

FINANCIAL REPORT CONTENTS

Cochlear Limited and its controlled entities
Financial report for the year ended 30 June 2003

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DIRECTORS' REPORT

Cochlear Limited for the year ended 30 June 2003

The Directors present their report, together with the financial report of Cochlear Limited (Company) and the consolidated financial report of the Consolidated Entity, being the Company and its controlled entities, for the year ended 30 June 2003, and the Auditors' Report thereon.

DIRECTORS

The Directors of the Company in office during the financial year or since the financial year are Prof. BDO Anderson, AO, Mr TCE Bergman, Prof. E Byrne, Ms EC Holley, Mr PJ North, Mr JJ O'Mahony, Dr JL Parker, Mr JH Veeneklaas, and Prof. DG Penington, AC. Information on the Directors is presented on page 8 of the Annual Report.

DIRECTORS' MEETINGS

The number of Directors' meetings (including meetings of committees of Directors) and number of meetings attended by each of the Directors of the Company during the financial year are:

	BOARD OF DIRECTORS		REMUNERATION COMMITTEE		AUDIT COMMITTEE		TECHNOLOGY AND INNOVATION COMMITTEE		MEDICAL SCIENCE COMMITTEE	
	HELD ^(a)	ATTENDED ^(b)	HELD ^(a)	ATTENDED ^(b)	HELD ^(a)	ATTENDED ^(b)	HELD ^(a)	ATTENDED ^(b)	HELD ^(a)	ATTENDED ^(b)
Prof. BDO Anderson, AO	9	9					3	3	2	2
Mr TCE Bergman	9	9	3	3	4	4				
Prof. E Byrne	9	9					3	3	2	2
Ms EC Holley	9	9	1	1	4	4				
Mr PJ North	9	9			4	4	3	3		
Mr JJ O'Mahony	9	9	3	3	4	4	3	3	2	2
Dr JL Parker	9	9					3	3		
Mr JH Veeneklaas ^(c)	9	6	3	2			3	1		
Prof. DG Penington, AC ^(c)	4	4	1	1	1	1				

(a) Number of meetings held while in office.

(b) Number of meetings attended.

(c) Mr Veeneklaas only attended six of the Directors' meetings held during the financial year due to illness. Prof. David Penington retired at the Company annual general meeting in October 2002.

PRINCIPAL ACTIVITIES AND REVIEW OF OPERATIONS AND RESULTS

The principal activities and a review of the operations of the Consolidated Entity during the year ended 30 June 2003, and the results of those operations, are set out in the CEO/President's Report.

Other than as discussed in this Report, there were no significant changes in the nature of those activities during the year ended 30 June 2003 and the results of those operations are set out in the CEO/President's Report.

CONSOLIDATED RESULTS

The consolidated results for the financial year attributable to the members of the Company are:

	2003 \$000	2002 \$000
Revenue from ordinary activities	290,045	256,201
Profit from ordinary activities before related income tax expense	80,010	51,030
Net profit attributable to members of the Company	58,213	40,110
Basic earnings per share (cents)	110.0	76.6
Diluted earnings per share (cents)	110.0	76.6

DIRECTORS' REPORT

Cochlear Limited for the year ended 30 June 2003

DIVIDENDS

Dividends paid or declared by the Company to members since the end of the previous financial year are:

TYPE	CENTS PER SHARE	TOTAL AMOUNT \$000	DATE OF PAYMENT	TAX RATE FOR FRANKING CREDIT
• As proposed and provided in last year's report: Final – ordinary shares	30.0	15,759	24 Sept 02	30%
• In respect of the current financial year: Interim – ordinary shares	33.0	17,513	19 Mar 03	30%

All the dividends paid or declared by the Company since the end of the previous financial year were 100% franked.

The final dividend in respect of the current financial year has not been provided for in this financial report as it was not declared until after 30 June 2003. Since the end of the financial year, the Directors declared a final 44.0 cents dividend franked at the tax rate of 30% amounting to a total of \$23,351,042.

ENVIRONMENTAL REGULATIONS

The Consolidated Entity's operations are not subject to any significant environmental regulations under either Commonwealth of Australia or State/Territory legislation. However, the Board believes that the Consolidated Entity has adequate systems in place to manage its environmental obligations and is not aware of any breach of those environmental requirements as they apply to the Consolidated Entity.

EVENTS SUBSEQUENT TO REPORTING DATE

There has not arisen in the interval between the end of the financial year and the date of this Report, any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the Consolidated Entity, the results of those operations, or the state of affairs of the Consolidated Entity in future financial years.

STATE OF AFFAIRS

The significant changes to the state of affairs of the Consolidated Entity during the financial year were as follows:

- on 10 August 2002, the Company issued 31,405 ordinary shares to eligible employees of the Consolidated Entity under the Cochlear Employee Share Plan for nil consideration;
- on 24 September 2002, options over 539,000 ordinary shares were exercised respectively as part of the Executive Share Option Plan for a total consideration of \$8,130,000;
- capital expenditure was \$10.5 million. Major investments included a spend of approximately \$4.4 million on plant and equipment and approximately \$2.5 million on the enterprise resource planning system; and
- a loan of \$10 million was repaid to Westpac Banking Corporation.

LIKELY DEVELOPMENTS

Further information as to likely developments in the operations of the Consolidated Entity and the expected results of those operations in subsequent financial years has not been included in this Report because the Directors believe, on reasonable grounds, that to include such information would be likely to result in unreasonable prejudice to the Consolidated Entity.

DIRECTORS' REPORT

Cochlear Limited for the year ended 30 June 2003

DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS

The Consolidated Entity's remuneration policy is structured to ensure that remuneration packages properly reflect the accountabilities and responsibilities of the Directors and executives and are sufficient to attract, motivate and retain personnel of the appropriate calibre.

Working within this policy framework, the Remuneration Committee makes recommendations to the Board in relation to the Board members and to executives of the Consolidated Entity.

Remuneration packages are structured in such a way that a significant part of the executive's package depends upon achievement of individual performance goals linked to the business objectives and the financial performance of the Consolidated Entity. Performance related bonus payments are therefore contingent on the achievement of agreed individual performance goals and the financial performance of the Consolidated Entity.

An Executive Share Option Plan is also in place with offers determined by reference to the level of accountability and responsibility for development and implementation of corporate strategy. The exercise price of options is based on the opening price of the Company's shares sold in the ordinary course of trading on the Australian Stock Exchange on the date of the offer of the option. Share options have a three year vesting period and exercise is dependent on achieving earnings per share growth hurdles, which are detailed later in this Report.

