Annual Report 2003

challenger
Financial Services Group

Directory

Responsible Entity of Challenger Financial Services Group	CPH Management Limited (ACN 080 207 496)
Principal registered office in Australia	Level 3 54 Park Street Sydney NSW 2000 Tel 02 9288 9699 Fax 02 9267 2150
Directors of the Responsible Entity	James Douglas Packer (Chairman) Christopher Edgar Cuffe Ashok Peter Jacob James Glen Service Brenda Mary Shanahan Russell Richard Roberts Hooper Peter Leith Polson Michael Tilley
Secretary	Robert Bernard Davis
Solicitors	Minter Ellison Aurora Place, 88 Phillip Street Sydney NSW 2000
Bankers	ANZ Bank Limited Westpac Banking Corporation
Share register	Computershare Investor Services Pty Limited Level 3, 60 Carrington Street Sydney NSW 2000 Tel 02 8234 5000 Fax 02 8234 5050 Website: www.computershare.com
Auditor	Ernst & Young 321 Kent Street Sydney NSW 2000
Internet address	www.challenger.com.au

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Building a multi-faceted financial services organisation

A letter from the Chairman and CEO

16 September 2003

Dear Unitholder

On behalf of the Board of CPH Management Limited, the Responsible Entity of Challenger Financial Services Group (formerly CPH Investment Corp), we are pleased to present Challenger's annual report for the 2003 financial year.

The report covers the results for CPH Investment Corp in the 2002/2003 financial year. The profit after tax for CPH Investment Corp was $21.3 million for the year ended June 2003, compared with $8.7 million in the previous year.

The merger between CPH Investment Corp and Challenger International Limited was completed at the end of the financial year and therefore this annual report excludes the profit and loss result from the former Challenger International Limited business.

Highlight of the year

There have been a number of remarkable days over the past year, most notable however is 1 July 2003 when the merger between CPH Investment Corp and Challenger International Limited came into effect, resulting in a name change for the group to Challenger Financial Services Group and setting in motion the development of a dynamic, multi-faceted financial services organisation.

Since 1 July 2003

Since the merger became effective, management has been focused on simplifying Challenger's business, including bringing more clarity into its overall structure and accounting principles.

To this end, over the last few months Challenger has exited a number of non-core businesses, including operations in the United Kingdom and New Zealand.

The team is exiting the Howard Finance division (no relation to the Howard Mortgage Trust), the endowment warrants business and has exited the mergers and acquisitions activities of the Corporate Finance team.

The new management team has also completed a thorough review of Challenger's products and systems. The result is back office improvement to IT and administration infrastructure which will continue over time. Additionally, Challenger will be rolling out the details of its product review by the end of December 2003 as outlined in the Outlook section on the following page.

Board appointments

On 23 July 2003, Challenger appointed a new board (see Directors report on page 20). The eight member board comprises seven non-executive directors, including five independents who have an extensive range of experience in Australian financial services across funds management, insurance, property, retail banking and investment banking.

Dividend policy

As outlined to the market on 9 September 2003, the CPH Management Limited Board decided no final distribution would be paid to Challenger's unitholders. It is the view of the Board and Challenger's management that the business requires maximum use of capital while it is still building its structure and developing new business streams.

The CPH Management Limited Board and Challenger's management believe capital is better deployed internally in the short term and expect no distribution will be paid over the coming 12 month period.

The CPH Management Limited Board will continually assess Challenger's requirements in determining an appropriate distribution policy in future years.

Building a broad-based financial services company

Going forward, the CPH Management Limited Board and Challenger's management team see Challenger as having four major business segments:

- the annuities business
- the funds management/administration business (which will also encompass the financial planning business in a reporting sense)
- the wholesale mortgage financing business (which reflects Challenger's recent acquisition of Interstar Securities)
- the margin lending business (which is in an early stage but is an area of expected future significant growth for Challenger).

Interstar Securities

On 1 September 2003, the Group announced it had entered into an agreement with Zurich Capital Markets Asia to acquire Interstar Securities, one of Australia's largest independent wholesale mortgage financiers.

The acquisition provides Challenger with an opportunity to enhance its broader financial services platform with Interstar's expanding wholesale mortgage distribution base and leverage on its reputation in global capital markets.

Financial position

As a result of the merger, Challenger's management was able to move capital to the Life company in accordance with the capital management plan outlined to the market in May.

Challenger's management team is committed to looking at future acquisition opportunities on merit, although it is expected that the coming 12 months will see us largely focus on organic growth.

Outlook

Challenger today is a very different business than it was only 12 months ago. The CPH Management Limited Board and Challenger's management team are focused on building a multi-faceted financial services organisation.

The activities you will see over the next 12 months will support this proposition. We expect that by the end of the current financial year, our products should be very easy to understand, consistently branded and managed on an effective administration system, which will provide much better client service through single contact points. Challenger's management team is committed to building a set of high quality funds management products – including Australian equities funds, fixed interest funds, property securities funds and international equity funds.

Previously, Challenger's product set, outside of the annuity products and the Howard Mortgage Trust, had fairly limited coverage by financial planners. Challenger's relationships with financial planners have expanded from earlier in the year and we are getting wider coverage and opening new doors every day through the skilled efforts of our distribution and marketing teams.

Corporatisation

Finally we'd like to comment on our most recent announcement to the market, a proposal being worked on to corporatise Challenger Financial Services Group.

Challenger, like CPH Investment Corp before it, is a listed trust. The Trust structure exists as a matter of history and is most common in investment or property vehicles but unusual for an operating business. Corporatisation for Challenger would result in the Responsible Entity function being internalised and unitholders becoming shareholders in a company operating the business.

The consideration has come as a result of feedback from a number of unitholders who have expressed the desire to see a more conventional, simple corporate structure.

Under the proposal, the current Responsible Entity for the group, CPH Management Limited, will receive consideration for foregoing its rights to receive management and performance fees as a result of the corporatisation.

If the board of directors decides to proceed and formally propose to unitholders corporatising Challenger's structure, an independent expert will be engaged so unitholders have the assurance of a third-party view before voting on the matter at a general meeting.

The consideration to corporatise Challenger will include some wider changes, which will be subject to board approval before a formal proposal is presented to Challenger's unitholders.

If the Board agree to proceed with the proposal further information will be provided to unitholders over the next couple of months.

On behalf of the Board, we would like to extend our appreciation to unitholders, old and new, for their ongoing support of the Challenger business.

Additionally, we would also like to extend our thanks to Challenger's executive team and Challenger employees for their efforts, commitment and support during the previous year.

James D Packer
Chairman

Chris E Cuffe
Chief Executive Officer

Introducing the new Challenger Financial Services Group

Since first listing on the Australian Stock Exchange in 1987, Challenger has grown to become a force in Australian financial services, with a well-earned reputation for delivering innovative, high quality investment solutions. Today, Challenger manages and administers more than $10 billion on behalf of over 100,000 Australian investors.

Earlier this year, the board of directors of Challenger International Limited and CPH Management Limited, as the Responsible Entity for CPH Investment Corp, announced their intention to merge. In June, the Federal Court approved the merger of the two entities. Challenger security holders and CPH Investment Corp unitholders approved the merger at general meetings held earlier that month, and the merger took effect on 1 July 2003.

The merged entity is now known as Challenger Financial Services Group, a listed managed investment scheme (ASX code: CFG). CPH Management Limited remains the Responsible Entity.

A stronger capital base and significant growth opportunities

Challenger's recent merger with CPH Investment Corp has significantly increased the Group's capital base and improved our opportunity set. This now provides the foundation for us to deliver on our long-term vision of becoming a broad-based, truly multi-faceted financial services provider.

The coming months will see Challenger expand our range of leading managed investments and innovative investment solutions across each major asset class and tax structure, in both the retail and institutional markets. Some of these solutions we are building in-house, using the skills of our growing investment team, and others will be sourced through partnerships or strategic alliances with quality external providers.

In the first of these alliances, we have recently announced an exclusive arrangement with Orion Asset Management to launch a cobranded Australian share fund.

But our vision is about much more than investments. Going forward, the sources of growth for Challenger will focus on organic expansion and development of our existing business, establishment of strategic alliances and a focused acquisition strategy. As evidence of Challenger's intentions in the broader financial services market, we recently acquired Interstar Securities, one of Australia's largest independent mortgage financiers.

We want to make it easier for Australians to build and preserve their wealth

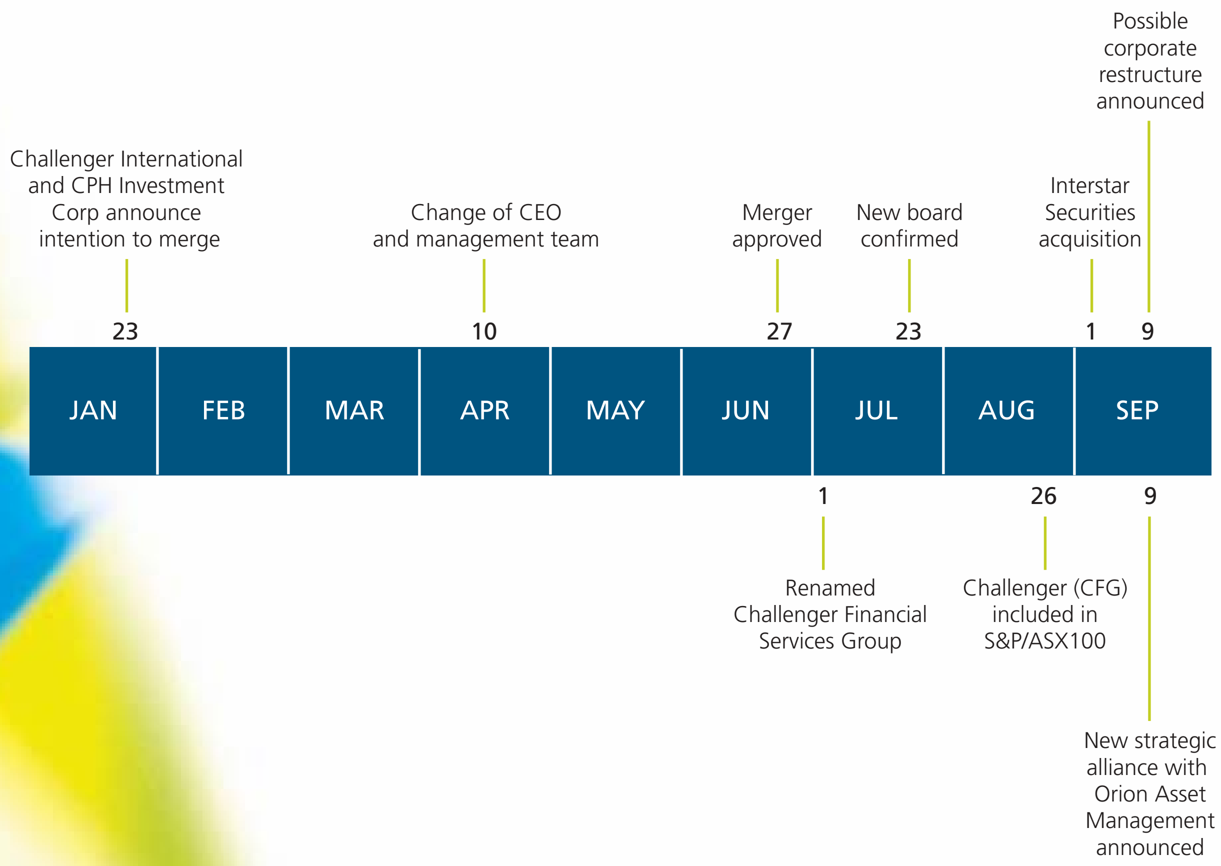
Over time, we want to provide a complete range of quality financial solutions. Our ultimate aim is to help more Australians build and preserve their wealth. Look for the diamond.

The stylised, multi-faceted diamond in the new Challenger logo communicates many of the qualities that we see as inherent in our business. Not just tremendous strength, but transparency, quality, integrity and longevity. And just as the quality of a diamond is judged by its clarity, exact cut and carat weight, so in time we will be judged by the clarity of our purpose, the precision of our execution and the scale we can achieve.

An extraordinary year

By any measure, this has been an extraordinary year in the life of the Challenger organisation. Here are just a few of the highlights.

(Given the enormous change in the business in recent months, we have included in this report a number of significant developments that occurred outside the reporting period.)



Corporate profile

The long-term vision of the new Challenger – to become a genuinely broad-based, multi-faceted financial services provider – is already on the way to being realised.

Challenger's current offer includes solutions from a range of different investment structures (including superannuation and retirement income), different asset classes (including shares, property and fixed interest) and different investment markets (local and international, debt and equity). These investment products and services are widely distributed through retail and institutional markets, master trusts and wrap platforms.

Already, Challenger leads the market in several areas, including mortgage funds, property trusts and annuities. Importantly, Challenger has been able to create real synergies between these businesses, with strengths in one area leveraged to increase profitability and market penetration in another.

In addition, the acquisition of Interstar Securities – one of Australia's largest wholesale mortgage financiers – marks the start of a new era for Challenger.

The Challenger business model

The Challenger business divides neatly into four major focus areas or profit centres:

- **Annuities**
- **Funds management/administration (including financial planning)**
- **Mortgage financing**
- **Margin lending**

Each of these business streams stands to benefit from a number significant profit drivers and growth opportunities. Challenger is already well-positioned in each, with significant enhancements, developments and initiatives in train.

Annuities

Challenger is one of Australia's leading providers of non-complying and complying annuities, having sold more than $700 million worth of annuities over the past year. Challenger's success in the Australian annuities market is the result of a number of factors, including:

- the way the assets are structured to provide consistently attractive returns for annuitants
- flexible and innovative marketing and distribution.

Challenger's annuity model

Challenger's annuity model allows us to provide annuities with very competitive rates. Challenger invests annuity premiums in growth assets and borrows against these assets on a limited recourse basis. To this point, the growth assets have typically been commercial and government properties with long-term leases. However, less aggressive (though still very competitive) pricing is easing the 'pressure' to purchase only property, and making possible greater use of fixed interest assets while still maintaining profit margin.

Innovative asset structure → very attractive returns

The income earned from these assets (whether property or fixed interest or other assets) is used to service debt, with income from these assets primarily used to pay annuity obligations.

Over time, the income generated by the assets, net of interest, extinguishes the annuity obligations. Once all annuity obligations have been extinguished, only the outstanding debt remains. This means that Challenger indirectly owns the residual equity, being the market value of the assets at that time less the outstanding debt. In addition to residual equity in the market value of the assets, Challenger is entitled to retain the income after the annuity obligations expire.

Flexible and innovative marketing and distribution

In addition to marketing annuities under the Challenger name, Challenger also makes its annuity products available to investors via cobranding arrangements with financial planning groups, as well as providing annuities – as unbadged wholesale investments – to other financial institutions.

These marketing and distribution arrangements provide benefits to both parties: giving the clients of financial planning groups and other institutions access to Challenger's consistently high annuity rates, while providing Challenger with regular inflows at a relatively low distribution cost.

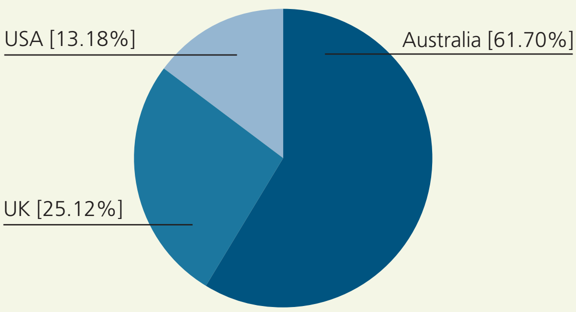
Challenger's direct property portfolio

The property portfolio that largely underpins Challenger's complying annuities products was valued at $2.61 billion at 30 June 2003 (52 properties with an average value of $50 million).

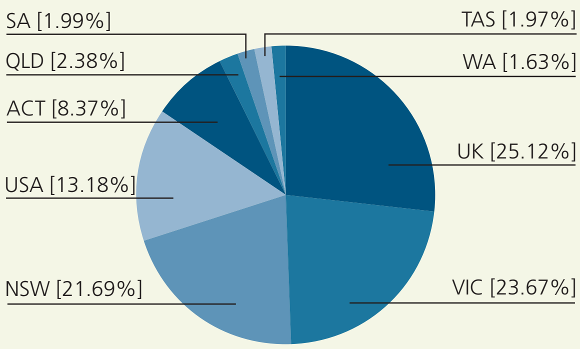
Challenger's property portfolio is characterised by high occupancy (better than 99%), long tenancy (an average lease expiry of 11.3 years) and solid yields (an average yield of 7.92% on current valuations and 8.35% on cost base). The net property income forecast for the next financial year (2003/04) is $207 million (annualised).

