financial instruments of the Group measured at fair value and transacted in an active market are valued at the mid price less acquisition costs. The Group has adjusted all mid prices to bid prices and adjusted for transaction costs. This has resulted in a decrease in retained earnings on 1 July 2005 as the Group took advantage of the exemption granted in AASB 1: *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* and chose not to restate its comparatives.

3. Adjustments to valuations from investment contract and life insurance contract liabilities
AIFRS requires life insurers to classify insurance policies between Life Insurance Contracts and Life Investment Contracts. The majority of life insurance policies (annuities) issued by Challenger Life No. 2 Limited do not contain 'significant' insurance risk and are classified as Life Investment Contracts under the revised version of AASB 1038: *Life Insurance Contracts*.

Note 39. Impact of Transition to AIFRS (continued)

AASB 1038 requires Life Investment Contracts to be measured in accordance with the fair value principles set forth in AASB 139: *Financial Instruments: Recognition and Measurement* and AASB 118: *Revenue*. Measuring policy liabilities under AASB 139 and AASB 118 results in changes in the valuation principles currently applied by Challenger Life No. 2 Limited as follows:

(a) Under Australian GAAP, the discount rate applied in the valuation of the investment contract and life insurance contract liabilities was based on the expected market return on the investments that backed those contracts. Under AIFRS, where investment contract and life insurance contract liabilities are not linked to the performance of investments that back those contracts, a risk free discount rate must be used. The risk free discount rate is determined by the Appointed Actuary based on the mid swap rates, depending on the nature, structure and term of the contract liabilities.

(b) The opening retained earnings adjustment reflects the changes from (a) above, as they impact the valuation of the investment contract and life insurance contract liabilities at the date of transition (1 July 2005). The Group has taken advantage of the exemption granted in AASB 1 and chosen not to restate its comparatives.

(c) Under AGAAP, all acquisition costs incurred in relation to acquiring new life insurance business were deferred as part of investment contract and life insurance contract liabilities and subsequently recognised in the income statement over the life of the contract. Under AIFRS, the treatment differs for those contracts which are designated as investment contracts.

Under AIFRS, acquisition costs arising in relation to investment contracts can only be deferred to the extent they are incremental and directly attributable to securing the individual contracts. Otherwise costs are recognised and expensed as they are incurred. The AIFRS adjustments are prior to accounting for any related tax impact, as any tax effect is recorded separately. The opening retained earnings adjustment to policy holder liabilities includes the derecognition of cumulative deferred acquisition costs in respect of investment contracts at the date of transition.

4. Recognition of cash flow hedge derivatives

The Group uses derivative financial instruments including interest rate swaps and futures. Under AGAAP, costs arising at the time of entering into hedge transactions were brought to account in the income statement over the lives of the hedge contracts. Borrowings were recorded at amortised historic cost.

AASB 139: *Financial Instruments: Recognition and Measurement* requires all derivatives to be recognised on the balance sheet and measured at fair value. Gains and losses arising from changes in fair value will be recognised in the income statement, unless hedge accounting is applied. In accordance with AASB 1: *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* the Group has elected to adopt the exemption applying to AASB 139 'Financial Instruments: Recognition and Measurement' and thus there is no restatement of comparative information. These adjustments are reflected in a statement of changes to equity at 1 July 2005 as per note 39(c) above.

Under AGAAP all derivatives transacted within Challenger Life No. 2 Limited were accounted for on a fair value basis with changes in fair value recorded in the profit and loss account. Therefore the treatment of derivatives in Challenger Life No. 2 Limited will not to be significantly affected by the introduction of AIFRS.

The Special Purpose Vehicles in the Mortgage Management business hedge exposure to interest rate and exchange rate risk using derivative financial instruments. All derivatives in these Special Purpose Vehicles are designated as cash flow hedges. The adoption of AASB 139 in this area has resulted in derivative assets and liabilities recognised on the balance sheet measured at fair value and a new cash-flow hedge reserve account created within equity.

There is no opening retained earnings adjustment as at the 1 July 2005 date of transition, as all derivative instruments were cash flow hedges and met the requirements of hedge accounting. The derivatives are reflected as interest rate swap assets or liabilities and result in the creation of a cash flow hedge reserve. The tax effect is also taken to the cash flow hedge reserve in accordance with AASB 112.