Details of the nature and amount of each major element of the emoluments of each Director and of the five most highly remunerated executives of the Consolidated Entity and the Company are shown below:

AMOUNTS IN \$	SALARY OR FEES	PERFORMANCE RELATED BONUS	BENEFITS ¹	SUPER-ANNUATION	LEAVING BENEFITS	TOTAL BEFORE OPTIONS	ESTIMATED VALUE OF OPTIONS ⁴	TOTAL
Directors of the Company								
Prof. BDO Anderson, AO	70,454	–	–	6,341	36,500 ²	113,295	–	113,295
Mr TCE Bergman	152,927	–	–	9,861	–	162,788	–	162,788
Prof. E Byrne	70,454	–	–	6,341	–	76,795	–	76,795
Ms EC Holley	86,193	–	–	7,757	47,000 ²	140,950	–	140,950
Mr PJ North	79,923	–	–	7,193	48,000 ²	135,116	–	135,116
Mr JJ O'Mahony	590,160	416,845	65,879	87,141	–	1,160,025	648,318	1,808,343
Dr JL Parker	249,898	131,835	–	10,520	–	392,253	330,710	722,963
Mr JH Veeneklaas	70,454	–	–	6,341	36,500 ²	113,295	–	113,295
Prof. DG Penington, AC	86,805	–	–	3,318	335,914	426,037	–	426,037
Consolidated Entity executives								
Mr M Sundler ³ President – European Region	224,074	146,841	21,511	58,752	305,364	756,542	338,609	1,095,151
Mr J Miller ³ President – Americas Region	343,584	272,938	11,609	30,818	–	658,949	280,452	939,401
Mr NJ Mitchell Chief Financial Officer and Company Secretary	201,401	114,345	10,648	25,175	–	351,569	313,004	664,573
Mr JF Patrick Senior Vice President – Chief Scientist	126,260	104,500	1,990	96,489	–	329,239	313,004	642,243
Mr V Marrant Senior Vice President – New Business Development	147,102	121,275	–	87,141	–	355,518	280,452	635,970
Company executives								
Mr NJ Mitchell Chief Financial Officer and Company Secretary	201,401	114,345	10,648	25,175	–	351,569	313,004	664,573
Mr JF Patrick Senior Vice President – Chief Scientist	126,260	104,500	1,990	96,489	–	329,239	313,004	642,243
Mr V Marrant Senior Vice President – New Business Development	147,102	121,275	–	87,141	–	355,518	280,452	635,970
Mr P Nicholl President – Asia Pacific Region	192,923	104,580	13,597	10,520	–	321,620	280,452	602,072
Mr L Port Vice President – Business Systems	164,232	93,280	1,990	32,505	–	292,007	263,453	555,460

1. Benefits include the provision of car allowances, telecommunication costs and health insurance.

2. Amounts accrued during the financial year to the Directors' Retirement Scheme. Refer to Note 28 for further information.

3. Denotes overseas based executive.

4. The ability to exercise the options is conditional on the Consolidated Entity achieving certain performance hurdles. The estimated value disclosed above is calculated at the date of grant using a Black-Scholes model applying a 10% volatility as reflected in the price movement between 30 June 2000 and 30 June 2003. Further details of options granted during the financial year are set out under options below. The value of options granted has been calculated for disclosure purposes only and there is no current requirement to recognise these amounts in determining the net profit for the financial year.

DIRECTORS' REPORT

Cochlear Limited for the year ended 30 June 2003

OPTIONS

During and since the end of the financial year, the Company granted options over unissued ordinary shares at an exercise price of \$38.12 per share to the Executive Directors of the Company, Mr JJ O'Mahony and Dr JL Parker, and those of the five most highly remunerated executives of the Company and of the Consolidated Entity as part of their remuneration:

	NUMBER OF OPTIONS GRANTED	EXERCISE PERIOD
Directors		
Mr JJ O'Mahony CEO/President	100,000	Aug - Sept 2005
Dr JL Parker Senior Vice President and Chief Technology Officer	50,000	Aug - Sept 2005
Executives		
Mr M Sundler President – European Region	50,000	Aug - Sept 2005
Mr J Miller President – Americas Region	50,000	Aug - Sept 2005
Mr NJ Mitchell Chief Financial Officer and Company Secretary	50,000	Aug - Sept 2005
Mr JF Patrick Senior Vice President – Chief Scientist	50,000	Aug - Sept 2005
Mr V Marrant Senior Vice President – New Business Development	50,000	Aug - Sept 2005
Mr P Nicholl President – Asia Pacific Region	50,000	Aug - Sept 2005
Mr L Port Vice President – Business Systems	40,000	Aug - Sept 2005

At the date of this Report, unissued ordinary shares of the Company under option are:

	NUMBER OF OPTIONS	EXERCISE PRICE PER SHARE	EXERCISE PERIOD
	10,000	\$15.00	July - Aug 2003
	1,039,000	\$26.50	Aug - Sept 2003
	100,000	\$36.00	Aug - Sept 2003
	1,142,000	\$37.62	Aug - Sept 2004
	1,232,000	\$38.12	Aug - Sept 2005

The share price at 30 June 2003 was \$32.30.

During the financial year, the Company granted options over 1,268,000 unissued ordinary shares to employees under an Executive Share Option Plan. The options are exercisable in the month following lodgement with the Australian Stock Exchange (ASX) of the Company's preliminary financial report for the year ending 30 June 2005. The number of options which will be exercisable by the executives will depend upon the compound annual growth rate of the earnings per ordinary share achieved by the Consolidated Entity since 1 July 2002. Three different levels of growth rate have been set which will determine the number of options exercisable by the executives in any particular financial year. If the minimum earnings per share compound growth rate of 10% per annum is not achieved, no ordinary shares will be issued. To achieve a 100% allocation, an annual earnings per share compound growth rate of 18% over the three year period must be achieved.

The Company cancelled 134,000 share options during the financial year.

DIRECTORS' REPORT

Cochlear Limited for the year ended 30 June 2003

DIRECTORS' INTERESTS

The relevant interest of each Director in the share capital of the Company, as notified by the Directors to ASX in accordance with Section 205G(1) of the Corporations Act 2001, at the date of this Report is as follows:

	COCHLEAR LIMITED ORDINARY SHARES	OPTIONS OVER ORDINARY SHARES
Prof. BDO Anderson, AO	4,000	—
Mr TCE Bergman	8,000	—
Prof. E Byrne	1,000	—
Ms EC Holley	9,000	—
Mr PJ North	12,000	—
Mr JJ O'Mahony	11,286	325,000
Dr JL Parker	5,000	150,000
Mr JH Veeneklaas	—	—

INDEMNIFICATION OF OFFICERS

Under the terms of Article 35 of the Company's Constitution, and to the extent permitted by law, the Company has indemnified the Directors of the Company named in this Report, the Company Secretary, Mr NJ Mitchell, and other persons concerned in or taking part in the management of the Consolidated Entity. The indemnity applies when persons are acting in their capacity as officers of the Company in respect of:

- liability to third parties (other than the Company or related bodies corporate), if the relevant officer has acted in good faith; and
- the cost and expenses of successfully defending legal proceedings in which relief under the Corporations Act 2001 is granted to the relevant officer.