The portfolio is diversified across the major Australian capital cities, the UK and US, and largely consists of quality commercial properties in each region.

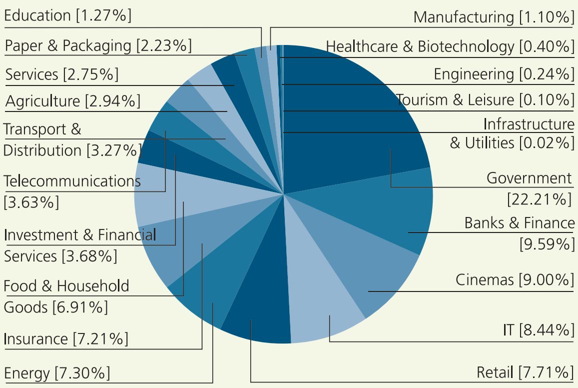
Value by country



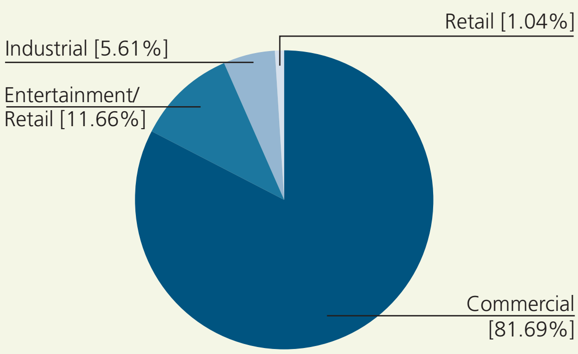
Value by region



Rental by industry



Value by sector



Funds management/administration (including financial planning)

As part of the ongoing review of the Challenger offer, we are looking at extending our range of investment options to include a number of new funds that complement the existing Challenger managed funds. We recently announced an exclusive alliance with **Orion Asset Management** to launch a cobranded Australian share fund.

Additional options are expected to also include a multi-manager Australian share fund and other funds developed in collaboration with strategic alliance partners. We intend to offer a suite of international share funds through one or more strategic alliances with international managers.

Challenger is also gaining momentum in the very competitive institutional asset management market, winning nine new institutional mandates totalling approximately $300 million since the start of July 2003.

Challenger's Australian share funds have delivered consistently outstanding performance

Other recent highlights in funds management are outlined below.

Challenger's Australian share funds

Challenger's Australian equity management team has continued to deliver 'first quartile' investment returns. In fact, the **Challenger Australian Share Fund** has yielded 'first quartile' investment performance (relative to other Australian equity managers) over 1, 2, 3, 5 and 7 year periods as at 30 June 2003. Since inception (October 1994), the Challenger Australian Share Fund has generated a pre-tax return of 13.08% p.a., outperforming the benchmark by 4.39% p.a.

Investors in **Challenger's Smaller Companies Fund** have enjoyed similar outperformance, and that fund is now attracting considerable interest, particularly from the institutional market. The Fund was one of only two smaller companies funds recently awarded the highest AA rating by van Eyk Research, as well as a five-star rating by Morningstar.

Challenger's Howard Mortgage Trust

Challenger's **Howard Mortgage Trust**, already Australia's largest mortgage trust, continued its strong growth, in the past year achieving net increase in funds under management of 46.8% (on top of an increase of 44.5% in 2002).

Australia's largest mortgage trust almost doubles in size again

Confirming our leadership position in this industry, Challenger was awarded the coveted Money Management ASSIRT Fund Manager of the Year Award for Mortgage Funds in May 2003, the third time in the past four years that Challenger has received this award.

Challenger's High Yield Fund

Challenger's High Yield Fund – launched in July 2001 – invests in hybrid equity-income securities. In August 2002, Challenger made the Fund available to retail investors and will soon be promoting it to financial planners as part of our broader product suite.

Challenger's administration platforms

Against a backdrop of lacklustre returns from investment markets, Challenger's flagship master trust – **Synergy** – continued to grow over the year, welcoming several thousand new investors and increasing funds under administration by 8.4% to $1.42 billion.

September 2002 saw the launch of a range of 'multi-manager' funds, each consisting of a number of underlying managed funds, designed to achieve more consistent performance than investing through a single fund manager. In only nine months, the Funds have grown to over $100 million in funds under management.

In December 2002, we launched the **Galaxy Investment Wrap**, a comprehensive asset administration service that broadened the range of assets that the Challenger platforms can administer to include most shares listed on the Australian Stock Exchange.

Challenger's alternative investments

In addition to Challenger's expanding suite of mainstream investment funds, Challenger also provides a range of innovative alternative investment products. These investments generally have a low correlation to traditional asset classes like shares, property and fixed interest. That is, the performance of these investments bears little relationship to the investment returns normally attributed to general property and share markets, so they can often be used to complement more conventional portfolios and provide additional portfolio diversification. These investments include the following:

- The **BluePeak Long Short Australia Fund** will be renamed Challenger Long Short Australia Share Fund in October 2003. This renaming will ensure the Fund is considered as part of the Group's stable of offerings and will occur at the same time we appoint GMO Australia to manage the assets of the Fund. Currently the Fund is managed using an index provided by Merrill Lynch.

  The investment strategy of the Fund remains unchanged, with the Fund holding equal long short positions.

  The Fund was closed to new investment in October 2002 having reached the desired funds under management objective. Like many other hedge funds this fund has struggled in the volatile local share market over the past two years and recent performance has been disappointing. We are confident the Fund will benefit with the appointment of GMO.

- The **Beston Wine Industry Trust** is a specialist funding vehicle that provides capital to wine companies and grape growers by the sale and leaseback of vineyards and infrastructure to allow for growth in brand building, wine inventories and receivables. Listed on the Australian Stock Exchange in July 1999, the Trust currently has 28 investment properties including 25 vineyards and 3 wineries in all the premium wine growing regions of South Australia, New South Wales, Victoria, Western Australia and New Zealand. The Trust has a total value of more than $131 million.

- **BioTech Capital Limited** invests primarily in entities developing technology-driven medical research for life science and healthcare applications. The BioTech Capital portfolio typically includes 10–20 unlisted investments.

The PH Sydney Hotel Group

Beginning in August this year, Challenger also provided investors with an opportunity to share in the benefits of owning the prestigious Park Hyatt Hotel in Sydney, via an investment in the PH Sydney Hotel Group. The Hotel is one of Australia's best performing tourism properties, and the PH Sydney Hotel Group (whose sole asset is the Park Hyatt, Sydney) is designed to provide very attractive, tax-effective investment returns over a five-year investment term. The offer is expected to raise more than $69 million and is scheduled to close in November 2003. At the time of writing (mid-September 2003), interest in the PH Sydney Hotel Group has been very high and the offer looks like it may close well ahead of schedule.

Garrisons Financial Planning

Garrisons Financial Planning is a licensed financial planning dealership and registered life broker that is wholly owned by Challenger Financial Services Group. As well as its own national network of financial advisers, Garrisons provides a range of corporate and dealer services to other financial planning groups around Australia.

Despite it being a difficult year for the financial advisory industry generally, Garrisons experienced strong growth in its adviser network, increasing its number of offices from 80 to 92, with the number of Garrisons financial planners growing 26% from 128 to 162.

The level of service provided to Garrisons' clients was also enhanced, with full-time practice development managers appointed in each region to help advisers enhance the range, consistency and quality of financial planning services they deliver to their clients.

As part of this commitment to providing high quality, comprehensive financial planning services, Garrisons significantly increased its focus on risk insurance advice and estate planning. This has resulted in a 61% increase in revenue from insurance-related advice from the previous year.

In other developments, Garrisons formed an exclusive alliance with COTA National Seniors, the largest representative body for Australians aged 50+, to provide financial planning services to its 280,000 members around Australia.

Mortgage financing

The Interstar acquisition

On 1 September 2003, we announced that Challenger had entered into an agreement with Zurich Capital Markets to acquire the assets of their Australian Principal Finance business. The focus of this acquisition is Interstar Securities, one of the largest independent mortgage financiers in Australia.

Interstar finances and services residential home loans originated by third party distributors (i.e. mortgage managers). With many financial planners expanding their businesses to offer debt management solutions to their clients via alliances with mortgage managers, we see Interstar as being a natural fit for our business.

A great strategic fit ...

We aim to become the business partner of choice for advisers, to help them develop their businesses, compete in a changing market and deliver great advice and great outcomes to their clients. As advisers move towards providing more holistic advice to their clients (for example, advice on debt management and risk management in addition to advice on portfolio management), so we will move to develop and/or acquire capability in a broader-range of financial services.

Interstar is a great strategic long-term fit for Challenger. And in addition to the synergies it provides, the Interstar business is a very exciting addition to the Challenger group in its own right, bringing strong earnings growth, further strengthening our financial position, and fitting seamlessly into our current operating model.

...and a robust business in its own right

Interstar has been a major beneficiary of the secular change we are seeing in the home lending business, with consumers trending away from the banks towards mortgage brokers and originators.

In short, Interstar is a very good business experiencing phenomenal growth from $2 billion to $11 billion in just four years. It's both a great immediate addition to the Challenger stable and a neat fit with our broader, long-term strategy.

The acquisition of Interstar was one of a number of assets included in Zurich's Australian Principal Financial Business. Others included:

- a high-yield fixed interest and loan portfolio – which will be incorporated into our existing fixed interest portfolios

- 84,500 hectares of forestry assets (there is already considerable interest in these assets from a number of buyers and alternative investment 'packagers').

Margin lending

Challenger sees margin lending as an important component of our product suite. Margin lending offers a very attractive margin to the lending institution and also aligns well with the trend of the financial planning advice industry generally towards more holistic wealth management advice and helping clients in the wealth building and accumulation phases of life as much as in retirement. We recently appointed Paul Johnston, previously head of margin lending at Colonial (the industry benchmark), to head up and further develop this business.

A very profitable business and an important piece in the holistic advice puzzle

The launch of Premium Option, includes instalment gearing and Portfolio 25 (which gives investors leverage of up to 80% against 21 of the top ASX stocks and 4 managed funds) – making it more attractive to active investors and traders. The closing balance of share financed securitised loans (as at the end of June 2003) was $162.6 million.

Overview of Private Equity assets held by Challenger Financial Services Group

Challenger Financial Services Group held a portfolio of listed and unlisted investments. The table below summarises the book value as at 30 June 2003.

Book value means that the investments, other than investments in controlled entities and associates, are carried at fair value. The fair value of unlisted investments is based on a valuation by the Responsible Entity at the relevant balance date. The book value for investments in controlled entities means that the investments are carried at the lower of cost and recoverable amount.

Asset	Book value ($'000) as at 30 Jun 2003
Listed securities	13,064
Jurlique International Pty Limited	28,111
Endeavour Health Care Limited	10,000
Australian Fast Foods Pty Limited	9,063
AVC Holdings Pty Limited	16,820
Other unlisted investments	6,782
Total	**83,840**

General management team

Chris Cuffe – Chief Executive Officer

Chris Cuffe entered the funds management industry in 1985 following a five year period with chartered accountants, Peat Marwick Mitchell & Co, now KPMG. In 1988 he joined the newly formed investment arm of State Bank NSW, First State Fund Managers and assumed the position of CEO in 1990.

During his tenure as CEO, Mr Cuffe led Colonial First State Investments, from a small start-up operation to one of Australia's leading fund managers. In early 2003 when Mr Cuffe left Colonial First State, the company was valued in excess of $5 billion, managed nearly $70 billion on behalf of 500,000+ investors and employed more than 1,000 employees.

In February 2003, Chris joined CPH Investment Corp as the CEO designate of the merged financial services group. The merger finalised in early July 2003, now an S&P/ASX 100 entity.

Dominic Stevens – General Manager Capital Management

Dominic Stevens joined Challenger in September 2003. Prior to joining, Mr Stevens was Senior Managing Director Zurich Capital Markets (Asian region) specializing in the areas of structured finance, derivative solutions and risk management products to investors in alternative assets. Challenger's Capital Management team led by Mr Stevens will oversee the investment allocation of assets held on Challenger's balance sheet and the market and credit risk as it pertains to those investments.

Brian Benari – General Manager Investments

Brian Benari is a chartered accountant with extensive experience in investment banking in Australia and overseas. Most recently, Mr Benari was with Zurich Capital Markets (ZCM) in the role of Chief Financial Officer and Chief Operating Officer for ZCM Asia Ltd and was responsible for investment approvals for equity and debt participations, new transaction approvals and the development and management of all operational and reporting infrastructure. Mr Benari also held a number of committee roles, including executive, credit and market risk and human resources.

Rob Adams – General Manager Distribution & Product Strategy

Rob Adams joined Challenger in July 2003 and has more than 17 years experience in the funds management and broader financial services industry in Australia and overseas. Prior to that, Mr Adams held a variety of senior roles including Chief Executive Officer of First State Investments, the global asset management operation of the Commonwealth Bank of Australia, based in the United Kingdom. First State Investments managed more than $A15 billion with a team of sixty investment professionals.

Tim Foster – Chief Financial Officer

Tim Foster joined Challenger in May 2003 as Chief Financial Officer. Mr Foster was previously Chief Financial Officer of Colonial First State, the Australian funds management arm of the Commonwealth Bank. Mr Foster joined the Colonial group in January 1995 and held a number of senior positions before being appointed Chief Financial Officer of Colonial First State in August 2000. Prior to joining the Colonial group, Mr Foster worked for Coopers & Lybrand in the UK.

Derek Goh – General Manager Information Technology

Derek Goh has a strong reputation for technology development in the financial services industry, having developed numerous systems and infrastructure for large and small businesses in Australia. Mr Goh previously held the position of General Manager Information Technology for Colonial First State and was a director of the Colonial group subsidiary, Colonial eCommerce before joining Challenger in March 2003.

Hayden King – General Manager Administration & Operations

Hayden King has more than 20 years experience in the financial services industry covering both banking and funds management. In the early 1980s, Mr King joined the Commonwealth Bank before moving to Australian Bank and later to Lend Lease/MLC, where he held a number of senior roles. In November 1996, Mr King joined First State Fund Managers, later renamed Colonial First State, and assumed the role of General Manager, Administration Services & Business Systems in 1997, a position he held until his departure in 2003 to join Challenger.

Joanna Wagstaff – General Manager Marketing & Communications

Joanna Wagstaff has worked in the financial services industry for more than 12 years and most recently held the role of General Manager, Marketing & Client Services for Colonial First State. In this role Ms Wagstaff led a team of 150 people and was ultimately responsible for Colonial First State's successful brand and advertising strategy, communications, marketing and call centres. Prior to this role, Ms Wagstaff held a number of senior distribution roles for both Colonial First State and Rothschild Australia Asset Management. Ms Wagstaff joined Challenger in March 2003.

Steve Rowe – General Manager Human Resources Development

In November 2002 Steve Rowe joined Challenger International, as it was then known. Prior to joining the group, Mr Rowe owned a management consulting business in the United Kingdom. Mr Rowe has also held a number of senior Human Resources roles in companies including UBS Warburg, Redland PLC, International Computers Limited, Sony Broadcast Limited and Honeywell Control Systems Limited.

Blair Beaton – Head of Corporate Development

Blair Beaton joined Challenger in 2002. Previously, Mr Beaton worked in a number of senior executive roles in the areas of corporate finance and accounting in Canada and Australia. Mr Beaton has more than 20 years experience in mergers and acquisitions, capital raisings and advisory work.

Tanya Atkins – Head of Shareholder & Media Relations

Tanya Atkins joined the Challenger Group in March 2003. Previously, Ms Atkins was Head of Media Relations at Colonial First State Investments. Prior to joining Colonial First State in 2001, Ms Atkins worked as a journalist, including Editor, Investor Weekly and Finance Producer/Reporter ABC TV News.

Management incentive arrangements

The Board of CPH Management Limited is considering establishing an executive share incentive scheme, which will benefit the employees of the Challenger Financial Services Group (CFG). The scheme would link a portion of their remuneration to the performance of the Challenger Financial Services Group unit price. A remuneration sub-committee of the new board has been established to determine appropriate terms for such a scheme, including performance hurdles, exercise prices and vesting periods, based on current market best practice. Pending the establishment of such a scheme, CPH Management Limited notes that Challenger has suspended its existing employee and executive share and option schemes.

CPH Management Limited Board

Board composition

At the date of this report, the CPH Management Limited Board comprised eight directors, including five independent directors who come from a variety of business and professional backgrounds.

James Packer – Chairman
As well as being Chairman of CPH Management Limited, James Packer is also Executive Chairman of Publishing and Broadcasting Ltd (PBL), a position he has held since May 1998, prior to which he was Chief Executive Officer of that company.

Since 1998, Mr Packer has worked in various senior positions within the PBL group and he is a member of PBL's Investment Committee. Mr Packer is also the joint Chief Executive Officer of CPH and a director of various companies, including Regal Entertainment Group, Foxtel and Puma AG.