Directors' Declaration

In accordance with a resolution of the Directors of Challenger Financial Services Group Limited, I state that:

1. In the opinion of the Directors of Challenger Financial Services Group Limited ('the Company'):
   - (a) the financial statements and notes of the Company and Group are in accordance with the Corporations Act 2001, including:
     - (i) giving a true and fair view of the financial position of the Company and the Group as at 30 June 2006 and of their performance for the year ended on that date; and
     - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
   - (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
2. This declaration has been made after receiving the declarations required to be made to the Directors in accordance with section 295A of the Corporations Act 2001 for the financial period ending 30 June 2006.
3. In the opinion of the Directors, as at the date of this declaration, there are reasonable grounds to believe that the members of the Closed Group identified in note 35 will be able to meet any obligations or liabilities to which they are or may become subject, by virtue of the Deed of Cross Guarantee.

On behalf of the Board

M Tilley
Director

G A Cubbin
Director

Sydney 25 August 2006

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Independent audit report to members of Challenger Financial Services Group Limited

Scope

The financial report, remuneration disclosure and directors' responsibility

The financial report comprises the balance sheet, income statement, statement of changes in equity, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for Challenger Financial Services Group Limited (the company) and the consolidated entity, for the year ended 30 June 2006. The consolidated entity comprises both the company and the entities it controlled during that year.

The company has disclosed information as required by paragraphs Aus 25.4 to Aus 25.7.2 of Accounting Standard 124 Related Party Disclosures ("remuneration disclosures"), under the heading "Remuneration Report" in Section 13 of the directors' report, as permitted by Corporations Regulation 2M.6.04.

The directors of the company are responsible for preparing a financial report that gives a true and fair view of the financial position and performance of the company and the consolidated entity, and that complies with Accounting Standards in Australia, in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report. The directors are also responsible for the remuneration disclosures contained in the directors' report.

Audit approach

We conducted an independent audit of the financial report in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement and the remuneration disclosures comply with Accounting Standard AASB 124 Related Party Disclosures. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, including compliance with Accounting Standards in Australia, and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the company's and the consolidated entity's financial position, and of their performance as represented by the results of their operations and cash flows and whether the remuneration disclosures comply with Accounting Standard AASB 124 Related Party Disclosures.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report and the remuneration disclosures; and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

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

We performed procedures to assess whether the substance of business transactions was accurately reflected in the financial report and the remuneration disclosures. These and our other procedures did not include consideration or judgement of the appropriateness or reasonableness of the business plans or strategies adopted by the directors and management of the company.

Independence
We are independent of the company and the consolidated entity and have met the independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001. We have given to the directors of the company a written Auditor's Independence Declaration a copy of which is included in the Directors' Report. In addition to our audit of the financial report and the remuneration disclosures, we were engaged to undertake the non-audit services disclosed in the notes to the financial statements. The provision of these services has not impaired our independence.

Audit opinion
In our opinion:

1. the financial report of Challenger Financial Services Group Limited is in accordance with:

(a) the Corporations Act 2001, including:

  (i) giving a true and fair view of the financial position of Challenger Financial Services Group Limited and the consolidated entity at 30 June 2006 and of their performance for the year ended on that date; and

  (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and

(b) other mandatory financial reporting requirements in Australia.

2. the remuneration disclosures that are contained in Section 13 of the directors' report comply with Accounting Standard AASB 124 Related Party Disclosures.