INSURANCE FOR DIRECTORS AND OFFICERS

During the financial year, the Company paid a premium for a Directors' and Officers' Liability Insurance policy and a Supplementary Legal Expenses Insurance policy. The insurance provides cover for the Directors named in this Report, the Company Secretary, and Officers and former Directors and Officers of the Company. The policy also provides cover for present and former Directors and Officers of the Consolidated Entity. The Directors have not included details of the nature of the liabilities covered and the amount of the premium paid in respect of the Directors' and Officers' Liability and Supplementary Legal Expenses Insurance policies, as such disclosure is prohibited under the terms of the contract.

ROUNDING OFF

The Company is of a kind referred to in Australian Securities and Investments Commission Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the financial report and Directors' Report have been rounded off to the nearest one thousand dollars, unless otherwise indicated.

Dated at Sydney this 19th day of August 2003.

Signed in accordance with a resolution of the Directors:



Director



Director

STATEMENTS OF FINANCIAL PERFORMANCE

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$000	2002 \$000	2003 \$000	2002 \$000
Revenue from ordinary activities	3	290,045	256,201	205,044	187,752
Expenses	4(b)	209,239	204,021	131,110	136,448
Borrowing costs		796	1,150	153	195
Profit from ordinary activities before related income tax expense		80,010	51,030	73,781	51,109
Income tax expense relating to ordinary activities	6(a)	21,797	10,920	19,892	11,952
Net profit attributable to members of the parent entity		58,213	40,110	53,889	39,157
Non-owner transaction changes in equity					
Translation adjustment in general reserve	22	(8)	3	–	–
Net (decrease)/increase in retained profits on the initial adoption of:					
Revised AASB 1028 “Employee Benefits”	2	(116)	–	(90)	–
AASB 1044 “Provisions, Contingent Liabilities and Contingent Assets”	2	311	–	2,411	–
Net exchange difference relating to self-sustaining foreign operations	22	(4,737)	2,507	–	–
Total changes in equity from non-owner related transactions attributable to the members of the parent entity		53,663	42,620	56,210	39,157
Basic earnings per share (cents)					
Ordinary shares	9	110.0	76.6		
Diluted earnings per share (cents)					
Ordinary shares	9	110.0	76.6		

The statement of financial performance is to be read in conjunction with the notes to the financial statements set out on pages 38 to 63.

STATEMENTS OF FINANCIAL POSITION

Cochlear Limited and its controlled entities as at 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$000	2002 \$000	2003 \$000	2002 \$000
Current assets					
Cash assets	24(i)	43,891	10,539	23,661	3,698
Receivables	10	78,578	69,284	59,849	31,228
Inventories	11	45,023	36,380	32,901	27,258
Other	12	11,990	6,976	3,998	3,870
Total current assets		179,482	123,179	120,409	66,054
Non-current assets					
Receivables	10	9,796	215	9,632	–
Other financial assets	13	–	–	3,944	3,944
Plant and equipment	14	27,336	24,925	24,599	22,156
Deferred tax assets	6(c)	13,965	12,109	6,918	7,158
Total non-current assets		51,097	37,249	45,093	33,258
Total assets		230,579	160,428	165,502	99,312
Current liabilities					
Payables	15	29,340	21,136	13,447	9,534
Interest bearing liabilities	17	15,005	24,252	1,984	10,000
Current tax liabilities	6(b)	10,707	3,835	8,493	2,155
Provisions	19	18,838	34,149	16,355	30,653
Other	16	25,550	–	21,660	–
Total current liabilities		99,440	83,372	61,939	52,342
Non-current liabilities					
Provisions	19	1,820	1,640	902	759
Other	16	9,632	–	9,632	–
Total non-current liabilities		11,452	1,640	10,534	759
Total liabilities		110,892	85,012	72,473	53,101
Net assets		119,687	75,416	93,029	46,211
Equity					
Contributed equity	21	23,089	14,959	23,089	14,959
Reserves	22	1,188	5,933	–	–
Retained profits	23	95,410	54,524	69,940	31,252
Total equity		119,687	75,416	93,029	46,211

The statement of financial position is to be read in conjunction with the notes to the financial statements set out on pages 38 to 63.

STATEMENTS OF CASH FLOWS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$000	2002 \$000	2003 \$000	2002 \$000
Cash flows from operating activities					
Cash receipts in the course of operations		306,471	233,437	202,336	178,747
Cash payments in the course of operations		(210,853)	(215,609)	(127,468)	(150,706)
Grant received		422	622	422	–
Interest received		596	702	470	183
Borrowing costs paid		(796)	(997)	(153)	–
Income taxes paid		(17,023)	(12,373)	(13,286)	(10,233)
Purchase of core technology		–	(4,884)	–	(4,884)
Net cash provided by operating activities	24(ii)	78,817	898	62,321	13,107
Cash flows from investing activities					
Payment for plant and equipment		(10,499)	(17,130)	(9,199)	(15,769)
Net cash used in investing activities		(10,499)	(17,130)	(9,199)	(15,769)
Cash flows from financing activities					
Repayment of borrowings		(10,000)	–	(10,000)	–
Proceeds from borrowings		1,984	14,121	1,983	10,000
Proceeds from the issue of shares		8,130	4,076	8,130	4,076
Dividends paid		(33,272)	(21,948)	(33,272)	(21,948)
Net cash used in financing activities		(33,158)	(3,751)	(33,159)	(7,872)
Net increase/(decrease) in cash held		35,160	(19,983)	19,963	(10,534)
Cash at beginning of financial year		8,474	29,374	3,698	14,232
Effects of exchange fluctuation on the balances of cash held in foreign currencies		(1,616)	(917)	–	–
Cash at end of financial year	24(i)	42,018	8,474	23,661	3,698

The statement of cash flows is to be read in conjunction with the notes to the financial statements set out on pages 38 to 63.

NOTES TO THE FINANCIAL STATEMENTS

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NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

I. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The significant policies which have been adopted in the preparation of this financial report are:

(a) Basis of Preparation

The financial report is a general purpose financial report which has been prepared in accordance with Accounting Standards, Urgent Issues Group Consensus Views, other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001. It has been prepared on the basis of historical costs and except where stated, does not take into account changing money values or fair values of non-current assets. These accounting policies have been consistently applied by each entity in the Consolidated Entity and, except where there is a change in accounting policy as disclosed in Note 2, are consistent with those of the previous financial year. Unless otherwise stated, these accounts have been prepared in Australian Dollars.