Chris Cuffe – Managing Director and CEO
Chris Cuffe was appointed Chief Executive Officer of CPH Management Limited on 3 February 2003 and joined the board of CPH Management Limited as Managing Director in July 2003 when the merger with Challenger International Limited became effective.

Ashok Jacob – Joint CEO of CPH
Ashok Jacob, along with James Packer, is joint Chief Executive Officer of CPH. Prior to joining CPH he was the Managing Director of the investment arm of the Pratt group of companies. Mr Jacob is also a director of PBL.

James Service – Independent Director
James Service was a non-executive director of Challenger International Limited and joined the Board of CPH Management Limited in July 2003. Mr Service has extensive experience in the areas of the financial services and property. He is Executive Chairman of JG Service Pty Limited a specialist property consulting company and Deputy Chairman of Australand Holdings Limited. 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.

Brenda Shanahan – Independent Director
Brenda Shanahan was also a non-executive director of Challenger International Limited and joined the Board of CPH Management following the merger 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. She is chair of St Vincent's Health and St Vincent's Medical Research Institute and a non-executive director of JM Financial Group Limited.

Russell Hooper – Independent Director
Russell Hooper was previously a Director 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 Advance Bank Limited and St George Bank Limited for more than 13 years. Mr Hooper joined the Board of CPH Management Limited in July 2003.

Peter Polson – Independent Director
Peter Polson retired from the Commonwealth Bank in October 2002, where he held the position of Group Executive, Investment and Insurance Services. In this capacity Mr Polson was responsible for all investment and insurance services for the group, including the funds management, master funds, superannuation, property and insurance businesses and third party support services for brokers, agents and financial advisers.

Mr Polson joined the Colonial group, later acquired by the Commonwealth Bank, in 1994. Prior to joining the Colonial group, Mr Polson was Managing Director of National Mutual Funds Management (International) Limited. Mr Polson joined the Board of CPH Management Limited in July 2003.

Michael Tilley – Independent Director
Michael Tilley was a Director of Incitec Limited until 31 March 2003. Mr Tilley also spent a number of years with the investment bank Merrill Lynch where he held the positions of Chairman, Merrill Lynch (Australia), 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, Mr Tilley was principal and managing partner of Centaurus Corporate Finance Pty Limited and a partner at Deloitte Touche Tohmatsu. Mr Tilley joined the Board of CPH Management Limited in July 2003.

Directors' report
Corporate governance statement
Financial statements

Contents

This financial report covers both Challenger Financial Services Group (the Trust) and its controlled entities (the Group).

The Trust is an Australian registered scheme. CPHML, the Responsible Entity of the scheme, is incorporated and domiciled in Australia. The registered office of the Responsible Entity is located at Level 3, 54 Park Street, Sydney, NSW 2000. The principal place of business of the Group is located at Level 41, 88 Phillip Street, Sydney, NSW 2000.

A description of the nature of the Group's operations and its principal activities is included in the directors' report on pages 20–22.

Directors' report

CPH Management Limited (CPHML), the Responsible Entity of Challenger Financial Services Group (CFSG), formerly CPH Investment Corp (the Trust) presents its report, together with the financial statements of the Trust and its controlled entities (the Group) for the year ended 30 June 2003. The names of the directors of the Responsible Entity holding office during the period beginning 1 July 2002 until the date of this report are:

- Kerry Francis Bullmore Packer AC (resigned 23/07/03)
- James Douglas Packer (Chairman)
- Ashok Peter Jacob
- Graham Allan Cubbin (resigned 23/07/03)
- Guy Jalland (resigned 23/07/03)
- David John Barnett (resigned 23/07/03)
- Timothy John Purcell (resigned 23/07/03)
- Chris Edgar Cuffe (appointed 23/07/03)
- James Glen Service (appointed 23/07/03)
- Brenda Mary Shanahan (appointed 23/07/03)
- Russell Richard Roberts Hooper (appointed 23/07/03)
- Peter Leith Polson (appointed 23/07/03)
- Michael Tilley (appointed 23/07/03)

Scheme information

The Trust is an Australian registered scheme. CPHML, the Responsible Entity of the scheme, is incorporated and domiciled in Australia. The registered office of the Responsible Entity is located at Level 3, 54 Park Street, Sydney, NSW 2000.

The Trust was constituted on 24 October 1997 and will terminate on 23 October 2077 unless terminated earlier in accordance with the provisions of the Trust Constitution (as amended).

Interests

At the date of this report the Responsible Entity and its associates had an interest in the Trust of 609,941,381 fully paid units representing 25.01% of the Trust's units on issue. Refer to note 26 for details of directors' interest in the Trust.

Principal activities

Prior to the 27 June 2003 acquisition of Challenger Financial Services Group Limited (CFSGL), formerly Challenger International Limited, the principal activity was pursuing investment opportunities which the Responsible Entity considered to be undervalued.

As a result of the acquisition the principal activities have expanded to include the provision of financial services, in particular:

- Life Insurance
- Funds Management
- Margin Lending

Results

Net profit after tax for the year ending 30 June 2003 was $21,323,000 (2002: $8,660,000). The Group's consolidated result excludes the pre-acquisition results from CFSGL.

Review of operations

For the year ended 30 June 2003, the Group earned interest income of $20,818,000 (2002: $17,475,000). The Group had an overall profit before income tax on its current investment portfolio of $8,819,000 (2002: $6,351,000 – loss). This included realised gains of $10,714,000 (2002: $3,645,000 – loss).

The contribution to profit of associates AVC Holdings Pty Ltd and Jurlique International Pty Ltd was $4,949,000 (2002: $6,386,000).

Distributions
An interim distribution of 1.0 cent per unit fully franked was paid on 23 April 2003. No final distribution has been proposed.

State of affairs
On 27 June 2003 the Trust assumed control by way of merger of CFSGL. Per the schemes approved by unitholders of the Trust and shareholders of CFSGL, the shareholders of CFSGL received 4.5 units per share. For further details refer to note 27 in the financial statements.

Following the acquisition of CFSGL the planned injection of $235 million into CFSGL's Life business occurred. The plan to review and restructure the business also commenced.

Apart from the acquisition of CFSGL there have been no significant changes to the state of affairs of the Trust, other than those changes identified in the financial statements for the year ended 30 June 2003.

Likely developments
Further information on likely developments in the operations of the consolidated entity and the expected results of operations have not been included in this report because the directors believe it would be likely to result in unreasonable prejudice to the consolidated entity.

Environmental regulation
The Directors are satisfied that adequate systems are in place for the management of its environmental responsibility and compliance with various licence requirements and regulations. Further, the Directors are not aware of any breaches to these requirements and to the best of their knowledge all activities have been undertaken in compliance with environmental requirements.

Insurance of directors and officers
The Responsible Entity has insured the directors and officers against liabilities incurred in their role as directors and officers of the Responsible Entity of the Trust. The Responsible Entity is prohibited by the insurance contract itself from disclosing the nature of the liabilities covered and the amount of the premium. Neither the Trust nor the Responsible Entity has given or agreed to give any indemnity to an auditor of the Responsible Entity or Trust and have not paid any premium for insurance against those auditors' liabilities for legal costs.

Units on issue
The Trust had 2,439,035,734 fully paid units on issue, or units committed to be issued, at 30 June 2003 (2002: 917,522,392 fully paid units).

Responsible Entity's remuneration
Disclosure of benefits provided to the Responsible Entity during the financial year is made in note 26 of the financial statements.

Scheme assets
At 30 June 2003, the Trust held consolidated assets to a total value of $5,365,826,000 (2002: $526,915,000). The basis for valuation of the assets is disclosed in the summary of significant accounting policies within the financial statements.

Subsequent events

On 1 September an agreement was reached with Zurich Capital Markets to acquire the assets of their Australian Principal Finance Business. The focus of this acquisition is to acquire 100% of the issued capital of Interstar Securities, one of Australia's largest independent and privately held mortgage financiers for $85 million, together with a high yield fixed interest portfolio for $48 million. To secure Interstar, an agreement has also been made to acquire 84,500 hectares of forestry assets, valued at $54 million, on a 12-month deferred settlement basis.

No other matter or circumstance has arisen that has affected or may significantly affect:
(a) the consolidated entity's operations in future financial years, or
(b) the results of those operations in future financial years, or
(c) the consolidated entity's state of affairs in future financial years.

Units under option

Pursuant to the merger, all outstanding options over CFSGL shares were converted to options over units of the Trust at a rate of 4.5 times. Unissued units of the Trust under option at the date of this report are as follows:

Options series	Exercise date price	Options vested %	CFSGL exercise price	Number of shares	CFSG exercise price	CFSG units under option
D	31/07/03	100	$4.176	1,400,000	$0.928	6,300,000
E	31/07/03	100	$3.926	6,600,000	$0.872	29,700,000
F	31/07/04	100	$3.320	700,000	$0.738	3,150,000
G	31/07/04	67	$3.660	9,250,000	$0.813	41,625,000
Garrisons Financial Planning						
Garrisons GD 12-1999	31/01/05	33	$3.499	54,171	$0.778	243,770
Garrisons GD 6-2000	31/01/05	33	$2.872	143,859	$0.638	647,366
Garrisons GD 12-2000	31/01/05	33	$4.256	109,879	$0.946	494,456
Garrisons GD 6-2001	31/01/05	33	$3.517	149,936	$0.782	674,712
Garrisons GD 12-2001	31/01/05	33	$3.240	169,654	$0.720	763,443

The Series D, E, F and G options are exercisable at any time on or before the expiry date.

One-third of the Garrisons options are exercisable at any time on or before expiry. A further one-third are exercisable on 31 December 2003, with the remainder exercisable on 31 December 2004.

Convertible notes

Pursuant to the merger, CFSG issued units to acquire 37.4 million convertible notes that had been issued by CFSGL. For every note held 5.5 units were issued. When a notice to convert is received for the remaining 200,000 convertible notes issued by CFSGL the noteholders will receive 4.5 CFSG units for every share.

Rounding

The amounts contained in this report and in the financial statements have been rounded off under the option available to the Trust under ASIC Class Order 98/0100. The Trust is an entity to which the class order applies.

Signed in accordance with a resolution of the directors of the Responsible Entity:

JD Packer
Director

CE Cuffe
Director

Signed at Sydney this 8th day of September 2003.

Statement of principal corporate governance policies of the Responsible Entity

Board of directors (of the Responsible Entity)
The Board of CPHML is responsible for the overall corporate governance of the Group.This includes setting strategic direction, establishing management's performance objectives and monitoring the achievement of those objectives. It also includes ensuring that significant risks facing the Group have been identified, and that appropriate and adequate control, monitoring, and reporting mechanisms are in place.

The relationship between the Board and senior management is important to the Group's long term success. Day-to-day management of the Group's affairs and the implementation of the corporate strategy and policy initiatives are delegated by the Board to the Chief Executive Officer and senior executives.

Composition of the Board
Details of the directors of the Responsible Entity in office at the date of this report are set out in the directors' report. The Board currently consists of 8 directors (7 non-executive, 1 executive).

The Board considers the appointment or retirement of directors, where appropriate, and with regard to the size of the Responsible Entity. Each director has the right to seek independent professional advice at the Responsible Entity's expense. The Board's prior consent to obtain such advice is required, the director concerned does not participate in the decision.

Remuneration
The Responsible Entity received a fee, which is calculated with reference to the Trust Constitution.

Governance structure
The management structure is overlaied with a formal governance structure to provide stringent compliance and review across all of the Group's operations.

To assist the Board in the execution of its duties several permanent board committees have been established as follows:
- Compliance Committee
- Group Board Audit & Compliance Committee
- Board Remuneration Committee
- Board Property Investment Committee

Compliance Committee
The Compliance Committee members during the financial year and until the date of this report are:

External appointees	Internal appointee
Paul Dortkamp (Chairperson)	Robert Davis
Anne Ridgway	

The functions of the committee include:
- monitoring compliance with the Trust's Constitution, Compliance Plan, the Corporations Act 2001, Stock Exchange listing rules and any matters outstanding with taxation and other regulatory authorities; and
- monitoring the adequacy and effectiveness of compliance systems.

Meetings are held quarterly, or more frequently at the discretion of the chairperson.

Group Board Audit & Compliance Committee
Following the acquisition of CFSGL the Audit Committee was disbanded and replaced with the Group Board Audit & Compliance Committee.

The members of the Group Board Audit & Compliance Committee are:

External appointees

Brenda Shanahan (Chairperson)
Ashok Jacob
Russell Hooper

The primary objectives of the Group Board Audit & Compliance Committee are to ensure:

- effective management of financial and operational risks
- compliance with laws and regulations
- accurate management and financial reporting
- maintenance of an effective and efficient audit
- high standards of business ethics

Meetings are to be held quarterly, or more frequently at the discretion of the chairperson.

Board Remuneration Committee

Following the acquisition of CFSGL the Board Remuneration Committee was formed with the following members:

External appointees

Peter Polson (Chairperson)
James Packer
Michael Tilley

The function of the Board Remuneration Committee includes:

- setting policies for senior officers' and directors' remuneration
- making specific recommendations to the Board on remuneration of directors and senior officers
- setting the terms and conditions of employment for the CEO
- overseeing management succession plans

Meetings are to be held semi-annually, or more frequently at the discretion of the chairperson.

Board Property Investment Committee

Following the acquisition of CFSGL the Board Property Investment Committee was formed with the following members:

External appointees

James Service (Chairperson)
Peter Polson
Russell Hooper

The function of the Board Property Investment Committee includes:

- approving the acquisition and disposal of properties held on the statement of financial position
- approving the acquisition and disposal of properties held within single asset property syndicates
- assessing the appropriateness of the property assets and the property risks contained in the overall portfolio held on the statement of financial position
- reviewing the performance of the property portfolio
- approving the investment criteria for the property portfolio

Meetings are to be held quarterly, or more frequently at the discretion of the chairperson.

Statement of principal corporate governance policies of the Responsible Entity (cont.)

Ethical standards

The directors and other employees are expected to act lawfully, in a professional manner, and with the utmost integrity and objectivity in their dealings with clients, contractors, candidates and competitors, the community and each other, striving at all times to enhance the reputation and performance of both the Group and the Responsible Entity.

Unitholders

The Board of Directors of the Responsible Entity aims to ensure that the unitholders are informed of all major developments affecting the Group's state of affairs. Information is communicated to unitholders as follows:

- the annual report is distributed to all unitholders and includes relevant information about the operations of the Trust during the year, changes in the state of affairs of the Trust and details of future developments, in addition to other disclosures required by the Corporations Act 2001
- announcements are made to the Australian Stock Exchange (ASX) in respect of annual and half-yearly results and on other occasions consistent with the ASX's disclosure rules.

Compliance with March 2003 ASX Corporate Governance Council Guidelines

The Board and management are currently reviewing the ASX's March 2003 'Principles of Good Corporate Governance and Best Practice Recommendations'. Upon completion of the review, modifications to Board Charters, policies and the Group's website may be made to enable the practical application of these principles and recommendations to the Group.

Statement of financial performance

For the year ended 30 June 2003

		Consolidated		Parent entity	
	Notes	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Revenue from ordinary activities	2	237,984	513,641	16,303	5,042
Expenses from ordinary activities	3	(214,993)	(507,311)	(6,659)	(4,505)
Borrowing costs	3	(423)	(5,092)	(666)	(601)
Share of net profits of associates accounted for using the equity method	29	4,949	6,386	–	–
Profit from ordinary activities before income tax expense		27,517	7,624	8,978	(64)
Income tax expense	4	(6,194)	1,036	–	–
Net profit attributable to unitholders after tax from ordinary activities		21,323	8,660	8,978	(64)
Net increase/(decrease) in asset revaluation reserve	20	(7,215)	(10,120)	–	–
Net increase/(decrease) in equity option premium reserve	20	1,700	–	1,700	–
Total valuation adjustments attributable to unitholders		(5,515)	(10,120)	1,700	–
Total changes in unitholders' funds from non-unitholder transactions		15,808	(1,460)	10,678	(64)
Basic and diluted earnings per unit	35	2.3 cents	0.9 cents		

The above statement of financial performance should be read in conjunction with the accompanying notes.