Ernst & Young

Ernst & Young

Brian Long

Brian Long
Partner
Sydney
25 August 2006

Investor Information

Investor Information

(a) Distribution of shares as at 28 September 2006

Range	Number of shareholders	Number of shares	% of issued capital
1–1,000	11,229	5,688,590	0.95
1,001–5,000	15,547	38,742,694	6.48
5,000–10,000	3,744	27,488,482	4.60
10,001–100,000	2,342	56,036,820	9.37
100,001 and over	210	469,896,954	78.60
	33,072	597,853,540	100.00

Number of unmarketable parcels: 145
Number of unmarketable shares: 47,927

(b) Substantial shareholders as at 28 September 2006
The number of shares held by substantial shareholders and their associates are set out below:

Shareholder	Number	Percentage
Consolidated Press Holdings Limited Group	121,988,278	20.4
Wallara Asset Management Pty Ltd	30,210,667	5.05

(c) Twenty largest shareholders as at 28 September 2006

Shareholder	Shares held at end of period	% of issued capital
1. Cavalane Holdings Pty Limited	64,848,539	10.85
2. CPU Share Plans Pty Limited	63,363,656	10.60
3. National Nominees Limited	59,789,285	10.00
4. Conpress Holdings Pty Limited	54,340,394	9.09
5. Westpac Custodian Nominees Limited	46,858,382	7.84
6. ANZ Nominees Limited	39,728,653	6.65
7. J P Morgan Nominees Australia Limited	32,495,358	5.44
8. Citicorp Nominees Pty Limited	11,813,345	1.98
9. Thorney Holdings Pty Limited	7,397,500	1.24
10. Cogent Nominees Pty Limited	6,814,731	1.14
11. AMP Life Limited	5,011,008	0.84
12. WIN Television NSW Pty Limited	4,000,267	0.67
13. Invia Custodian Pty Limited	3,484,752	0.58
14. Consolidated Press Holdings Limited	2,799,345	0.47
15. Australian Reward Investment Alliance	2,513,626	0.42
16. Sandhurst Trustees Limited	2,492,531	0.42
17. Bell Securities Limited	2,263,820	0.38
18. Audant Investments Pty Limited	1,796,002	0.30
19. Carstock Nominees Pty Limited	1,627,280	0.27
20. Invia Custodian Pty Limited	1,572,819	0.26
	415,011,293	
Total shares on issue	597,853,540	

(d) Shares subject to restrictions
The following issued ordinary shares are subject to either restrictions or to voluntary escrow:
- 8,873,927 shares issued under a Scheme of Arrangement in relation to Associated Planners Group Limited, where restrictions cease on 13 August 2007.

(e) Voting rights

On a show of hands, every member present at the meeting in person or by proxy shall have one vote and upon a poll each share shall have one vote.

(f) ASX listing

Challenger Financial Services Group Limited shares are listed on the ASX under code CGF and company information, as well as trading information, can be accessed via the ASX website at www.asx.com.au. Share prices can also be accessed on Challenger's website at www.challenger.com.au.

(g) Shareholder queries

Please contact Computershare Investor Services for information about the Challenger Financial Services Group Limited share registry if you have any questions about your shareholding.

Computershare Investor Services Pty Limited
Level 3, 60 Carrington Street, Sydney NSW 2000.
Investor queries 1800 780 782
Facsimile +61 2 8234 5050

To assist with all enquiries, please quote your current address and Security Reference Number (SRN) when speaking with Computershare's associates.

Consolidated Profit and Loss
Three year history

	Historic cost[1]		
	FY06	FY05	FY04[2]
Income			
Net investment income	126	122	86
Net fee income	315	218	140
Other income	5	2	–
Net income	446	342	226
Total operating expenses	(236)	(210)	(147)
EBIT	209	132	79
Interest and borrowing costs	(35)	(17)	(11)
Significant items	(13)	–	(280)
Net profit before tax	161	115	(212)
Tax	(45)	(31)	(21)
Net profit after tax	116	84	(233)

[1]Challenger adopts modified historic cost accounting basis for reporting the operations of the Life company within the Asset Management division.

All other aspects of Challenger's financial reporting are per AIFRS.

[2]Excludes goodwill amortisation for comparative purposes with AIFRS.

Directory

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Directors
Peter Leith Polson (Chairman)
Michael Tilley (Chief Executive Officer)
Graham Allan Cubbin
Russell Richard Roberts Hooper
Ashok Peter Jacob
James Douglas Packer
Sarina Russo (appointed 15/9/06)
James Glen Service
Brenda Mary Shanahan
Leon Zwier (appointed 15/9/06)

Secretary
Chris Robson

Share Register
Computershare Investor Services Pty Limited

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