(b) Principles of Consolidation

The consolidated financial statements of the Consolidated Entity include the financial statements of the Company, being the parent entity, and its controlled entities. Where an entity either began or ceased to be controlled during the financial year, the results are included only from the date control commenced or up to the date control ceased. The balances, and effects of transactions, between controlled entities included in the consolidated financial statements have been eliminated.

(c) Revenue Recognition

Revenues are recognised at fair value of the consideration received net of the amount of goods and services tax (GST).

Sales revenue

Sales revenue comprises revenue earned (net of returns, discounts and allowances) from the provision of products or services to entities outside the Consolidated Entity. Revenue from the sale of goods is recognised when control of the goods passes to the customer. Revenue attributable to unfulfilled obligations is deferred and recognised when that obligation has been satisfied or the right to satisfy the obligation lapses.

Revenue from the sale of services is recognised when the service has been provided to the customer and where there are no continuing unfulfilled service obligations.

Interest income

Interest income is recognised as it accrues.

Other revenue

Other revenue, including government grants, is recognised when the entitlement is confirmed.

Asset sales

The gross proceeds of asset sales are included as revenue of the Consolidated Entity. The profit or loss on disposal of assets is brought to account at the date an unconditional contract of sale is signed.

(d) Goods and Services Tax

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

(e) Foreign Currency

Transactions

Foreign currency transactions are translated to Australian Dollars at the rates of exchange ruling at the dates of the transactions. Amounts receivable and payable in foreign currencies at reporting date are translated at the rates of exchange ruling on that date.

Exchange differences relating to amounts receivable and payable in foreign currencies are brought to account as exchange gains or losses in the statement of financial performance in the financial year in which the exchange rates change.



NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

Hedges

Transactions are designated as a hedge of the anticipated specific purchase or sale of goods or services, purchase of qualifying assets, or an anticipated interest transaction, only when they are expected to reduce exposure to the risks being hedged, are designated prospectively so that it is clear when an anticipated transaction has or has not occurred and it is probable the anticipated transaction will occur as designated. Gains or losses on the hedge arising up to the date of the anticipated transaction, together with any costs or gains arising at the time of entering into the hedge, are deferred and included in the measurement of the anticipated transaction when the transaction has occurred as designated. Any gains or losses on the hedge transaction after that date are included in the statement of financial performance.

The net amounts receivable or payable under forward foreign exchange contracts and the associated deferred gains or losses are recorded on the statement of financial position from the date of inception of the hedge transaction. When recognised, the net receivables or payables are revalued using the foreign currency exchange rate current at reporting date. Refer to Note 30.

When the anticipated transaction is no longer expected to occur as designated, the deferred gain or loss relating to the hedged transaction is recognised immediately in the statement of financial performance.

Where a hedge transaction is terminated early and the anticipated transaction is still expected to occur, the deferred gains and losses that arise on the foreign currency hedge prior to its termination, continue to be deferred and are included in the measurement of the purchase or sale when it occurs. Where a hedge transaction is terminated early because the anticipated transaction is no longer expected to occur, deferred gains and losses that arose on the foreign currency hedge prior to its termination are included in the statement of financial performance.

Where a hedge is redesignated as a hedge of another transaction, gains or losses arising on the hedge prior to its redesignation are only deferred where the original anticipated transaction is still expected to occur as designated. When the original anticipated transaction is no longer expected to occur as designated, any gains or losses relating to the hedge instrument are included in the statement of financial performance.

Gains or losses that arise prior to and upon the maturity of transactions entered into under hedge rollover strategies are deferred and included in the measurement of the hedged anticipated transaction if the transaction is still expected to occur as designated. If the anticipated transaction is no longer expected to occur as designated, the gains or losses are recognised immediately in the statement of financial performance.

Translation of controlled foreign entities

The assets and liabilities of controlled foreign entities that are self-sustaining are translated at the rates of exchange ruling at reporting date. The statements of financial performance are translated at the average rate for the financial year. Exchange differences arising on translation are taken directly to the foreign currency translation reserve.

Translation of controlled foreign branches

The assets and liabilities of controlled foreign branches that are integrated foreign operations are translated using the temporal method. Monetary assets and liabilities are translated into Australian currency at rates of exchange current at reporting date, while non-monetary items and revenue and expense items are translated at exchange rates current when transactions are brought to account in the statements of financial performance and position.

(f) Provisions

A provision is recognised when there is a legal, equitable or constructive obligation as a result of a past event and it is probable that a future sacrifice of economic benefits will be required to settle the obligation, the timing or amount of which is uncertain.

Warranties

Warranty costs are expensed as incurred with a provision determined by discounting the future estimated liability on products still under warranty. The amount provided each financial year for warranty is calculated based on historical claims experience and respective product populations.

Dividends

A provision for dividends payable is recognised in the financial period in which the dividends are declared, for the entire undistributed amount, regardless of the extent to which they will be paid in cash.

Restructuring, employee termination benefits and surplus lease space

Provisions for restructuring or termination benefits are only recognised when a detailed plan has been approved and the restructuring or termination has either commenced or been publicly announced, or firm contracts related to the restructuring or termination benefits have been entered into. Costs related to ongoing activities are not provided for. The liabilities for termination benefits that will be paid as a result of these restructurings have been included in the provision for employee benefits.

Provision is made for non-cancellable operating lease rentals payable on surplus leased premises when it is determined that no substantive future benefit will be obtained from its occupancy and sub-lease rentals are less than the lease rentals paid. The estimate is calculated based on discounted net future cash flows, using the interest rate implicit in the lease or an estimate thereof.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

(g) Classification of Assets and Liabilities

Assets and liabilities have been classified in the statement of financial position as either current or non-current. Current assets are cash assets and other assets that would in the ordinary course of business be consumed or converted to cash within 12 months. Current liabilities are liabilities that would in the ordinary course of business be due and payable within 12 months.

(h) Research and Development Expenditure

Research and development expenditure is expensed as incurred.

(i) Recoverable Amount of Non-Current Assets Valued on a Cost Basis

The carrying amounts of non-current assets valued on a cost basis are reviewed to determine whether they are in excess of their recoverable amount at reporting date. If the carrying amount of a non-current asset exceeds the recoverable amount, the asset is written down to the lower amount. The write down is recognised as an expense in the financial period in which it occurs.

In assessing recoverable amounts of non-current assets, the relevant cash flows have not been discounted to their present value.

(j) Plant and Equipment

Acquisition

Items of plant and equipment are initially recorded at their cost of acquisition, being fair value of the consideration provided plus incidental costs directly attributable to the acquisition and depreciated or amortised as outlined below.

The cost of plant and equipment constructed by the Consolidated Entity includes the cost of material and direct labour, an appropriate proportion of fixed and variable overheads and capitalised interest.