Statement of financial position

As at 30 June 2003

	Notes	Consolidated 2003 $000's	Consolidated 2002 $000's	Parent entity 2003 $000's	Parent entity 2002 $000's
Assets					
Cash assets	5	660,421	390,641	23,062	42,297
Receivables	6	243,591	1,048	35,865	19,720
Debt securities	22	846,237	12,424	–	–
Other financial assets		19,645	–	–	–
Equity securities	7	229,452	106,615	–	–
Investment properties	8	2,613,851	–	–	–
Fixed assets	9	10,820	–	–	–
Deferred tax assets	10	29,279	2,301	–	–
Investment in controlled entities	27	–	–	1,109,738	380,260
Investment in associates	29	47,416	13,886	–	–
Intangible assets	11	278,461	–	–	–
Other assets	12	11,282	–	–	–
Excess of net market value of the interests of Challenger Life Limited in its subsidiaries over their net assets	13	375,371	–	–	–
Total assets		5,365,826	526,915	1,168,665	442,277
Liabilities					
Payables	14	223,099	4,372	12,879	3,771
Current tax liabilities		4,601	10,059	–	–
Interest bearing liabilities	15	2,023,361	29,580	13,501	12,835
Provisions	16	34,095	–	–	–
Deferred tax liabilities	17	69,867	–	–	–
Life insurance policy liabilities	18	1,806,155	–	–	–
Total liabilities		4,161,178	44,011	26,380	16,606
Net assets		1,204,648	482,904	1,142,285	425,671
Unitholders' funds					
Units on issue	19	1,140,502	425,391	1,140,502	425,391
Reserves	20	25,012	30,527	1,700	–
Undistributed income	21	39,134	26,986	83	280
Total unitholders' funds		1,204,648	482,904	1,142,285	425,671

The above statement of financial position should be read in conjunction with the accompanying notes.

Statement of cash flows

For the year ended 30 June 2003

	Notes	Consolidated 2003 $000's	Consolidated 2002 $000's	Parent entity 2003 $000's	Parent entity 2002 $000's
Cash flows from operating activities					
Receipts from customers (inclusive of GST)		66	18	4,790	2,979
Payments to suppliers and employees (inclusive of GST)		(8,241)	(5,360)	(7,254)	(4,203)
Dividends received		896	329	8,500	–
Interest received		20,068	17,262	3,013	2,242
Borrowing costs		(423)	(2,030)	(666)	(601)
Income taxes paid		(11,615)	(61)	–	–
GST received		674	245	515	–
Net cash inflow from operating activities	33	1,425	10,403	8,898	417
Cash flows from investing activities					
Purchase of investments		(202,169)	(101,184)	–	–
Payment for purchases of controlled entities, net of cash acquired	27	298,659	–	–	–
Capitalised costs of acquisition paid		(3,722)	–	(3,722)	–
Advance from/to related entities		–	–	(15,236)	752
Proceeds from sale of investments		215,973	502,740	–	–
Other		(1,631)	(650)	–	–
Net cash inflow/(outflow) from investing activities		307,110	400,906	(18,958)	752
Cash flows from financing activities					
Proceeds from issue of units		–	40,763	–	40,763
Proceeds from borrowings		–	25,000	–	–
Repayment of borrowings		(29,580)	(200,000)	–	–
Distributions paid		(9,175)	–	(9,175)	–
Other		–	–	–	(175)
Net cash inflow/(outflow) from financing activities		(38,755)	(134,237)	(9,175)	40,588
Net increase/(decrease) in cash held		269,780	277,072	(19,235)	41,757
Cash at the beginning of the financial year		390,641	113,569	42,297	540
Effects of exchange rate changes on cash		–	–	–	–
Cash at the end of the financial year	5	660,421	390,641	23,062	42,297
Non-cash financing and investing activities	34				

The above statement of cash flows should be read in conjunction with the accompanying notes.

Notes to the financial statements

Note 1. Summary of significant accounting policies

This general purpose financial report has been prepared in accordance with the requirements of the Trust Constitution (as amended), Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Consensus Views and the Corporations Act 2001.

The financial report is prepared in accordance with the historical cost convention except for all life insurance assets and liabilities, and certain other assets and liabilities which are stated at valuation as described in the summary of significant accounting policies.

Unless otherwise stated, the accounting policies adopted are consistent with those of the previous year. The statement of financial position is presented in order of liquidity. Comparative information is reclassified where appropriate to enhance comparability.

(a) Principles of consolidation

The consolidated financial statements incorporate the assets and liabilities of all entities controlled by Challenger Financial Services Group (Parent Entity) as at 30 June 2003 and the results of all controlled entities for the year then ended. Challenger Financial Services Group and its controlled entities together are referred to in this financial report as the consolidated entity. The effects of all transactions between entities in the consolidated entity are eliminated in full.

Where control of an entity is obtained during a financial year, its results, where material, are included in the consolidated statement of financial performance from the date on which control commences. Where control of an entity ceases during a financial year its results are included for that part of the year during which control existed.

Life insurance controlled entities

Both the shareholders' and policy owners' interests in the life insurance funds of the controlled entities are consolidated.

Some aspects of generally accepted Australian accounting practices applicable to life insurers, in particular net market value accounting, differ from generally accepted practices for non-life insurers. Where a life insurer consolidates a subsidiary, any differences between the values consolidated line by line and the market value of the controlled entity recorded in the life insurer's financial statements is shown as 'excess of the net market values of its interests in its subsidiaries over their net assets'.

Non-life insurance controlled entities

Where controlled entities of non-life insurance companies are consolidated the excess of the purchase price over the fair value of net assets of controlled entities is goodwill and is amortised as described in 1(n).

Investments in associates

Investments in associates are carried at the lower of equity accounted amount or recoverable amount in the consolidated financial report.

(b) Life insurance financial reporting

Assets, liabilities, revenues and expenses are measured on the following basis.

(i) Investment assets relating to Challenger Life Limited and its life subsidiary Challenger Life No.2 Limited (together 'Challenger Life') have been recorded at net market value including an allowance for estimated realisation costs. Where no quoted market values exist, various methods determined by the directors have been adopted. They include the following:

- Investments in unit trusts that are not controlled entities are recorded at their latest available market value.
- Investments in controlled property trusts consist of income units (entitlements to rental income less financing and hedging costs) and capital units (entitlements to residual net assets upon the maturity of the income units).

The values of investments in income and capital units are derived from net market valuations on the underlying properties, undertaken by independent accredited valuers, less the costs of related debt and hedging contracts.

Revaluation gains and losses on property investments arise where the net market value differs to cost. Net market value (fair value) is the most probable price reasonably obtainable in the market from a willing and knowledgeable buyer. The cost of acquired properties includes the purchase price, and any directly attributable expenditure including professional fees for legal services, property transfer taxes and other related transaction costs.

- Investments in controlled entities that do not have a market price are recorded at fair value as determined by the directors. For details refer to note 13.
- Interest-bearing securities listed on exchanges are shown at quoted prices at balance date.
- Loans are recorded at market value based on discounting the estimated recoverable amount using prevailing interest rates.

Gains and losses arising from the revaluation of investments are included as part of investment income in the statement of financial performance.

(ii) Overview of Margin on Services (MoS) methodology

MoS is the financial reporting methodology for Australian life insurance companies as prescribed in the Life Insurance Act 1995 (the Act). MoS is designed to recognise profits on life insurance as services are provided to policyholders and income is received. Services used to determine profit recognition include the cost of the expected claims, maintaining policies, and investment management. Policy liabilities are valued by the Life Insurance Actuarial Standard 1.02 ‘Valuation of Policy Liabilities’ issued by the Life Insurance Actuarial Standards Board under the Life Insurance Act.

Policy liabilities are amounts which, when taken together with future premiums and investment earnings:
- are required to meet the payment of future benefits and expenses; and
- incorporate profit margins on existing business to be released when earned in future periods.

Life insurance policy liabilities are not categorised as current or non-current, which is consistent with the presentation of investment assets backing those liabilities.

On the basis of an actuarial assessment under the MoS methodology the excess of net assets over policy liabilities accrues to the benefit of Challenger Financial Services Group Limited.

MoS profit can be analysed in the following categories:
- Planned margins of revenues and expenses.

  At the time of writing a policy and at each balance date, best estimate assumptions are used to determine all expected future payments and premiums. Where actual experience replicates best estimate assumptions, the expected profit margins will be released to profit over the life of the policy.

- The difference between actual and assumed experience.

  Experience profits/(losses) are realised where actual experience differs from best estimate assumptions. Instances giving rise to experience profits/(losses) include variations in claims, expenses, mortality, discontinuance and investment returns. For example, an experience profit will emerge when the expenses of maintaining all in-force business in a year are lower than the best estimate assumption in respect of those expenses.

- Changes to underlying assumptions.

  Assumptions used for measuring policy liabilities are reviewed each period by the appointed actuary. Where the review leads to a change in assumptions, the change is deemed to have occurred from the end of the financial year.

  The financial effect of changes to the assumptions underlying the measurement of policy liabilities made during the reporting period are recognised in the statement of financial performance over the future reporting periods during which services are provided to policyholders. However, if based on best estimate assumptions, written business for a group of related products is expected to be unprofitable, the whole expected loss for that related product group is recognised in the statement of financial performance immediately. When loss making business becomes profitable, it is necessary to reverse previously recognised losses.

(iii) Basis of expense apportionments

Direct expenses are allocated on the basis of statutory fund, class and category of business. Other expenses have been apportioned between statutory funds, classes and categories of business in accordance with Division 2 of Part 6 of the Life Insurance Act 1995, with general management expenses being apportioned on a similar basis.

Apportionment between policy acquisition, policy maintenance and investment management has been made in line with principles set out in the Life Insurance Actuarial Standards Board (LIASB) Valuation Standard (Actuarial Standard AS 1.02).

(iv) Policy acquisition costs are the fixed and variable costs of acquiring new business and include the related commission, policy issuing and underwriting costs, agency expenses and other sales costs. The actual acquisition costs incurred in life business are recorded in the statement of financial performance.

In determining life insurance policy liabilities, the appointed actuary takes account of the deferral and the future recovery of acquisition costs. The acquisition costs deferred are determined as the greater of actual costs incurred and any explicit policy charges for the recovery of those costs, subject to an overall limit that the value of future profits at inception cannot be negative. Acquisition losses are recognised at inception to the extent the latter situation arises.

(v) Consolidated payables include all of Challenger Life's creditors, other liabilities and some of its borrowings. The non-current borrowings and 'other liabilities' relating to life insurance operations are measured at net present values, and changes to those net present values, as well as borrowing costs, are recognised as expenses (and, in some cases, revenues) of the period. The borrowings and other liabilities relating to the retail operations are measured at their face values with only borrowing costs recognised as expenses of the period.

(c) Income tax

Tax effect accounting is applied using the balance sheet liability method, which focuses on the tax effect of transactions and other events that affect amounts recognised in either the statement of financial position or tax based balance sheet.

The Trust is liable to pay income tax on its taxable income at the general company rate of tax (currently 30%). The Trust's controlled entities are also subject to income tax. Unitholders will be required to include in their assessable income distributions paid or credited to them by the Trust. Any distributions by the Trust may be franked or unfranked, depending inter alia upon the franking balance of the Trust.

The Trust is classed as a corporate unit trust rather than a flow-through trust for taxation purposes. Accordingly the Trust is taxed similarly to a company in many respects. The classification of the Trust as a corporate unit trust or a flow-through trust must be reviewed on an annual basis in accordance with the requirements of the relevant taxation law.

As a result of the changes from the Income Tax Amendment Bill, the income tax expense of Challenger Life is determined at the corporate tax rate, except for complying superannuation policies and segregated exempt assets (including immediate annuities).

The income tax expense or revenue for the period is the tax payable on the current period's taxable income adjusted by changes in deferred tax assets and liabilities attributable to amounts recognised as assets or liabilities, and to unused tax losses.

Deferred tax assets and liabilities are recognised for temporary differences between the carrying amount of assets and liabilities for accounting purposes and the tax bases of those assets and liabilities, and for unused tax losses. The tax rates expected to apply when the assets are recovered or liabilities are settled, based on those tax rates which are enacted or substantively enacted for each jurisdiction, are applied to the cumulative amounts of deductible and assessable temporary differences to measure the deferred tax asset or liability.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax liabilities are not recognised for temporary differences between the carrying amount and tax bases of investments in controlled entities as there is currently no intention to repatriate undistributed profits or dispose of those controlled entities.

(d) Foreign currency translation

(i) Transactions

Foreign currency transactions are initially translated into Australian currency at the rate of exchange at the date of the transaction. At balance date amounts payable and receivable in foreign currencies are translated to Australian currency at rates of exchange current at that date. Resulting exchange differences are brought to account in determining the profit or loss for the year.

(ii) Foreign controlled entities

As the foreign controlled entities are self-sustaining, their assets and liabilities are translated into Australian currency at rates of exchange current at balance date, while their revenues and expenses are translated at the average of rates ruling during the year. Exchange differences arising on translation are taken to the foreign currency translation reserve.

(e) Acquisitions of assets

The purchase method of accounting is used for all acquisitions of assets, except for those assets held by Challenger Life, regardless of whether shares or other assets are acquired. Cost is determined as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition plus costs incidental to the acquisition. Where units are issued in an acquisition, the value of the units is determined having reference to the assessed fair value of the assets or net assets acquired, including goodwill or discount on acquisition where applicable.

Goodwill is brought to account on the basis described in note 1(n).

The fair value of acquired tax losses is determined via their recoverability in the hands of the acquirer and probability of recognition in future periods.

(f) Revenue and expense recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured. Revenue and expenses are generally recognised on an accruals basis. The following specific recognition criteria must also be met before revenue is recognised:

Dividend income

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.

Responsible Entity expenses

The Responsible Entity is entitled under the Trust Constitution to be reimbursed for certain expenses incurred in administration of the Trust. The basis on which the expenses are reimbursed is defined in the Trust Constitution. The amount reimbursed is disclosed in the statement of financial performance and is calculated in accordance with the Trust Constitution.

Responsible Entity fees

In accordance with the Trust Constitution, the Responsible Entity is entitled to:

- A management fee of 1.5% per annum of the Trust's gross asset value at the end of June and December each year. The fee is payable to the Responsible Entity half-yearly in arrears. However, the Responsible Entity has elected to receive no management fees in respect of the acquisition of Challenger Financial Services Group Limited (formerly Challenger International Limited) until the volume weighted average price of units in the Trust on ASX over a consecutive 10 trading day period has exceeded 60 cents.

- Realisation performance fees, payable on the realisation of individual investments once a hurdle rate of return of 10% compounded per annum (pre-tax) is achieved; and
- 5 year performance fees, payable every 5 years on both realised and unrealised performance of the Trust.

(g) Receivables

All trade debtors are recognised at the amounts receivable. Trade debtors are due for settlement no more than 120 days from the date of recognition, and other debtors no more than 30 days from the date of recognition.

The recoverability of trade debtors is reviewed on an ongoing basis. Debtors that are known to be uncollectible are written off. A provision for doubtful debts is raised where it is probable the debt will not be fully recoverable.

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 received.

(h) Recoverable amount of non-current assets

The recoverable amount of an asset is the net amount expected to be recovered through the net cash inflows arising from its continued use and subsequent disposal.

Where the carrying amount of a non-current asset is greater than its recoverable amount, the asset is written down to its recoverable amount. Where net cash inflows are derived from a group of assets working together the recoverable amount is determined on the basis of the relevant group of assets.

(i) Revaluations of strategic non-current assets

Asset revaluation increments in respect of strategic non-current investments are credited directly to the asset revaluation reserve, unless they are reversing a previous decrement charged to the statement of financial performance, in which case the increment is credited to the statement of financial performance.

Revaluation decrements in respect of strategic non-current investments are recognised as expenses in the statement of financial performance, unless they are reversing revaluation increments previously credited to, and still included in the balance of, the asset revaluation reserve in respect of that same class of assets, in which case they are debited directly to the asset revaluation reserve.

Revaluation increments and decrements are offset against one another within a class of non-current assets, but not otherwise.

Potential capital gains tax is not taken into account in determining revaluation amounts unless it is expected that a liability for such tax will crystallise, except for Challenger Life where deferred tax liabilities are recognised on all revaluations.

(j) Investments

Investments held outside the Life company in listed and unlisted securities, other than controlled entities, associates and strategic non-current investments in the consolidated financial statements, are brought to account at the lower of cost or net realisable value. Controlled entities and associates are accounted for in the consolidated financial statements as set out in note 1(a).

The fair value of strategic quoted investments is determined by reference to the last available sales price of the security, as quoted on its primary stock exchange on the day of valuation or an alternative basis if deemed more appropriate. The fair value of unlisted strategic investments is based on valuation by the Responsible Entity at balance date. Periodic determinations of fair value are made when necessary.

(k) Depreciation of fixed assets

Depreciation is calculated on a straight line basis to write off the net cost or revalued amount of each item of property, plant and equipment (excluding land) over its expected useful life to the consolidated entity. 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 – 4 years

Computer equipment and software – 3 years

(l) Leasehold improvements

The cost of improvements to or on leasehold properties is amortised over the unexpired period of the lease or the estimated useful life of the improvement to the consolidated entity, whichever is the shorter. Leasehold improvements held at the reporting date are being amortised over 5 years.

(m) Leased assets

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 non-current 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 consolidated entity 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 3 to 5 years.

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

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 consolidated entity. Each lease payment is allocated between the liability and finance charge.

Other operating lease payments are charged to the statement of financial performance in the periods in which they are incurred, as this represents the pattern of benefits derived from the leased assets.

(n) Intangible assets and expenditure carried forward

On acquisition of some, or all, of the assets of another entity or, in the case of an investment in a controlled entity, on acquisition of some, or all, of the equity of that controlled entity, the identifiable net assets acquired are measured at fair value. The excess of the fair value of the cost of acquisition over the fair value of the identifiable net assets acquired, including any liability for restructuring costs, is brought to account as goodwill and amortised on a straight line basis over the period during which the benefits are expected to arise, being no more than twenty years.

(o) Payables

These amounts represent liabilities for goods and services provided to the consolidated entity prior to the end of the financial year and which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

(p) Interest-bearing liabilities

Loans and debentures are carried at their principal amounts which represent the present value of future cash flows associated with servicing the debt. Interest is accrued over the period it becomes due and is recorded as part of other creditors.

(q) Derivative financial instruments

The consolidated entity is exposed to changes in interest rates and foreign exchange rates and may use interest rate swaps and forward foreign exchange contracts to hedge these risks. Derivative financial instruments designated as hedges are accounted for on the same basis as the underlying exposure.

The net amount receivable or payable under interest rate swap agreements is progressively brought to account over the period to settlement. The amount recognised is accounted for as an adjustment to interest and finance charges during the period and included in other debtors or other creditors at each reporting date.

(r) 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 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.

(s) Employee entitlements

(i) Wages and salaries, and annual leave

Liabilities for wages and salaries and annual leave expecting to be settled within 12 months of the reporting date are recognised in provisions in respect of employees' services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled.

(ii) Long service leave

A liability for long service leave is recognised and is 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 outflows.

(iii) Termination benefits

Liabilities for termination benefits relating to an acquired entity or operation that arise as a consequence of acquisition are recognised as at the date of acquisition if, at or before the acquisition date, the main features of the termination were planned and a valid expectation had been raised in those employees affected that the terminations would be carried out and this is supported by a detailed plan developed within three months of the acquisition or prior to the completion of the financial report, if earlier. These liabilities are disclosed in aggregate with other restructuring costs as a consequence of the acquisition.

Liabilities for termination benefits expected to be settled within 12 months are measured at the amounts expected to be paid when they are settled.

(t) Restructuring costs

Liabilities for the cost of restructuring entities or operations acquired are recognised as at the date of acquisition of an entity, or part thereof, if the main features of the restructuring were planned and there was a demonstrable commitment to the restructuring at the acquisition date and this is supported by a detailed plan developed within three months of the acquisition or prior to the completion of the financial report, if earlier.

The cost of restructurings provided for, other than related employee termination benefits, is the estimated cash flows, having regard to the risks of the restructuring activities.

Liabilites for employee termination benefits associated with restructurings are brought to account on the basis described in the accounting policy note for employee entitlements (note 1 (s)). Liabilities for costs of restructurings and related employee termination benefits are disclosed in aggregate where the restructuring occurs as a consequence of an acquisition.

Reversals of part or all of a provision for restructuring relating to an acquisition because costs are no longer expected to be incurred as planned are adjusted against goodwill on acquisition. The adjusted carrying amounts of the goodwill are amortised from the date of the reversal.

(u) Borrowing costs

Borrowing costs are recognised as expenses in the period in which they are incurred.

Borrowing costs include:

- interest on bank overdrafts and short-term and long-term borrowings
- amortisation of ancillary costs incurred in connection with the arrangement of borrowings
- finance lease charges

(v) Cash

For purposes of the statement of cash flows, cash includes deposits at call which are readily convertible to cash on hand and are subject to an insignificant risk of changes in value, net of outstanding bank overdrafts.

(w) Earnings per unit

(i) Basic earnings per unit

Basic earnings per unit is determined by dividing net profit after income tax attributable to members of the Trust by the weighted average number of units outstanding during the financial year.

(ii) Diluted earnings per unit

Diluted earnings per unit adjusts the figures used in the determination of basic earnings per unit by taking into account amounts unpaid on units and any reduction to earnings per unit that will probably arise from the exercise of options outstanding during the financial year.

(x) Funds under management

Within the economic entity certain controlled entities act as the single Responsible Entity/manager for a number of investment funds and trusts.

These funds and trusts have not been consolidated in the financial statements, because individual entities within the economic entity do not have control of the funds and trusts defined by AASB 1024 'Consolidated Accounts'.

Challenger Life has arrangements in place to ensure that the asset management activities are managed separately from Challenger Life.

(y) Restrictions on assets

Investments held in Challenger Life 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.

(z) Distributions

Provision is made for the amount of any distribution declared, determined or publicly recommended by the directors of the Responsible Entity on or before the end of the financial year but not distributed at balance date.

This policy was adopted with effect from 1 July 2002 to comply with AASB1044 Provisions, Contingent Liabilities and Contingent Assets. This change in accounting policy did not require adjustment to the Trust or Group's opening retained earnings given no distributions were paid by the Trust in the 2002 financial year.

(aa) Rounding of amounts

The entity is of a kind referred to in Class Order 98/0100, issued by the Australian Securities and Investment Commission, relating to the 'rounding off' of amounts in the financial report. Amounts in the financial report have been rounded off in accordance with the class order to the nearest thousand dollars, or in certain cases, to the nearest dollar.

Note 2. Revenue from ordinary activities

	Consolidated 2003 $000's	Consolidated 2002 $000's	Parent entity 2003 $000's	Parent entity 2002 $000's
Dividend income				
Wholly owned entities	–	–	8,500	–
Other persons/corporations	812	414	–	–
Interest income				
Wholly owned entities	–	–	1,104	836
Other persons/corporations	20,818	17,475	1,909	1,406
Proceeds on sale of investment	216,332	495,750	–	–
Management fee income				
Wholly owned entities	–	–	4,790	2,800
Other income	22	2	–	–
Revenue from ordinary activities	237,984	513,641	16,303	5,042

Note 3. Expenses from ordinary activities

	Consolidated 2003 $000's	Consolidated 2002 $000's	Parent entity 2003 $000's	Parent entity 2002 $000's
Borrowing costs				
Interest expense				
Wholly owned entities	–	–	666	596
Other persons/corporations	423	2,172	–	5
Other borrowing costs	–	2,920	–	–
	423	5,092	666	601
Expenses from ordinary activities, excluding borrowing costs				
Cost of investments sold	205,618	499,395	–	–
Unrealised losses on investments	1,895	2,706	–	–
Management fee	5,475	3,697	5,475	3,697
Other expenses	2,005	1,513	1,184	808
	214,993	507,311	6,659	4,505
Total expenses from ordinary activities	215,416	512,403	7,325	5,106

Note 4. Income tax

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
(a) The income tax expense for the financial year differs from the amount calculated on the profit. The differences are reconciled as follows:				
Profit from ordinary activities before income tax expense	27,517	7,624	8,978	(64)
Income tax calculated @ 30%	8,255	2,287	2,693	(19)
Tax effect of permanent differences:				
Non-allowable expenses	154	21	–	–
Non-assessable items	(1,485)	(1,916)	(2,550)	–
Other items	(1,148)	(28)	20	–
Net adjustment to deferred income tax liabilities and assets to reflect the decrease in company tax rate to 30%	–	(314)	–	–
Under/(over) provision in previous year	581	(1,086)	–	–
Tax losses (utilised)/not recognised	(163)	–	(163)	19
Aggregate income tax expense	6,194	(1,036)	–	–
Aggregate income tax expense comprises:				
Current income tax expense	7,660	15,545	–	–
Deferred income tax (revenue)/expense	(2,047)	(15,495)	–	–
Under/(over) provision in prior years	581	(1,086)	–	–
	6,194	(1,036)	–	–
Deferred income tax (revenue)/expense comprises:				
Decrease/(increase) in deferred tax asset (note 10)	(2,047)	(2,301)	–	–
(Decrease)/increase in deferred tax liability (note 17)	–	(13,194)	–	–
	(2,047)	(15,495)	–	–
Tax losses				
The directors estimate that the potential deferred tax asset at 30 June 2003 in respect of tax losses not brought to account is	–	–	50	225

The benefit for tax losses will be obtained only if:

(i) the consolidated entity derives future assessable income of a nature and of an amount sufficient to enable the benefit from the deductions for the losses to be realised, or

(ii) the losses are transferred to an eligible entity in the consolidated entity, and

(iii) the consolidated entity continues to comply with the conditions for deductibility imposed by tax legislation, and

(iv) no changes in tax legislation adversely affect the consolidated entity in realising the benefit from the deductions for the losses.

Note 4. Income tax (cont.)

Deferred tax liabilities

Deferred tax liabilities have not been recognised where:

(i) amounts are recognised in equity such as the revaluations of non-life company investments in the asset revaluation reserve.

(ii) amounts relating to investments in subsidiaries where the Trust controls the timing of distributions and dividends, and it is probable that temporary differences will not reverse in the foreseeable future.

Tax consolidation legislation

The Trust and its wholly owned Australian subsidiaries intend to form a tax consolidation group as at 30 June 2003 in terms of the tax consolidation legislation. Whilst the Minister for Revenue and Assistant Treasurer of the Commonwealth Government, Senator Helen Coonan, announced in March 2003 that legislation allowing a corporate unit trust to be the head entity of a tax consolidated group was to be introduced as soon as is practical, this legislation has not been substantively enacted. Given this, the financial effect of the forming of a tax consolidation group has not been recognised in these financial statements. The Group intends to enter into a tax-sharing agreement but the details of this agreement are not yet finalised.

Once the legislation is enacted, the Trust, as the head entity in the tax-consolidated group, will recognise current and deferred tax amounts relating to transactions, events and balances of the wholly owned Australian subsidiaries in this group in future financial statements as if those transactions, events and balances were its own, in addition to the current and deferred tax balances arising in relation to its own transactions, events and balances. Amounts receivable or payable under the tax sharing agreement will be recognised separately by the Trust as tax-related amounts receivable or payable.

Franking credits

	Consolidated		Parent entity	
	2003 $000's	**2002 $000's**	**2003 $000's**	**2002 $000's**
Franking credits available for subsequent financial years based on a tax rate of 30%	28,774	26,245	264	554

The above amount represents the balances of the franking account as at the end of the financial year, adjusted for:

(a) franking credits that will arise from the payment of the current tax liability

(b) franking debits that will arise from the payment of dividends recognised as a liability at the reporting date

(c) franking credits that will arise from the receipt of dividends recognised as receivables at the reporting date, and

(d) franking credits that may be prevented from being distributed in the subsequent year.

In accordance with the New Business Tax System (Imputation) Act 2002, the measurement basis of the dividend franking account changed on 1 July 2002 from an after-tax profits basis to an income tax-paid basis. For comparative purposes, the prior year balances have been converted to an income tax-paid basis.

The change in the basis of measurement does not change the underlying value of franking credits or tax offsets available to shareholders from the dividend franking account.

Note 5. Cash assets

	Consolidated		Parent entity	
	2003 $000's	**2002 $000's**	**2003 $000's**	**2002 $000's**
Cash at bank and on hand	313,376	2,315	178	179
Deposits at call	347,045	388,326	22,884	42,118
	660,421	390,641	23,062	42,297

Note 6. Receivables

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Secured loans*	177,253	–	–	–
Less: Provision for doubtful debts	(5,343)	–	–	–
	171,910	–	–	–
Lease receivables	9	–	–	–
Less: Provision for doubtful debts	(5)	–	–	–
	4	–	–	–
Trade debtors	14,741	–	–	–
Bills of exchange	5,821	–	–	–
Amounts recoverable from managed trusts	5,672	–	–	–
Loans to related entities	–	–	35,597	19,695
Accrued dividends	1,356	–	–	–
Accrued interest	4,788	–	–	–
Other debtors	39,299	1,048	268	25
	243,591	1,048	35,865	19,720

* Includes margin lending receivables amounting to $162,628,742 (2002: $nil).

Bills of exchange

The bills have a face value of $5,850,000 (2002 - $nil) and mature at various dates over 3 months following balance date. The average interest rate is 4.80%.

Note 7. Equity securities

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Shares in listed corporations	45,658	15,887	–	–
Unit trusts and managed funds	78,759	–	–	–
Shares in listed corporations held in relation to endowment warrants (non-current)	66,126	–	–	–
Strategic equity investments (non-current)	38,909	90,728	–	–
	229,452	106,615	–	–

Note 8. Investment properties

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Unit trusts	9,656	–	–	–
Land and buildings	2,604,195	–	–	–
	2,613,851	–	–	–
Reconciliation				
Carrying amount at 1 July 2002	–			
Additions by way of acquisition	2,613,851			
Closing balance at 30 June 2003	2,613,851			

Note 8. Investment properties (cont.)

	Acquisition date	Acquisition price $M	Total cost including additions $M	Independent valuation $M	Valuer	Date of latest valuation	Valuation 30/6/03 $M
Australian properties							
Aust Commercial							
ABS Building, ACT	01/01/00	35.2	78.1	118.8	Colliers	06/03	118.8
Bird Cameron Building, WA	23/11/98	10.1	10.8	10.8	FPD Savills	06/03	10.8
County Court, VIC	30/06/00	153.7	186.4	239.6	CBRE	06/03	239.6
CSIRO, NSW	27/06/01	137.0	151.9	145.0	FPD Savills	06/03	145.0
Discovery House, ACT	28/04/98	30.6	32.9	35.0	Colliers	06/03	35.0
Elders House, SA	21/06/02	40.2	43.0	41.6	JLL	06/03	41.6
Executive Building, Hobart, TAS	30/03/01	20.7	21.5	23.2	M3	06/03	23.2
Globe, Port Melbourne, VIC	13/11/02	17.3	18.5	17.7	CKC	06/03	17.7
Goodman Fielder, North Ryde, NSW	23/02/01	35.2	37.3	41.4	DTZ	06/03	41.4
Heidelberg, Bowen Hills, NSW & QLD	07/01/00	14.8	15.7	15.9	CBRE/Chesterton	06/03	15.9
Kraft, Port Melbourne, VIC	28/06/02	24.1	25.7	24.8	CKC	06/03	24.8
Makerston, QLD	14/12/00	38.0	39.7	42.5	CBRE	06/03	42.5
Mobil House, VIC	27/06/02	73.0	74.7	74.4	CKC	06/03	74.4
Rexel, North Ryde, NSW	18/12/99	15.1	16.0	18.2	FPD Savills	06/03	18.2
Taylors Institute, Waterloo, NSW	16/05/01	35.0	37.1	38.5	M3	06/03	38.5
The Forum, Cisco, NSW	05/01/01	96.0	101.4	102.7	FPD Savills	06/03	102.7
The Forum, UUNet, NSW	05/01/01	61.0	65.8	65.0	FPD Savills	06/03	65.0
Vodafone, Kingston, TAS	19/03/99	11.9	12.8	13.8	M3	06/03	13.8
Sub-sector Aust commercial total		**848.7**	**969.3**	**1,068.9**			**1,068.9**
Entertainment							
Albury Cinema Complex	04/07/00	5.1	4.9	5.8	M3	06/03	5.8
Century City Walk, VIC	04/07/00	24.1	21.8	23.2	M3	06/03	23.2
Innaloo Cinema Centre, WA	17/12/01	20.3	22.9	23.8	FPD Savills	06/03	23.8
Jam Factory, VIC	04/07/00	74.9	86.6	105.5	M3	06/03	105.5
Rivoli, VIC	04/07/00	12.7	13.3	20.0	M3	06/03	20.0
Village City Centre, VIC	04/07/00	21.2	22.6	24.8	M3	06/03	24.8
Village Geelong, VIC	04/07/00	7.7	7.5	8.2	M3	06/03	8.2
Village Hobart, TAS	04/07/00	10.0	10.8	12.0	M3	06/03	12.0
Village Hoyts Cinema Centre, NSW	04/07/00	68.5	68.1	79.0	M3	06/03	79.0
Village Launceston, TAS	04/07/00	2.0	2.2	2.6	M3	06/03	2.6
Sub-sector entertainment total		**246.5**	**260.7**	**304.9**			**304.9**
Industrial							
Toll Drive, Altona North, VIC	31/01/01	18.9	20.0	20.0	CKC	06/03	20.0
API, Richlands, QLD	29/12/99	10.5	11.0	10.9	CBRE	06/03	10.9
Auto Group, Enfield, NSW	17/02/99	15.6	16.6	20.4	FPD Savills	06/03	20.4
Elders Woolstore, Gillman, SA	25/06/99	8.1	8.1	10.4	JLL	06/03	10.4
Spicers, Cannington, WA	29/12/99	7.3	7.8	8.0	FPD Savills	06/03	8.0
Spotlight, Laverton North, VIC	11/05/00	12.1	12.9	13.3	CKC	06/03	13.3
Tetra Pak, Fairfield, NSW	15/05/02	17.4	18.5	18.4	Chesterton	06/03	18.4
Tyco, QLD	01/12/00	6.5	6.8	6.5	Landmark White	06/03	6.5
Wesfarmers Woolstore, Brooklyn, VIC	28/05/99	26.3	28.0	29.0	CKC	06/03	29.0
CPI Braeside, VIC (JV)	29/12/99	6.4	6.4	5.8	M3	06/03	5.8
CPI Wetherill Park, NSW (JV)	29/12/99	4.5	4.5	3.9	Chesterton	06/03	3.9
Sub-sector industrial total		**133.6**	**140.6**	**146.6**			**146.6**
Retail							
Chapel Street Airrights, VIC	15/05/01	6.0	6.0	12.4	M3	06/03	12.4
Kings Langley, NSW	29/07/01	14.1	14.6	14.9	M3	06/03	14.9
Sub-sector retail total		**20.1**	**20.6**	**27.3**			**27.3**
Development							
DIMIA Building, ACT		43.4	70.7	65.1	Colliers	06/03	65.1
Sub-sector Development total		**43.4**	**70.7**	**65.1**			**65.1**
Total Australia		1,292.3	1,461.9	1,612.8			1,612.8

Note 8. Investment properties (cont.)