Enterprise resource planning system

The external expenditure incurred on hardware and software and the external costs necessary for the implementation of the enterprise resource planning system are recognised as an asset to the extent that the entity controls future economic benefits as a result of the costs incurred. All internal development, licence and support costs attributable to feasibility, alternative approach assessment and implementation are expensed as incurred.

Carrying value

All items of plant and equipment are carried at the lower of cost, less accumulated depreciation and amortisation, and their recoverable amount.

Depreciation and amortisation

Items of plant and equipment, including leasehold assets, are depreciated or amortised using the straight line method over their estimated useful lives. Assets are depreciated or amortised from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and held ready for use.

Depreciation and amortisation rates and methods are reviewed annually for appropriateness. When changes are made, adjustments are reflected prospectively in current and future financial periods only.

The annual depreciation and amortisation rates used for each class of asset are as follows:

	2003	2002
Leasehold improvements	12 - 20.0%	12 - 20.0%
Plant and equipment	17 - 33.3%	17 - 33.3%
Enterprise resource planning system	25 - 40.0%	25 - 40.0%

Leased assets

Leases under which the Consolidated Entity assumes substantially all the risks and benefits of ownership are classified as finance leases. Other leases are classified as operating leases.

Finance leases

Finance leases are capitalised. A lease asset and a liability equal to the present value of the minimum lease payments are recorded at the inception of the lease. Contingent rentals are expensed as incurred. Capitalised lease assets are amortised on a straight line basis over the term of the relevant lease, or where it is likely the Consolidated Entity will obtain ownership of the asset, the life of the asset. Lease liabilities are reduced by repayments of principal. The interest components of the lease payments are charged to the statement of financial performance.

Operating leases

Payments made under operating leases are expensed on a straight line basis over the term of the lease, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased property.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

(k) Inventories

Inventories are carried at the lower of cost and net realisable value.

Manufacturing activities

Cost is based on the first-in-first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing condition and location. In the case of manufactured inventories and work in progress, cost includes an appropriate share of both variable and fixed overhead costs. Fixed overhead costs are allocated on the basis of normal operating capacity.

Net realisable value

Net realisable value is determined on the basis of each entity's normal selling pattern. Expenses of marketing, selling and distribution to customers are estimated and are deducted to establish net realisable value.

(l) Investments

Controlled entities

Investments in controlled entities are carried in the Company's financial statements at the lower of cost and recoverable amount. Dividends and distributions are brought to account in the statement of financial performance of the parent entity when they are proposed by the controlled entities. All intra-group transactions are eliminated on consolidation.

(m) Employee Benefits

Wages, salaries and annual leave

Liabilities for employee benefits for wages, salaries and annual leave expected to settle within 12 months of the year end represent present obligations resulting from employees' services provided up to reporting date, calculated at undiscounted amounts based on remuneration wage and salary rates that the Consolidated Entity expects to pay after reporting date including related on-costs.

Long service leave

The provision for employee benefits to long service leave represents the present value of the estimated future cash outflows to be made by the employer resulting from employees' services provided up to reporting date.

The provision is calculated using expected future increases in remuneration rates, including related on-costs and expected settlement dates based on turnover history, and is discounted using the rates attaching to national government securities at reporting date, which most closely match the terms of maturity of the related liabilities. The unwinding of the discount is treated as a long service leave expense.

Share options

The Company has granted options to certain employees under an Executive Share Option Plan. Further information is set out in the Directors' Report to the financial report. Other than the costs incurred in administering the plan which are expensed as incurred, the plan does not result in any expense to the Consolidated Entity.

No value is attributed to shares and options issued to employees as remuneration for future services in these financial statements. Shares issued to employees upon the exercise of options are recognised in equity at the fair value of consideration received.

Superannuation plans

The Consolidated Entity contributes to various employee superannuation plans. The liabilities of these plans are covered by the assets in the plans. The Consolidated Entity is obliged to contribute to the plans as a consequence of legislation or trust deeds. Legal enforceability is dependent on the terms of the legislation and the trust deeds. Contributions are charged against revenue as they are made. A liability is recognised when the accrued benefits of defined benefit members exceeds the market value of plan assets. Further information is set out in Note 28.

(n) Receivables

Trade debtors

Trade debtor terms vary from market to market depending on the economic factors relevant to the individual market. The Consolidated Entity has actual trading terms ranging up to 180 debtor days. The collectability of debts is assessed at reporting date and allowance made for any doubtful accounts.

The allowance for doubtful debts is calculated with reference to the profile of debtors in the Consolidated Entity's sales and marketing regions. Where specific material doubtful debts are identified, an additional amount is allowed for.

Credit risk

The credit risk related to the trade debtors of the Consolidated Entity which have been recognised and the carrying amount on the statement of financial position is net of any allowance for doubtful debts. The Consolidated Entity trades in more than 70 countries and at the end of the financial year there was no adverse material exposure to any individual overseas country or individual customer other than as allowed for in the financial statements.



NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

(o) Net Fair Values of Financial Assets and Liabilities

The carrying value of the Consolidated Entity's financial assets and liabilities approximate their net fair value.

(p) Taxation

The Consolidated Entity adopts the income statement liability method of tax effect accounting. Income tax expense is calculated on profit from ordinary activities adjusted for permanent differences between taxable and accounting income. The tax effect of timing differences which arise from items being brought to account in different years for income tax and accounting purposes, is carried forward in the statement of financial position as a future income tax benefit or a provision for deferred income tax.

Future income tax benefits are not brought to account unless realisation of the asset is assured beyond reasonable doubt. Future income tax benefits relating to tax losses are only brought to account when their realisation is virtually certain.

(q) Payables

Liabilities are recognised for amounts to be paid in the future for goods and services received, whether or not billed to the Company or Consolidated Entity. Trade accounts payable are normally settled within 60 days but are negotiated on an individual basis where appropriate.

(r) Interest Bearing Liabilities

Bank loans are carried in the statement of financial position at their principal amount. Interest expense is accrued at the contracted rate and included in trade creditors and other creditors.

(s) Comparatives

Where necessary, comparative information has been reclassified to achieve consistency in disclosure with current financial year amounts and other disclosures.

(t) Earnings per Share

Basic earnings per share (EPS) is calculated by dividing the net profit attributable to members of the parent entity for the financial period, after excluding any costs of servicing equity by the weighted average number of ordinary shares of the Company, adjusted for any bonus issue.

Diluted EPS is calculated by dividing the basic EPS earnings, adjusted by the after tax effect of financing costs associated with the dilutive potential ordinary shares and the effect on revenues and expenses of conversion to ordinary shares associated with dilutive potential ordinary shares, by the weighted average number of ordinary shares and dilutive potential ordinary shares adjusted for any bonus issue.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

2. CHANGES IN ACCOUNTING POLICIES

(a) Foreign currency translation

The Consolidated Entity has applied the revised AASB 1012 "Foreign Currency Translation" for the first time from 1 July 2002.