	Acquisition date	Acquisition price current equivalent $M	Total cost including additions $M	Independent valuation $M	Valuer	Date of latest valuation	Valuation 30/6/03 $M
United Kingdom							
3 World Business Centre, Heathrow	22/03/02	60.2	61.8	64.0	CB Hillierparker	06/03	64.0
Hayes Park	08/10/01	182.1	185.3	176.4	CB Hillierparker	06/03	176.4
Minster Court (50%)	07/07/01	211.8	214.7	213.6	CB Hillierparker	06/03	213.6
Senator House	03/05/01	205.9	210.6	202.6	CB Hillierparker	06/03	202.6
Sub-sector UK total		**660.0**	**672.4**	**656.6**			**656.6**
United States							
Las Cimas II & III	15/07/02	89.7	94.5	95.3	C & W	06/03	95.3
50 Milk Street, Boston	15/10/02	162.7	166.3	161.9	C & W	06/03	161.9
Invesco, Denver	31/12/02	86.0	87.0	87.3	C & W	06/03	87.3
Sub-sector USA total		**338.4**	**347.8**	**344.5**			**344.5**
Grand total		2,290.7	2,482.1	2,613.9			2,613.9

As all valuations were conducted close to year end there are no additions since the valuations.

Qualifications of valuers

The valuer or valuation practice are authorised to practice 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 or 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.

Methodology

Valuations are prepared on the basis of market value as defined by the International Assets Valuation Standards Committee (TIAVSC) and endorsed by the API, being:

> 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 after property marketing costs 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 9. Fixed assets

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Plant, equipment and software – at cost	14,761	–	–	–
Less: Accumulated depreciation	(5,754)	–	–	–
	9,007	–	–	–
Fixed assets under finance lease	4,635	–	–	–
Less: Accumulated amortisation	(2,822)	–	–	–
	1,813	–	–	–
Total fixed assets	10,820	–	–	–

Reconciliations

Reconciliations of the consolidated entity of the carrying amounts of each class of property, plant and equipment at the beginning and end of the current financial year are set out below.

	Plant, equipment & software $'000	Leased fixed assets $'000	Total $'000
Consolidated			
Carrying amount at 1 July 2002	–	–	–
Additions	4,000	–	4,000
Additions through acquisition of entity (note 27)	5,007	1,813	6,820
Carrying amount at 30 June 2003	9,007	1,813	10,820

Note 10. Deferred tax assets

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
The balance arises as a result of temporary differences attributable to:				
Surplus lease space	2,214	–	–	–
Restructure provision	7,026	–	–	–
Provision for doubtful debts	3,047	–	–	–
Writedown of investments	6,486	–	–	–
Warrant premiums payable	1,497	–	–	–
Employee entitlements	989	–	–	–
Other	8,020	2,301	–	–
	29,279	2,301	–	–

Note 11. Intangible assets

	Consolidated 2003 $000's	Consolidated 2002 $000's	Parent entity 2003 $000's	Parent entity 2002 $000's
Goodwill	278,206	–	–	–
Acquisition costs	255	–	–	–
	278,461	–	–	–

Note 12. Other assets

	Consolidated 2003 $000's	Consolidated 2002 $000's	Parent entity 2003 $000's	Parent entity 2002 $000's
Prepayments	10,263	–	–	–
Other	1,019	–	–	–
	11,282	–	–	–

Note 13. Excess of net market values over the net book value of life insurance subsidiaries (EMVONA)

		Consolidated 2003 $000's	Consolidated 2002 $000's	Parent entity 2003 $000's	Parent entity 2002 $000's
Controlled entities					
Challenger Life No.2	(a)	136,189	–	–	–
Management rights Howard Mortgage Trust	(b)	150,000	–	–	–
Management rights Garrisons and Synergy	(b)	63,881	–	–	–
Other controlled entities	(b)	25,301	–	–	–
		375,371	–	–	–

(a) The net market value of Challenger Life No.2 has been determined by the directors. In making their assessment the directors have taken account of the high level valuation performed at 30 June 2003 by an independent expert, the valuations disclosed in the scheme document date 9 May 2003, and a full appraisal valuation performed at 30 June 2002.

(b) The net market value of management rights and other controlled entities is at directors' valuation. In making their assessment the directors have considered the independent valuations performed in the last six months, recent market sales of similar entities, and discounted cash flows arising from the underlying operations/assets.

Note 14. Payables

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Trade creditors and accruals	90,346	4,372	12,879	3,771
Warrant liability	25,848	–	–	–
Swaps and forwards at fair value	77,695	–	–	–
Other creditors	29,210	–	–	–
	223,099	4,372	12,879	3,771

Note 15. Interest-bearing liabilities

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Unsecured liabilities				
Unsecured notes	1,031	–	–	–
Convertible notes	200	–	–	–
Loans from related entities	–	–	13,501	12,835
	1,231	–	13,501	12,835
Secured liabilities				
Bank loans	1,308,224	–	–	–
Non-bank loans	661,100	29,580	–	–
Debentures	49,028	–	–	–
Lease liabilities	3,778	–	–	–
	2,022,130	29,580	–	–
Total interest-bearing liabilities	2,023,361	29,580	13,501	12,835

Security for borrowings

The CFSGL group corporate bank facility amounting to $100,000,000 is secured by fixed and floating charges granted by CFSGL, and Iroka Pty Limited and an Equitable Mortgage of Shares over the shares in Howard Mortgage Management Limited granted in favour of ANZ Banking Group Limited. The facility expires on 31 August 2004. The renegotiation of a new facility is underway. In addition, there are in place cross guarantees between certain Group companies.

Further bank loans and non-bank loans in the controlled entities are secured solely by first mortgages over properties. The remaining non-bank loans, $159 million, in relation to the margin lending business are secured over shares.

The debentures issued by Howard Finance Limited are secured by floating charges over the assets of the company and certain of its controlled entities.

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

Note 15. Interest-bearing liabilities (cont.)

	Consolidated 2003 $000's	Consolidated 2002 $000's	Parent entity 2003 $000's	Parent entity 2002 $000's
Financing arrangements				
Unrestricted access was available at balance date to the following lines of credit:				
Total facilities	1,347,660	–	–	–
Used at balance date	1,308,224	–	–	–
Unused at balance date	39,436	–	–	–

Interest on loan facilities accrues at a floating interest rate based on market rates plus a margin of between 0.5% and 1.65% per annum. The loans are repayable within 10 years. Interest on the bank overdraft is charged at the bank's floating index rate.

$19,085,000 (2002: $nil) of the unused facilities relate to capital expenditure commitments (refer to note 25).

Note 16. Provisions

	Consolidated 2003 $000's	Consolidated 2002 $000's	Parent entity 2003 $000's	Parent entity 2002 $000's
Restructuring on acquisition	23,420	–	–	–
Excess lease space	7,379	–	–	–
Employee entitlements (note 32)	3,296	–	–	–
	34,095	–	–	–

Movements in provisions

Consolidated	Restructuring provisions – acquisitions	Employee entitlements	Total
Opening carrying amount	–	–	–
Provisions acquired	30,799	3,296	34,095
Carrying amount at end of year	30,799	3,296	34,095

Restructuring provisions – acquisitions includes provisions for restructuring, excess lease space and employee termination benefits. Employee entitlements excludes termination benefits.

Note 17. Deferred tax liabilities

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
The balance arises as a result of temporary differences attributable to:				
Revaluation of Challenger Life No.2	35,701	–	–	–
Revaluation of management rights	40,438	–	–	–
Revaluation of properties	53,282	–	–	–
Losses	(59,525)	–	–	–
Other	(29)		–	–
	69,867	–	–	–

Note 18. Life insurance business

(a) Actuarial policies and methods

The amount of policy liabilities has been determined in accordance with methods and assumptions disclosed in this financial report and with the standards of the Life Insurance Actuarial Standards Board (LIASB) under section 114 of the Life Act.

Policy liabilities

These amounts, together with future premiums and investment earnings, are required to:

(i) meet the payment of future benefits and expenses; and

(ii) provide for future profits.

The policy liabilities 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 policy liabilities to be calculated in a manner that allows for the systematic release of planned margins as services are provided to policyholders and premiums are received.

The methods and profit carriers for particular policy types are as follows:

Business type	Method (projection or other)	Profit carrier
Individual		
Investment linked	Accumulation	–
Investment account	Projection and accumulation	Account balance
Annuity	Projection	Interest on annuity account balance
Allocated pension	Projection	Account balance

Investment earnings/discount rate

The expected future earnings rate is used as the discount rate. The assumption is based on the proportion of the fund that each asset sector represents. Expected earnings rates for each sector are then applied to these proportions with an appropriate allowance for tax dependent on the class of the business being valued. The expected earnings rates are reviewed annually for changes in the market environment. Where the products being valued are matched by a fixed interest portfolio, the earnings rate is determined with reference to the actual yield to maturity of those assets.

Note 18. Life insurance business (cont.)

Maintenance expenses

The assumption is based on budgeted maintenance expenses for the year ending 30 June 2004. These expenses are converted to a per policy unit cost based on an expense analysis for each fund.

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 2.5% p.a.

Voluntary discontinuances

The assumption is based on an investigation of recent experience. The current assumption range is 0.5% to 5.0%.

Surrender values

Current and future surrender values have been calculated using the surrender bases under the products. Where appropriate, surrender values have taken into account the requirements of AS4.02 'Minimum Surrender Values and Paid Up Values' standard issued by the Life Insurance Actuarial Standards Board.

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.

Shareholder tax

Tax has been projected in a manner consistent with the new tax environment applying from 30 June 2000. The corporate tax rate of 30% has been used.

Solvency position of the life insurers

These are amounts required to meet the prudential standards specified by the Life Insurance Act 1995 to provide protection against the impact of fluctuations and unexpected adverse circumstances on the company.

The methodology and bases for determining solvency requirements are in accordance with the requirements of Actuarial Standard 2.03 'Solvency Standard' and 6.02 'Management Capital Standard' under section 65 of the Life Insurance Act 1995.

As at 30 June 2003, the statutory funds of Challenger Life Limited and Challenger Life No.2 Limited satisfied the requirements of the solvency standard.

(b) Policyholder liabilities	**Consolidated**		**Parent entity**	
	2003 $000's	**2002 $000's**	**2003 $000's**	**2002 $000's**
Policy liabilities upon acquisition of Challenger Financial Services Group Limited (formerly Challenger International Limited)	1,806,155	–	–	–
Made up of:				
Value of future policy benefits	1,705,357	–	–	–
Value of future expenses	90,206	–	–	–
Value of future premiums	(15,643)	–	–	–
Planned margins of revenues over expenses	26,235	–	–	–
	1,806,155	–	–	–

Note 19. Unitholders' funds

	Consolidated and parent entity		Consolidated and parent entity	
	2003 Units	2002 Units	2003 $000's	2002 $000's
(a) Units in issue				
Fully paid units	2,439,035,734	917,522,392	1,140,502	425,391
	2,439,035,734	917,522,392	1,140,502	425,391

(b) Movement in units on issue

	2003		2002	
	Number of units	$000's	Number of units	$000's
Fully paid units				
Opening balance	917,522,392	425,391	509,895,094	188,661
Conversion of partly paid units to fully paid units	–	–	407,627,298	236,730
Commitments of units to acquire CFSGL	1,521,513,342	715,112	–	–
Closing balance	2,439,035,734	1,140,503	917,522,392	425,391
Partly paid units				
Opening balance	–	–	407,627,298	236,730
Conversion of partly paid units to fully paid units	–	–	(407,627,298)	(236,730)
Closing balance	–	–	–	–

Terms and conditions of units

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

(a) to benefit from distributions

(b) to be provided with copies of annual reports and other information in respect of the Trust

(c) to receive notice of, and vote at, meetings of holders of units

(d) after termination of the Trust, to receive the distribution of the net proceeds of trust assets according to the number of units registered at termination

(e) to transfer units and on death, to pass the units to a surviving joint holder, or by will or otherwise to the holder's estate

A holder of a unit is entitled to one vote on a show of hands and on a poll, each unitholder will have one vote for each dollar of the total value of units, determined from the sale of such units on the ASX on the trading day immediately before the day on which the poll is taken.

Note 20. Reserves

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Reserves				
Asset revaluation reserve	23,312	30,527	–	–
Equity option premium reserve	1,700	–	1,700	–
	25,012	30,527	1,700	–
Movements in reserves				
Asset revaluation reserve				
Opening balance	30,527	40,647	–	–
Revaluation decrement of strategic non-current investments	(9,305)	(14,458)	–	–
Change in deferred capital gains tax on decrement in value of strategic non-current investments	2,090	4,338	–	–
Closing balance	23,312	30,527	–	–
Equity option premium reserve				
Opening balance	–	–	–	–
Valuation assigned to the CFSGL options that were unissued on completion of merger	1,700	–	1,700	–
Closing balance	1,700	–	1,700	–

Nature and purpose of reserves

(i) Asset revaluation reserve

The asset revaluation reserve is used to record increments and decrements in the value of strategic non current investment assets that are not yet realised and any deferred capital gains taxation assets or liabilities arising from those increments and decrements in value.

(ii) Equity option premium reserve

Valuation assigned to the CFSGL options that were unissued on completion of merger.

Note 21. Undistributed income

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Opening balance	26,986	18,326	280	344
Net profit/(loss) from operating activities	21,323	8,660	8,978	(64)
Interim distribution	(9,175)	–	(9,175)	–
Balance at the end of the year	39,134	26,986	83	280

Note 22. Financial instruments

(a) Derivative instruments

Certain controlled entities of Challenger Financial Services Group are parties to derivative financial instruments in the normal course of business in order to hedge exposure to fluctuations in interest rates and foreign currencies.

Interest rate swap contracts

It is policy to protect part of the loans from exposure to increasing interest rates. Accordingly, the consolidated entity has entered into interest rate swap contracts whereby it is obliged to receive interest at variable rates and to pay interest at fixed rates. The contracts are settled on a net basis and the net amount receivable or payable at the reporting date is included in other debtors or other creditors.

The contracts require settlement of net interest receivable or payable between 60 – 120 days. The settlement dates coincide with the dates on which interest is payable on the underlying debt.

Swaps currently in place cover approximately 91% of the loan principal outstanding and are timed to expire as each loan repayment falls due. The fixed interest rates range between 2.58% and 8.50% and the variable rates are between 1.10% and 8.30%. The 180-day Bank Bill Rate at balance date was 4.56%.

At 30 June 2003, the notional principal amounts and periods of expiry of the interest rate swap contracts are as follows:

	2003 $000's
Less than 1 year	75,680
1–2 years	208,326
2–3 years	139,531
3–4 years	10,591
4–5 years	107,275
Greater than 5 years	1,529,319
	2,070,722

Swap contracts are accounted for on a fair value basis. The loss on the swap contracts outstanding at 30 June 2003 amounted to $142.5 million.

Forward exchange contracts

Challenger Life No.2 Limited owns property in the United Kingdom and the United States. In order to protect against exchange rate movements Challenger Life No.2 Limited has entered into forward exchange contracts to purchase Australian dollars. The contracts are timed to mature when major cash flows from the rental properties are scheduled to be paid.

Forward exchange contracts are accounted for on a fair value basis. The net gain on the forward exchange contracts outstanding at 30 June 2003 amounted to $66.3 million.

Note 22. Financial instruments (cont.)

At balance date, the details of the outstanding contracts are:

Sell GBP sterling	Buy Australian dollars 2003 $000's	Average exchange rate
Less than 1 year	17,613	0.3589
1–2 years	26,055	0.3622
2–3 years	10,095	0.3571
3–4 years	18,329	0.3529
4–5 years	9,645	0.3482
Greater than 5 years	514,140	0.3217
	595,877	

Sell US dollars	Buy Australian dollars 2003 $000's	Average exchange rate
Less than 1 year	19,373	0.5405
1–2 years	20,424	0.5286
2–3 years	19,264	0.5240
3–4 years	16,221	0.5218
4–5 years	14,695	0.5104
Greater than 5 years	257,875	0.5090
	347,852	

(b) Credit risk exposures

The credit risk on financial assets of the consolidated entity which have been recognised on the balance sheet, other than investments in shares, is generally the carrying amount, net of any provisions for doubtful debts.

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 consolidated entity could also be considered to include the difference between the carrying amount and the realisable amount.

(c) Interest rate risk exposures

The consolidated entity's exposure to interest rate risk and the effective weighted average interest rate by maturity period is set out in the following table. For interest rates applicable to each class of asset or liability, refer to individual notes to the financial statements.

Exposures arise predominantly from assets and liabilities bearing variable interest rates, as the consolidated entity intends to hold fixed rate assets and liabilities to maturity.

Note 22. Financial instruments (cont.)

2003	Note	Weighted average interest rate	Floating interest rate $000's	Fixed interest maturing in: 1 year or less $000's	Over 1 to 5 years $000's	More than 5 years $000's	Non-interest bearing $000's	Total $000's
Financial assets								
Cash and deposits	5	4.7%	627,216	29,691	–	–	3,514	660,421
Receivables	6	7.4%	129,429	10,663	43,420	–	60,079	243,591
Debt securities		7.4%	1,527	100,131	368,234	376,345	–	846,237
Other financial assets	7,8	8.3%	36,830	15,381	–	–	2,858,153	2,910,364
			795,002	155,866	411,654	376,345	2,921,746	4,660,613
Financial liabilities								
Payables	14		–	–	–	–	223,099	223,099
Interest bearing liabilities	15	6.1%	1,546,266	270,431	206,657	–	7	2,023,361
Interest rate swaps*			(1,496,157)	75,680	286,724	1,133,753	–	–
			50,109	346,111	493,381	1,133,753	223,106	2,246,460
Net financial assets (liabilities)			744,893	(190,245)	(81,727)	(757,408)	2,698,640	2,414,153

2002	Note	Weighted average interest rate	Floating interest rate $000's	Fixed interest maturing in: 1 year or less $000's	Over 1 to 5 years $000's	More than 5 years $000's	Non-interest bearing $000's	Total $000's
Financial assets								
Cash and deposits	5	4.5%	390,641	–	–	–	–	390,641
Receivables	6		–	–	–	–	1,048	1,048
Debt securities			–	–	–	–	12,424	12,424
Other non-interest bearing investments	7,8		–	–	–	–	120,501	120,501
			390,641	–	–	–	133,973	524,614
Financial liabilities								
Payables	14		–	–	–	–	4,372	4,372
Interest-bearing liabilities	15	4.9%	29,580	–	–	–	–	29,580
Interest rate swaps*			–	–	–	–	–	–
			29,580	–	–	–	4,372	33,952
Net financial assets (liabilities)			361,061	–	–	–	129,601	490,662

*Notional principal amounts, (excludes forward dated swaps).

The entity had 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.

Note 22. Financial instruments (cont.)

	2003 $000's	2002 $000's
Reconciliation of net financial assets to net assets		
Net financial assets as above	2,414,153	490,662
Non-financial assets and liabilities:		
Plant and equipment	10,820	–
Intangibles	278,461	–
Deferred tax assets	29,279	2,301
EMVONA	375,371	–
Other assets	11,282	–
Current tax liabilities	(4,601)	(10,059)
Deferred tax liabilities	(69,867)	–
Provisions	(34,095)	–
Policy liabilities	(1,806,155)	–
Net assets per balance sheet	1,204,648	482,904

(d) Net fair value of financial assets and liabilities

The net fair value of cash and cash equivalents and non-interest bearing monetary financial assets and financial liabilities of the consolidated entity approximates their carrying amounts.

The net fair value of financial assets or financial liabilities arising from interest rate swap agreements and forward exchange contracts have been determined as the carrying amount, which represents the amount currently receivable or payable at the reporting date, and the present value of the estimated future cash flows.

Net fair value of financial assets, excluding investments relating to Life Business, is exclusive of costs which would be incurred on realisation of an asset, and inclusive of costs which would be incurred on settlement of a liability.

Note 23. Remuneration of auditors

	Consolidated		Parent entity	
	2003 $	2002 $	2003 $	2002 $
Amounts received or due and receivable by Ernst & Young for:				
Audit of the controlled entity	100,000	82,100	65,000	47,100
Merger-related services	2,442,953	–	2,442,953	–
Other services	97,426	–	35,926	–
	2,640,379	82,100	2,543,879	47,100

Note 24. Contingent liabilities

A controlled entity, Challenger Financial Services Group Limited (formerly Challenger International Limited), has under the terms of a deed of cross guarantee entered into in accordance with the ASIC Class Order dated 19 December 1991, undertaken to meet any shortfall which might arise on the winding up of controlled companies which are party to the deed. The controlled companies are not in liquidation nor is there any indication that the controlled companies will be wound up (refer to note 28).

A controlled entity, Challenger Securities Limited, as manager of a number of unit trusts, has under the terms of the relevant trust deeds covenanted to repurchase units in the Trusts at the request of any unitholder at the redemption price prevailing at the date of the request. In complying with this covenant, the manager may, at its discretion, request the trustee to redeem any units repurchased out of the relevant trust funds. At 30 June 2003, the carrying values of units on issue in the relevant trusts and the underlying assets of the Trust amounted to $10 (2002: $10).

A controlled entity, Challenger Property Nominees Pty Limited has received an assessment of stamp duty in connection with the acquisition of an interest in a property at 417 St Kilda Road, Melbourne of $5,362,002. Based on legal advice received, the directors do not consider that any stamp duty is payable on the transaction and have lodged an objection to the assessment.

Note 25. Commitments for expenditure

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Capital commitments				
Lease commitments				
Commitments in relation to leases contracted for at the reporting date but not recognised as liabilities, payable:				
Not later than one year	8,298	–	–	–
Later than one year but not later than 2 years	3,136	–	–	–
Later than 2 years but not later than 5 years	11,106	–	–	–
Later than 5 years	34,957	–	–	–
	57,497	–	–	–
Representing:				
Non-cancellable operating leases	56,872	–	–	–
Future finance charges on finance leases	625	–	–	–
	57,497	–	–	–
Operating leases				
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:				
Not later than one year	9,243	–	–	–
Later than one year but not later than 2 years	4,156	–	–	–
Later than 2 years but not later than 5 years	14,667	–	–	–
Later than 5 years	44,185	–	–	–
Less: Liability recognised for surplus lease space and estimate of sub lease liabilities arising on relocation	(15,379)	–	–	–
Commitments not recognised in the financial statements	56,872	–	–	–
Finance leases				
Commitments in relation to finance leases are payable as follows:				
Not later than one year	1,211	–	–	–
Later than one year but not later than 5 years	3,192	–	–	–
Later than 5 years	–	–	–	–
Minimum lease payments	4,403	–	–	–
Less: Future finance charges	625	–	–	–
Total lease liabilities	3,778	–	–	–
Capital expenditure commitments:				
Commitments in relation to capital expenditure commitments contracted for at the reporting date but not recognised as liabilities, payable:				
Not later than one year	18,599	–	–	–
Later than one year but not later than 5 years	3,086	–	–	–
Later than 5 years	–	–	–	–
	21,685	–	–	–

Note 26. Related parties

Responsible Entity

The Responsible Entity of Challenger Financial Services Group is:

CPH Management Limited (ACN 080 207 496)

Directors

The names of persons who were directors of CPH Management Limited at any time during the financial year are as follows:

Kerry Francis Bullmore Packer AC
James Douglas Packer
Ashok Peter Jacob
Graham Allan Cubbin
Guy Jalland
David John Barnett
Timothy John Purcell

Related party transactions

	Consolidated		Parent entity	
	2003 $	2002 $	2003 $	2002 $
Total remuneration paid or due and payable to the Responsible Entity:				
Management fee	5,474,758	3,697,102	5,474,758	3,697,102
Performance fee	–	–	–	–
	5,474,758	3,697,102	5,474,758	3,697,102
Balances with related parties				
The aggregate amounts payable to related parties by the Group and Trust at balance date are as follows:				
Responsible Entity	3,636,086	3,697,102	3,636,086	3,697,102
	3,636,086	3,697,102	3,636,086	3,697,102

Transactions with related parties in the wholly owned group

The Trust has provided loans during the year to subsidiaries totalling $35,597,000 (2002: $19,695,000), with no fixed repayment date. Interest was charged at a rate of 5.19% (2002: 4.87%), giving rise to interest income of $1,104,000 (2002: $837,000).

The Trust utilised loans during the year from subsidiaries totalling $13,501,000 (2002: $12,835,000), with no fixed repayment date. Interest was paid at a rate of 5.19% (2002: 4.87%), giving rise to interest expense of $666,000 (2002: $596,000).

Following the merger with CFSGL an injection of capital was made into Challenger Life No.2 Limited.

Challenger Financial Services Group (the Trust) is the ultimate parent entity.

Investing activities

The Trust has no investment in the Responsible Entity or its affiliates.

Note 26. Related parties (cont.)

Unitholdings

Details of the holdings in the Trust as at 30 June 2003 by the Responsible Entity, directors of the Responsible Entity and their affiliates are set out below.

	Number of units		Interest held in the Trust	
	2003	**2002**	**2003**	**2002**
Responsible Entity				
CPH Management Ltd	609,941,381	284,048,690	25.01%	30.96%
Directors				
KFB Packer	609,941,381	284,048,690	25.01%	30.96%
AP Jacob	100,000	100,000	0.00%	0.02%
GA Cubbin	488,506	400,000	0.02%	0.10%
G Jalland	400,000	400,000	0.02%	0.10%
DJ Barnett	420,000	420,000	0.02%	0.10%
TJ Purcell	210,000	210,000	0.01%	0.05%

Mr KFB Packer holds interest in all the units held by the Responsible Entity and its affiliates.

Units acquired by the directors of 325,981,196 were at arm's length prices. Distributions paid/payable to the directors were $2,872,287 (2002: $nil).

Note 27. Investments in controlled entities

Name of entity	Country of incorporation	Class of shares	Equity holding 2003 %	Equity holding 2002 %	Cost of parent entity's investment 2003 $000's	Cost of parent entity's investment 2002 $000's
FXF Holdings Pty Limited	Australia	Ordinary & redeemable preference	100	100	380,260	380,260
Challenger Financial Services Group Limited	Australia	Ordinary	100	–	729,478	–
					1,109,738	380,260
Directly controlled by FXF Holdings Pty Limited:						
FXF Investments Pty Limited	Australia	Ordinary & redeemable preference	100	100		
FXF Finance Pty Limited	Australia	Ordinary	100	100		
CPH B2B Co. Pty Limited	Australia	Ordinary	100	100		
CPHIC Investments Pty Limited	Australia	Ordinary	100	100		
Leyton Limited	Bahamas	Ordinary	100	100		
Directly controlled by Leyton Limited:						
Conpress Limited Partnership	Bermuda	Ordinary	100	100		
Directly controlled by CPH B2B Co. Pty Limited						
CPH B2B Investments Pty Limited	Australia	Ordinary	100	100		
Directly Controlled by CPHIC Investments Pty Ltd:						
CPHIC Financial Services Pty Limited	Australia	Ordinary	100	100		

Note 27. Investments in controlled entities (cont.)

Name of entity	Country of incorporation	Class of shares	Equity holding 2003 %	2002 %
Directly controlled by Challenger Financial Services Group Limited:				
Challenger Group Services Pty Limited	Australia	Ordinary	100	–
Challenger Group Services (UK) Limited	United Kingdom	Ordinary	100	–
Challenger Property Capital Limited	Australia	Ordinary	100	–
Challenger Property Services Pty Limited	Australia	Ordinary	51	–
Challenger International Nominees Limited (i)	Australia	Ordinary	100	–
Venture Link Australia Limited (i)	Australia	Ordinary	100	–
Challenger Equity Lending Limited	Australia	Ordinary	100	–
Challenger Treasury Pty Limited	Australia	Ordinary	100	–
Challenger Property Finance Limited	Australia	Ordinary	100	–
Challenger Group Pty Limited (i)	Australia	Ordinary	100	–
Iroka Pty Limited	Australia	Ordinary	100	–
Directly controlled by Challenger Group Pty Limited:				
Challenger Securities Limited	Australia	Ordinary	100	–
Challenger Equities Limited (i)	Australia	Ordinary	100	–
Challenger Freeholds Limited (i)	Australia	Ordinary	100	–
Challenger E-Commerce Limited	Australia	Ordinary	100	–
Challenger Hedging Limited	Australia	Ordinary	100	–
Challenger Lending No.1 Pty Limited	Australia	Ordinary	100	–
Howard Finance Limited	Australia	Ordinary	100	–
Howard Leasing Limited	Australia	Ordinary	100	–
Challenger Share Finance Limited	Australia	Ordinary	100	–
Margaret Street Nominees Pty Limited	Australia	Ordinary	100	–
School Family Program Management Pty Limited	Australia	Ordinary	100	–

Note 27. Investments in controlled entities (cont.)

Name of entity	Country of incorporation	Class of shares	Equity holding 2003 %	2002 %
Directly controlled by Iroka Pty Ltd:				
Challenger Life Limited	Australia	Ordinary	100	–
Challenger Life No.2 Limited	Australia	Ordinary	100	–
Howard Mortgage Management Limited	Australia	Ordinary	100	–
Howard Pacific Limited	Australia	Ordinary	100	–
Challenger Managed Investments Limited	Australia	Ordinary	100	–
HFH Staff Pty Limited	Australia	Ordinary	100	–
BluePeak Private Equity Pooled Fund Limited	Australia	Ordinary	100	–
BluePeak Institutional Private Equity Pooled Fund Limited	Australia	Ordinary	100	–
Challenger Wealthlink Management Limited	Australia	Ordinary	100	–
Challenger Superannuation Pty Limited	Australia	Ordinary	100	–
Challenger Corporate Superannuation Pty Limited	Australia	Ordinary	100	–
Challenger Portfolio Management Limited	Australia	Ordinary	100	–
Challenger International (NZ) Limited	New Zealand	Ordinary	100	–
Challenger Securities (NZ) Limited	New Zealand	Ordinary	100	–
Coronet Asset Management Limited	New Zealand	Ordinary	100	–
Challenger First Pacific (NZ) Limited	New Zealand	Ordinary	100	–
Challenger Investment No.2 Limited	New Zealand	Ordinary	100	–
Targetonemillion Limited	New Zealand	Ordinary	100	–
Challenger Property Nominees Pty Limited	Australia	Ordinary	100	–
Challenger Property Funds Management Limited	Australia	Ordinary	100	–
Challenger Property Management Pty Limited	Australia	Ordinary	100	–
Challenger Superannuation Services Pty Limited	Australia	Ordinary	100	–
Challenger Life (UK) Limited	United Kingdom	Ordinary	100	–
Garrisons Pty Limited	Australia	Ordinary	100	–
Synergy Capital Management Limited	Australia	Ordinary	100	–
Integrated Equity Pty Limited	Australia	Ordinary	100	–
Challenger Beston Limited	Australia	Ordinary	100	–
Beston Pacific Vineyard Management Limited	Australia	Ordinary	100	–
Challenger Capital Fund Limited	Australia	Ordinary	100	–
Challenger Capital Markets Limited	Australia	Ordinary	100	–
Allfine Holdings Pty Limited	Australia	Ordinary	100	–
Bluezen Pty Limited	Australia	Ordinary	100	–
e-Financial Capital Limited	Australia	Ordinary	100	–

Additionally, Challenger Life No.2 Limited owns 100% of the units in 48 property trusts.

Ernst & Young does not audit Challenger Financial Services Group Limited or any of its controlled entities.

(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 28.

Note 27. Investments in controlled entities (cont.)

Acquisition of controlled entities

Details of the acquisitions are as follows.