For hedges of specific purchases or sales, the gains or costs on entering the hedge and the exchange differences up to the date of the purchase or sale are now deferred and recognised as assets or liabilities on the statement of financial position from the inception of the hedge contract, not when the specific purchase or sale occurs.

At 1 July 2002, the Consolidated Entity and the Company recognised for foreign currency hedge contracts:

- deferred exchange gains of \$10,322,000 (the Company: \$10,322,000); and
- a net foreign currency receivable of \$10,322,000 (the Company: \$10,322,000) on foreign currency hedge contracts.

There was no impact on opening retained profits at 1 July 2002 or on net profit for the current year to 30 June 2003.

(b) Employee benefits

The Consolidated Entity has applied the revised AASB 1028 "Employee Benefits" for the first time from 1 July 2002.

The liability for wages, salaries and annual leave is now calculated using the remuneration rates the Company expects to pay at each reporting date, not remuneration rates current at reporting date.

The adjustments to the Consolidated Entity and Company financial reports as at 1 July 2002 as a result of this change are:

- \$165,000 (the Company: \$128,000) increase in provision for employee benefits;
- \$116,000 (the Company: \$90,000) decrease in opening retained profits; and
- \$49,000 (the Company: \$38,000) increase in future income tax benefit.

As a result of this change in accounting policy, employee benefits expense increased by \$20,448 (the Company: \$20,448) and income tax expense decreased by \$6,134 (the Company: \$6,134) for the current year to 30 June 2003.

(c) Provisions and allowances

The Consolidated Entity has applied AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets" for the first time from 1 July 2002.

Dividends are now recognised at the time they are declared, determined or publicly recommended. Previously, final dividends were recognised in the financial year to which they related, even though the dividends were announced after the end of that financial year.

The adjustments to the Consolidated Entity and Company financial reports as at 1 July 2002 as a result of this change are:

- \$15,750,000 increase in opening retained profits; and
- \$15,750,000 decrease in provision for dividends.

The warranty provision is now determined by discounting the future estimated liability on products still under warranty. Previously, the warranty provision was determined without discounting the future estimated liability on products still under warranty.

The adjustments to the Consolidated Entity and Company financial reports as at 1 July 2002 as a result of this change are:

- \$311,000 increase in opening retained profits;
- \$445,000 decrease in provision for warranty; and
- \$134,000 decrease in future income tax benefit.

As a result of this change in accounting policy, warranty expense decreased by \$61,000 (the Company: \$61,000) and income tax expense increased by \$18,300 (the Company: \$18,300) for the current year to 30 June 2003.

The doubtful debtors allowance and other provisions in the Company relating to potential future losses have been reversed in accordance with the new standard. Previously, these provisions were carried in the Company on behalf of the controlled foreign operations.

The adjustments to the Company financial report as at 1 July 2002 as a result of this change are:

- \$2,100,000 increase in opening retained profits;
- \$3,000,000 decrease in allowance for doubtful debtors and other accruals; and
- \$900,000 decrease in future income tax benefit.

As a result of this change in accounting policy, there was no impact on the Consolidated Entity and the Company for the current year to 30 June 2003.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

(d) Pro forma statements of financial performance, and the restatement of retained profits, current provision for employee benefits, provision for dividends, warranty provision, doubtful debtor allowance, other provisions and future income tax benefit

The pro forma statements of financial performance, and the restatement of retained profits, current provision for employee benefits, provision for dividends, warranty provision, doubtful debtor allowance, other provisions and future income tax benefit below show the information that would have been disclosed had the new accounting policies disclosed in this Note always been applied:

		CONSOLIDATED		COMPANY	
	NOTE	2003 \$000	2002 \$000	2003 \$000	2002 \$000
Pro forma statements of financial performance					
Profit from ordinary activities before changes in accounting policies		79,969	51,030	73,740	51,109
Effect of adoption of:					
Revised AASB 1028 "Employee Benefits"		(20)	(165)	(20)	(128)
AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets"		61	445	61	3,445
Profit from ordinary activities before related income tax expense		80,010	51,310	73,781	54,426
Income tax expense related to ordinary activities					
Income tax expense before changes in accounting policies		(21,785)	(10,920)	(19,880)	(11,952)
Effect of adoption of:					
Revised AASB 1028 "Employee Benefits"		6	50	6	38
AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets"		(18)	(135)	(18)	(1,034)
Restated net profit attributable to members of the parent entity		58,213	40,305	53,889	41,478
Restatement of retained profits					
Reported retained profits at end of previous financial year		54,524	41,189	31,252	18,870
(Decrease)/increase in retained profits due to changes in accounting policies on adoption of:					
Revised AASB 1028 "Employee Benefits"		(116)	–	(90)	–
AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets" – Dividend provision		15,750	10,924	15,750	10,924
– Other		311	–	2,411	–
Restated retained profits at beginning of financial year		70,469	52,113	49,323	29,794
Restated net profit attributable to members of the parent entity		58,213	40,305	53,889	41,478
Dividends recognised during financial year – restated		(33,272)	(21,949)	(33,272)	(21,949)
Restated retained profits at end of financial year		95,410	70,469	69,940	49,323
Restatement of current provision for employee benefits					
Balance at end of financial year – as previously reported		8,478	8,295	6,106	5,579
Effect of change in accounting policy		–	165	–	128
Restated balance at end of financial year		8,478	8,460	6,106	5,707
Restatement of provision for dividends					
Balance at end of financial year – as previously reported		–	15,750	–	15,750
Effect of change in accounting policy		–	(15,750)	–	(15,750)
Restated balance at end of financial year		–	–	–	–
Restatement of warranty provision					
Balance at end of financial year – as previously reported		6,680	6,010	6,565	6,010
Effect of change in accounting policy		–	(445)	–	(445)
Restated balance at end of financial year		6,680	5,565	6,565	5,565
Restatement of doubtful debt allowance					
Balance at end of financial year – as previously reported		3,461	3,573	160	2,253
Effect of change in accounting policy		–	–	–	(2,093)
Restated balance at end of financial year		3,461	3,573	160	160
Restatement of provision – other					
Balance at end of financial year – as previously reported		3,680	4,094	3,684	3,314
Effect of change in accounting policy		–	–	–	(907)
Restated balance at end of financial year		3,680	4,094	3,684	2,407
Restatement of future income tax benefit					
Balance at end of financial year – as previously reported		13,965	12,109	6,918	7,158
Effect of change in accounting policy		–	(86)	–	(996)
Restated balance at end of financial year		13,965	12,023	6,918	6,162