	2003 $'000s	2002 $'000s
Fair value of identifiable net assets of CFSGL		
Cash	298,659	–
Receivables	475,860	–
Equity securities	160,016	–
Debt securities	846,237	–
Other financial assets	10,070	–
Investment properties	2,613,851	–
Fixed assets	6,820	–
Deferred tax assets	24,931	–
Investment in associates	2,485	–
Intangible assets	662	–
Excess of net market value of the interests of Challenger Life Limited in its subsidiaries over their recognised net amounts	375,371	–
Other assets	11,282	–
Payables	(206,087)	–
Current tax liabilities	–	–
Interest bearing liabilities less convertible notes eliminated	(2,258,361)	–
Provisions	(34,095)	–
Deferred tax liabilities	(69,867)	–
Life insurance policy liabilities	(1,806,155)	–
Net assets	451,679	–
Goodwill on consolidation	277,799	–
Consideration	729,478	–
Less: Equity issued (note 34)	(729,478)	–
Cash consideration	–	–

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Outflow of cash to acquire controlled entity, net of cash acquired				
Cash consideration	–	–	–	–
Less: (balances)/overdraft acquired	298,659	–	–	–
Net (inflow)/outflow of cash	298,659	–	–	–

On 27 June 2003 the Trust acquired, by way of merger, CFSGL. Consideration for the acquisition was 4.5 units for every 1 CFSGL share. Prior to the date of the proposed merger units were trading at approximately $0.39 to $0.40. Over the period that the scheme was being considered there was volatility in the unit price, with the units trading from $0.45 to $0.56. The quoted unit price at 27 June 2003, being the effective date control passed, was $0.52. The fair value of each unit was assessed to be $0.47. The difference between the quoted value at that date to the fair value applied is approximately $76m. The fair value was based on:

(a) the valuation ranges estimated by both Grant Samuel in their role as Independent Expert for CFSGL shareholders and KPMG Corporate Finance in their role as Independent Expert for CPHML; and

(b) notional price (based upon independent valuations) of what the Trust units could be ‘placed’ for in the market given their history of thin trading volumes.

Note 28. 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 into 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 & Investment Commission.

- Venture Link Australia Limited
- Challenger Group Pty Limited
- Challenger International Nominees Limited
- Challenger Equities Limited
- Challenger Freeholds 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 CFSGL, they also represent the 'Extended Closed Group'.

Set out below is a consolidated statement of financial performance for the year ended 30 June 2003 of the Closed Group.

	2003 $'000s
Revenue from ordinary activities	3,663
Depreciation and amortisation expenses	(76)
Other expenses from ordinary activities	(10,343)
Loss from ordinary activities before income tax benefit	(6,756)
Income tax benefit	1,173
Total changes in equity other than these resulting from transactions with owners as owners	(5,583)

Set out below is a summary of the movements in consolidated retained profits for the year ended 30 June 2003 of the Closed Group.

	2003 $'000s
Retained losses at the beginning of the financial year	(14,449)
Loss from ordinary activities after income tax expense	(5,583)
Retained losses at the end of the financial year	(20,032)

Set out below is a consolidated statement of financial position as at 30 June 2003 of the Closed Group.

Assets	
Cash assets	1,940
Receivables	7,203
Other financial assets	71,834
Total assets	80,977
Liabilities	
Payables	34,213
Interest bearing liabilities	40,423
Warrant liabilities	25,848
Total liabilities	100,484
Net assets	(19,507)
Equity	
Contributed equity	525
Retained losses	(20,032)
Total equity	(19,507)

Note 29. Investments accounted for using the equity method

Name of company	Principal activity	Ownership interest 2003 %	Ownership interest 2002 %	Consolidated 2003 $000's	Consolidated 2002 $000's
AVC Holdings Ltd	PVC resin manufacturer	50	50	16,820	13,886
Jurlique International Pty Ltd	Skin-care manufacturer	25	–	28,111	–
Garrisons (Toowong) Pty Ltd	Financial planning	40	–	268	–
Carter Bax	Financial planning	40	–	–	–
Barbacan Benefits	Financial planning	25	–	454	–
Quadrant Securities Limited	Financial planning	50	–	52	–
Garrisons (Burnie) Pty Ltd	Financial planning	49	–	135	–
Central Coast	Financial planning	40	–	482	–
DVG Pty Limited	Financial planning	50	–	1,370	–
EPIC Asset Management Limited	Distribution	33	–	800	–
Less: Provision for diminution in value				(1,076)	–
				47,416	13,886

	2003 $000's	2002 $000's
Movements in carrying amount of investments in associates		
Carrying amount at the beginning of the financial year	13,886	–
Cost of investment in associate	26,096	7,500
Investment in associates acquired on acquisition of CFSGL	2,485	–
Share of associates' net profit	4,949	6,386
Dividends received/receivable	–	–
Carrying amount at the end of the financial year	47,416	13,886
Results attributable to associates		
Profits from ordinary activities before related income tax	6,754	6,795
Income tax (expense)/credit	(1,805)	(409)
Profits from ordinary activities after related income tax	4,949	6,386
Retained profits attributable to associates at the beginning of the financial year	6,386	–
Retained profits attributable to associates at the end of the financial year	11,335	6,386
Summary of the share of associates' financial position		
Assets	65,201	43,082
Liabilities	(27,930)	(33,256)
Net assets	37,271	9,826

CPHIC Investments Pty Ltd (CPHIC), a controlled entity of the Trust, has entered into option agreements with two non-related parties enabling those parties to purchase a proportion of its shares in AVC Holdings Pty Ltd (AVCH). The options represent 7% of the total share capital of AVCH. The options are exercisable in 2007 and are exercisable at CPHIC's cost of shares. As it is likely, at this stage, for the options to be exercised, the Trust has only taken up 43% of its share of AVCH's net profit, assets and liabilities in this reporting period and since acquisition.

Note 30. Events occurring after reporting date

On 1 September 2003 an agreement was reached with Zurich Capital Markets to acquire the assets of their Australian Principal Finance Business. The focus of this acquisition is to acquire 100% of the issued capital of Interstar Securities, one of the Australia's largest independent and privately held mortgage financiers, for $85 million, together with a high yield fixed interest portfolio for $48 million. To secure Interstar, an agreement has also been made to acquire 84,500 hectares of forestry assets, valued at $54 million, on a 12 month deferred settlement basis.

There have been no other significant events to report since reporting date.

Note 31. Segment information

The consolidated entity operated in one industry segment prior to the acquisition of CFSGL, being the dealing with and the making of investments in securities. As a result comparative information has not been provided nor has separate disclosure been made in relation to the current period's Segment Revenue and Segment Results.

The consolidated entity operates predominantly in one geographical area, being Australia.

Following the acquisition, the primary business segments have been identified as follows:

2003	**Life $000's**	**Margin lending $000's**	**Funds management $000's**	**Other/ unallocated $000's**	**Total consolidated $000's**
Segment assets	4,131,219	173,219	322,134	739,254	5,365,826
Segment liabilities	3,617,176	159,854	103,007	281,141	4,161,178
Investments in associates	–	–	2,485	44,931	47,416
Acquisition of property, plant and equipment, intangibles and other non-current segment assets (excludes investments relating to Life business)	–	–	–	4,000	4,000

Note 32. Employee entitlements

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Employee entitlement liabilities				
Employee entitlements (note 16)	3,296	–	–	–

Only long service leave has amounts expected to settle in greater than 12 months and which are recorded at net present value.

Employees of the Group totalled 624 at balance date. Prior to the merger with CFSGL the Group had no employees.

Employee option plans

Under pre-merger employee option plans maintained by CFSGL employees were granted options based upon performance and subject to the approval of shareholders at general meetings.

Options were granted under plans for no consideration. Options did not carry dividend or voting rights and vested options are not conditional on the employee's future employment.

Pursuant to the merger, all outstanding options over CFSGL shares were converted to options over units of the Trust at a rate of 4.5 times. Unissued units of the Trust under option at the date of this report are as follows:

Options series	Exercise date price	Options vested %	CFSGL exercise	Number of shares	CFSG exercise price	CFSG units under option
D	31/07/03	100	$4.176	1,400,000	$0.928	6,300,000
E	31/07/03	100	$3.926	6,600,000	$0.872	29,700,000
F	31/07/04	100	$3.320	700,000	$0.738	3,150,000
G	31/07/04	67	$3.660	9,250,000	$0.813	41,625,000
Garrisons Financial Planning						
Garrisons GD 12-1999	31/01/05	33	$3.499	54,171	$0.778	243,770
Garrisons GD 6-2000	31/01/05	33	$2.872	143,859	$0.638	647,366
Garrisons GD 12-2000	31/01/05	33	$4.256	109,879	$0.946	494,456
Garrisons GD 6-2001	31/01/05	33	$3.517	149,936	$0.782	674,712
Garrisons GD 12-2001	31/01/05	33	$3.240	169,654	$0.720	763,443

No options were granted to employees of the Group during the year. No options were exercised during the period 27 June 2003 to 30 June 2003.

The valuation assigned to the options was $1,700,000 (refer to note 20).

Note 33. Reconciliation of operating profit after income tax to net cash inflow from operating activities

	Consolidated		Parent entity	
	2003 $000's	2002 $000's	2003 $000's	2002 $000's
Operating profit after income tax	21,323	8,660	8,978	(64)
(Profit)/loss on sale of investments	(10,714)	3,645	–	–
Net unrealised losses on investments	1,895	2,706	–	–
Equity accounted profits	(4,949)	(6,386)	–	–
Other	(580)	(3,459)	–	–
Change in operating assets and liabilities, net of effects from purchase of controlled entity:				
Decrease/(increase) in trade debtors and deferred expenditure	(2,337)	6,044	(244)	3
Decrease/(increase) in other assets	–	1,481	–	–
Increase/(decrease) in trade creditors	197	847	164	478
Increase/(decrease) in provision for income taxes payable	(5,458)	–	–	–
Increase/(decrease) in provision for deferred income tax	2,048	(3,135)	–	–
Net cash inflow from operating activities	1,425	10,403	8,898	417

Note 34. Non-cash financing and investing activities

	Consolidated 2003 $000's	Consolidated 2002 $000's	Parent entity 2003 $000's	Parent entity 2002 $000's
Acquisition of:				
Challenger International Limited	729,478	–	729,478	–
	729,478	–	729,478	–

Note 35. Earnings per unit

	Consolidated 2003 cents	Consolidated 2002 cents
Basic and diluted earnings per unit	2.3	0.9

	Consolidated 2003 Number	Consolidated 2002 Number
Weighted average number of units used as the denominator		
Weighted average number of units used as the denominator in calculating basic earnings per unit	917,522,392	900,537,921

	Consolidated 2003 $000's	Consolidated 2002 $000's
Reconciliations of earnings used in calculating basic earnings per unit		
Earnings used in calculating basic earnings per unit	21,323	8,660

Directors' declaration

In the opinion of the directors of the Responsible Entity of Challenger Financial Services Group:

(a) the financial statements and notes of the Trust and of the consolidated entity are in accordance with the Corporations Act 2001, including:
   (i) giving a true and fair view of the Trust and consolidated entity's financial position as at 30 June 2003 and of their performance as represented by the results of their operations and their cash flows for the year ended on that date; and
   (ii) complying with Accounting Standards and Corporations Regulations 2001; and
   (iii) complying with the provisions of the Trust Constitution

(b) there are reasonable grounds to believe that the Trust will be able to pay its debts as and when they become due and payable; and

(c) the register of unitholders has, during the year ended 30 June 2003, been properly drawn up and maintained so as to give a true account of the unitholders of the Trust; and

(d) at the date of this declaration, there are reasonable grounds to believe that the members of the Extended Closed Group identified in note 28 will be able to meet any obligations or liabilities to which they are, or may become liable, subject by virtue of the deed of cross guarantee described in note 28.

This declaration is made in accordance with a resolution of the directors of CPH Management Limited.

JD Packer
Director

CE Cuffe
Director

Sydney
8 September 2003

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Independent audit report to unitholders of Challenger Financial Services Group

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for Challenger Financial Services Group (formerly CPH Investment Corp) (the trust) and the consolidated entity for the year ended 30 June 2003. The consolidated entity comprises the trust and the entities it controlled during the year.

The directors of CPH Management Limited (the Responsible Entity) are responsible for preparing a financial report which gives a true and fair view of the financial position and performance of the trust and the consolidated entity, and that complies with Accounting Standards in Australia, in accordance with the Corporations Act 2001, and the trust's constitution. 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.

Audit approach

We conducted an independent audit of the financial report in order to express an opinion on it to the unitholders of the trust. 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. 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 and the trust's constitution, a view which is consistent with our understanding of the trust's and the consolidated entity's financial position, and of their performance as represented by the results of their operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors of the Responsible Entity.

While we considered the effectiveness of the 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. These and our other procedures did not include consideration or judgment of the appropriateness or reasonableness of the business plans or strategies adopted by the directors and management of the Responsible Entity.

Independence

We are independent of the trust and the Responsible Entity, and have met the independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

Audit opinion

In our opinion, the financial report of Challenger Financial Services Group 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 and the consolidated entity at 30 June 2003 and of their performance for the year ended on that date; and

  (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001;

(b) other mandatory financial reporting requirements in Australia; and

(c) the provisions of the trust's constitution.

Ernst & Young

BJ Long
Partner
Sydney
8 September 2003

Investor information

a) Spread of equity security holdings (as at 15 September 2003)

	Units
1–1,000	7,128
1,001–5,000	12,581
5,001–10,000	8,611
10,001–100,000	12,323
100,000 and over	1,047
	41,690

There were 5,116 holders of less than a marketable parcel of units.

b) Equity security holders

Twenty largest quoted equity security holders

The names of the twenty largest holders of quoted equity securities as at 15 September 2003 are listed below:

	Units	
Name	Number held	Percentage of issued units
Consolidated Press Holdings Limited	609,941,381	25.01%
Westpac Custodian Nominees Limited	153,873,831	6.31%
Universal Equity Pty Limited	90,920,999	3.73%
ANZ Nominees Limited	82,112,712	3.37%
National Nominees Limited	81,555,508	3.34%
Invia Custodian Pty Limited	75,351,279	3.09%
Perpetual Trustee Company Limited	70,000,000	2.87%
JP Morgan Nominees Australia Limited	36,314,998	1.49%
Audant Investments Pty Limited	26,719,461	1.10%
RBC Global Services Australia Nominees Pty Limited	25,401,501	1.04%
Suncorp Custodian Services Pty Limited	24,452,780	1.00%
WIN Television NSW Pty Ltd	20,001,334	0.82%
Caledonia Investments Limited	18,489,351	0.76%
Merrill Lynch (Australia) Nominees Pty Ltd	18,150,140	0.74%
Bell Securities Limited	16,934,400	0.69%
Carstock Nominees Pty Ltd	14,800,000	0.61%
Warneet Management Pty Ltd	13,052,732	0.54%
Mr Rodger Bacon	12,412,580	0.51%
RBC Global Services Australia Nominees Pty Limited	11,636,513	0.48%
Alfred Street Nominees Pty Ltd	11,053,568	0.45%
Top 20 holders	1,497,905,227	61.4%
Others	941,161,238	38.6%
Total	2,439,066,465	100%

b) Equity security holders cont...

Unquoted equity securities

	Number on Issue	Number of Holders
Options issued under the Challenger International Limited Option Plan to take up ordinary units*	18,577,499	187
*Number of unissued units under the options.	83,598,747	
Convertible notes	200,000	2

c) Substantial shareholders

Substantial shareholders in the Trust are set out below:

	Number Held	Percentage
Consolidated Press Holdings Limited	609,941,381	25.01%

d) Voting rights

The voting rights attaching to each class of equity securities are set out below:

a) Units

On a show of hands every member present at a meeting in person or by proxy shall have one vote and upon a poll each unit shall have one vote.

b) Options

No voting rights.

c) Convertible notes

No voting rights.

Investor information (cont.)

Unitholder enquiries

Please contact Computershare for information about Challenger Financial Services Group (CFG) share registry if you have questions about your units or distributions.

Computershare Investor Services Pty Limited level 3, 60 Carrington St, Sydney, NSW 2000.

Investor enquiries 1 800 780 782

Facsimile +61 2 8235 8160

To assist with your inquiry, please quote your current address and your Security Reference Number (SRN) when speaking with Computershare's associates.

Change of address or banking information

Please contact Computershare in writing to notify of changes to your personal details.

ASX listing

Challenger Financial Services Group units are listed on the Australian Stock Exchange under code CFG and can be accessed via the ASX website at www.asx.com.au. Unit prices can also be accessed on Challenger's website at www.challenger.com.au.

Dividend

An interim distribution of 1.0 cent per unit fully franked was paid on 23 April 2003. No final distribution has been proposed. The CPH Management Limited Board will continually assess Challenger's requirements in determining an appropriate distribution policy in future years.

Annual report

Challenger's annual report is one of two sources of information for Challenger unitholders. If you prefer not to receive an annual report for Challenger Financial Services Group or prefer to receive the information in electronic format, please notify Computershare at the details above.

Website

Challenger unitholders can also access information from our website at www.challenger.com.au including the latest annual and interim reports, media statements, and market presentations.

Additionally, unitholders can find information about Challenger's diverse range of products and services at the Challenger website.

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