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$'000	2002 \$'000	2003 \$'000	2002 \$'000
3. REVENUE FROM ORDINARY ACTIVITIES					
Sale of goods revenue from operating activities		286,011	252,706	203,909	186,795
Rendering of services revenue from operating activities		2,565	2,275	98	760
Other revenue:					
From operating activities					
Interest received or due and receivable from other persons		657	690	525	183
Grant received or due and receivable from outside operating activities		422	463	422	–
Other income		390	67	90	14
Total other revenue		1,469	1,220	1,037	197
Total revenue from ordinary activities		290,045	256,201	205,044	187,752
4. PROFIT FROM ORDINARY ACTIVITIES BEFORE RELATED INCOME TAX EXPENSE					
(a) Individually significant items included in profit from ordinary activities before related income tax expense:					
Acquisition of core technology from Implex AG Hearing Technology		–	5,229	–	5,229
(b) Expenses					
Cost of goods sold		65,103	72,966	62,274	69,916
Distribution, marketing and field clinical support		89,045	77,252	18,081	17,456
Research and development	4(a)	37,030	42,977	32,696	38,261
Administration and new system development		17,956	10,665	17,954	10,665
Other expenses from ordinary activities		105	161	105	150
		209,239	204,021	131,110	136,448
(c) Profit from ordinary activities before related income tax expense has been arrived at after charging/(crediting) the following items:					
Interest paid or due and payable to other parties		796	1,150	153	195
Write down in value of inventories		2,966	1,042	2,633	371
Net bad and doubtful debts expense including movements in allowance for doubtful debts		1,189	962	–	624
Amortisation of leasehold improvements		2,228	986	2,134	970
Depreciation of plant and equipment		3,667	3,632	2,766	2,403
Depreciation of enterprise resource planning system		1,852	129	1,852	129
Net expense/(income) from movements in provisions for:					
Employee benefits		9,729	4,683	5,980	3,956
Warranty		1,115	509	1,000	510
Other		(430)	(543)	1,272	(354)
Operating lease rental expense		4,387	4,285	2,397	1,701
Net foreign exchange loss/(gain)		105	(1,036)	105	150
Loss/(gain) on disposal of plant and equipment		2	393	(2)	–

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$000	2002 \$000	2003 \$000	2002 \$000
6. TAXATION					
(a) Income tax expense					
Prima facie income tax expense calculated at 30% (2002: 30%) on the profit from ordinary activities					
		24,003	15,309	22,134	15,333
Increase in income tax expense due to:					
Net higher overseas tax rate					
		802	650	231	175
Non-allowable/(assessable) permanent differences					
		1,112	480	(73)	61
Decrease in income tax expense due to:					
Overseas share options deductions					
		(681)	(2,017)	–	–
Research and development allowance					
		(2,684)	(3,322)	(2,502)	(3,166)
Income tax expense on profit from ordinary activities					
		22,552	11,100	19,790	12,403
Income tax (over)/under provided in prior financial year					
		(755)	(180)	102	(451)
Income tax expense attributable to profit from ordinary activities					
		21,797	10,920	19,892	11,952
Income tax expense attributable to profit from ordinary activities is made up of:					
Current income tax provision					
		24,899	13,348	20,630	12,373
Future income tax benefit					
		(2,347)	(2,248)	(840)	30
(Over)/under provision in prior financial year					
		(755)	(180)	102	(451)
		21,797	10,920	19,892	11,952
(b) Current tax liabilities					
Provision for current income tax					
Movements during financial year:					
Balance at beginning of financial year					
		3,835	3,209	2,155	2,578
Income taxes paid					
		(17,023)	(12,373)	(13,286)	(10,233)
Current year's income tax expense on profit from ordinary activities					
		24,899	13,348	20,630	12,373
(Over)/under provision in prior financial year					
		(755)	(180)	102	(451)
Tax loss transferred from a controlled entity					
		–	–	(1,108)	(2,112)
Net foreign currency difference on translation of foreign operations					
		(249)	(169)	–	–
		10,707	3,835	8,493	2,155
(c) Deferred tax assets					
Future income tax benefit comprises the estimated future benefit at the applicable local taxation rate on the following items:					
Provisions and other timing differences not currently deductible					
		13,965	12,109	6,918	7,158

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	CENTS PER SHARE	TOTAL AMOUNT \$'000	FRANKED/ UNFRANKED	DATE OF PAYMENT
7. DIVIDENDS				
Dividends recognised in the current financial year by the Company are:				
2003				
Interim – ordinary	33.0	17,513	Franked	19 March 2003
2002 final dividend recognised when declared during financial year: Refer to Note 2 “Changes in accounting policies”				
– Final – ordinary	30.0	15,759	Franked	24 September 2002
Total amount		33,272		
2002				
Interim – ordinary	21.0	11,025	Franked	20 March 2002
Final – ordinary	30.0	15,750	Franked	24 September 2002
Total amount		26,775		
Franked dividends declared or paid during the financial year were franked at the tax rate of 30%				
Subsequent events				
Since the end of the financial year, the Directors declared the following dividends:				
Final – ordinary	44.0	23,351	Franked	
Total amount		23,351		

The financial effect of the 2003 final dividend has not been brought to account in the financial statements for the year ended 30 June 2003 and will be recognised in the subsequent financial period.

Dividend franking account

	COMPANY	
	2003 \$'000	2002 \$'000
30% franking credits available to shareholders of Cochlear Limited for subsequent financial years	17,489	12,532

The above amounts are based on the balance of the dividend franking account at year end adjusted for:

- franking credits that will arise from the payment of the current tax liability;
- franking debits that will arise from the payment of dividends recognised as a liability at the year end; and
- franking credits that the entity may be prevented from distributing in subsequent financial years.

The ability to utilise the franking credits is dependent upon there being sufficient available profits to declare dividends.

Change in measurement of dividend franking account

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.

The amount of franking credits available to shareholders disclosed as at 30 June 2003 has been measured under the new legislation and represents income tax paid amounts available to frank distributions. The balance disclosed as at 30 June 2002 has been measured under the legislation existing at 30 June 2002 and represents after tax profits able to be distributed fully franked at the current tax rate.

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.

Comparative information has not been restated for this change in measurement. Had the comparative information been calculated on the new basis, the “franking credits available” balance as at 30 June 2002 would have been \$5,371,000.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

8. SEGMENT REPORTING

Inter-segment pricing is on an arms length basis and is determined in accordance with transfer pricing arrangements.

Segment results, assets and liabilities include items directly attributable to a segment, as well as those that can be allocated on a reasonable basis. Unallocated items mainly comprise corporate expenses and assets associated with the manufacturing process.

Geographical segments

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets are based on the geographical location of the assets.

The Consolidated Entity's business segments operate geographically as follows:

	AMERICAS		EUROPE		ASIA PACIFIC		UNALLOCATED		ELIMINATIONS		CONSOLIDATED	
	2003 \$000	2002 \$000	2003 \$000	2002 \$000	2003 \$000	2002 \$000	2003 \$000	2002 \$000	2003 \$000	2002 \$000	2003 \$000	2002 \$000
Revenue												
Revenue outside the Consolidated Entity	142,588	119,701	98,359	87,436	49,098	49,064	–	–	–	–	290,045	256,201
Inter-segment sales revenue	–	–	–	–	–	–	181,111	167,919	(181,111)	(167,919)	–	–
Profit												
Profit/(loss) from ordinary activities before interest and income tax	36,405	31,876	29,333	27,311	10,651	12,225	3,761	(19,922)	–	–	80,150	51,490
Net interest expense											(140)	(460)
Profit from ordinary activities before related income tax expense											80,010	51,030
Income tax expense relating to ordinary activities											(21,797)	(10,920)
Profit from ordinary activities after related income tax expense											58,213	40,110
Depreciation and amortisation	500	545	370	562	196	288	6,681	3,352	–	–	7,747	4,747
Non-cash expenses other than depreciation and amortisation	1,773	735	998	768	551	692	7,252	3,455	–	–	10,574	5,650
Inventory write down	210	172	112	–	11	–	2,633	870	–	–	2,966	1,042
Total assets	52,057	46,966	50,754	44,139	18,214	18,441	158,385	104,921	(48,831)	(54,039)	230,579	160,428
Total liabilities	25,109	19,843	33,594	30,385	14,495	6,035	70,836	69,856	(33,142)	(41,107)	110,892	85,012
Acquisition of non-current assets	709	1,214	447	465	145	108	9,198	15,343	–	–	10,499	17,130

Included in unallocated profit/(loss) from ordinary activities before interest and income tax expense is a foreign exchange profit/(loss) amounting to \$17,534,000 (2002: (\$4,995,000)) which has not been allocated to the regions.

Secondary reporting

The Consolidated Entity operates in a single business segment, being the cochlear implant industry.

9. EARNINGS PER SHARE

	CONSOLIDATED	
	2003	2002
Net profit used in the calculation of:		
Basic earnings per share	\$58,213,100	\$40,110,483
Diluted earnings per share	\$58,213,100	\$40,110,483
Weighted average number of ordinary shares used as the denominator:		
Number for basic earnings per share	52,944,555	52,381,173
Number for diluted earnings per share	52,944,555	52,381,173

As the number of shares to be issued under the Executive Share Option Plan is contingent upon the achievement of certain future earnings thresholds, the potential ordinary shares are considered to be contingently issuable and have not been included in the calculation of diluted earnings per share.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$'000	2002 \$'000	2003 \$'000	2002 \$'000
10. RECEIVABLES					
Current					
Trade debtors		60,379	72,857	5,226	4,378
Allowance for doubtful trade debtors		(3,461)	(3,573)	(160)	(2,253)
		56,918	69,284	5,066	2,125
Amount receivable from controlled entities	29	–	–	33,123	29,103
Deferred foreign exchange receivable		21,660	–	21,660	–
Total receivables		78,578	69,284	59,849	31,228
Non-current					
Deferred foreign exchange receivable		9,632	–	9,632	–
Other amounts receivable		164	215	–	–
		9,796	215	9,632	–
11. INVENTORIES					
Raw materials and stores, at net realisable value		21,489	19,257	21,501	19,257
Work in progress, at net realisable value		5,366	6,110	5,357	6,110
Finished goods, at net realisable value		18,168	11,013	6,043	1,891
Total inventories		45,023	36,380	32,901	27,258
12. OTHER CURRENT ASSETS					
Prepayments and other debtors		11,990	6,976	3,998	3,870
13. OTHER FINANCIAL ASSETS					
Non-current					
Shares in controlled entities, unlisted at cost	25	–	–	3,944	3,944

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$000	2002 \$000	2003 \$000	2002 \$000
14. PLANT AND EQUIPMENT					
Leasehold improvements					
At cost		16,597	14,186	15,904	13,417
Accumulated amortisation		(5,578)	(3,482)	(5,262)	(3,233)
		11,019	10,704	10,642	10,184
Plant and equipment					
At cost		28,525	24,086	21,942	17,799
Accumulated depreciation		(17,662)	(14,668)	(13,439)	(10,630)
		10,863	9,418	8,503	7,169
Enterprise resource planning system					
At cost		7,374	4,932	7,374	4,932
Accumulated depreciation		(1,920)	(129)	(1,920)	(129)
		5,454	4,803	5,454	4,803
Total plant and equipment at net book value		27,336	24,925	24,599	22,156
Reconciliations					
Reconciliations of the carrying amounts of each class of plant and equipment are set out below:					
Leasehold improvements					
Carrying amount at beginning of financial year		10,704	4,750	10,184	3,972
Additions		2,594	7,319	2,592	7,182
Disposals		–	(393)	–	–
Amortisation		(2,228)	(986)	(2,134)	(970)
Net foreign currency difference on translation of self-sustaining foreign operations		(51)	14	–	–
Carrying amount at end of financial year		11,019	10,704	10,642	10,184
Plant and equipment					
Carrying amount at beginning of financial year		9,418	7,791	7,169	5,917
Additions		5,402	4,880	4,104	3,655
Disposals		(18)	–	(4)	–
Depreciation		(3,667)	(3,632)	(2,766)	(2,403)
Net foreign currency difference on translation of self-sustaining foreign operations		(272)	379	–	–
Carrying amount at end of financial year		10,863	9,418	8,503	7,169
Enterprise resource planning system					
Carrying amount at beginning of financial year		4,803	–	4,803	–
Additions		2,503	4,932	2,503	4,932
Disposals		–	–	–	–
Depreciation		(1,852)	(129)	(1,852)	(129)
Carrying amount at end of financial year		5,454	4,803	5,454	4,803
Total carrying amount at end of financial year		27,336	24,925	24,599	22,156

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$'000	2002 \$'000	2003 \$'000	2002 \$'000
15. PAYABLES					
Trade creditors and other creditors		29,340	21,136	13,447	9,534
16. OTHER LIABILITIES					
Current					
Deferred foreign exchange gain		21,660	–	21,660	–
Deferred revenue		3,890	–	–	–
		25,550	–	21,660	–
Non-current					
Deferred foreign exchange gain		9,632	–	9,632	–
17. INTEREST BEARING LIABILITIES					
Bank overdrafts		1,873	2,065	–	–
Bank loans, secured		13,132	22,187	1,984	10,000
		15,005	24,252	1,984	10,000
Financing arrangements					
The Consolidated Entity has access to the following lines of credit at reporting date:					
Bank overdrafts		3,878	7,762	2,000	2,000
Bank loans		40,088	32,187	20,000	20,000
Standby letters of credit		227	500	227	500
		44,193	40,449	22,227	22,500
Facilities utilised at reporting date					
Bank overdrafts		1,873	2,065	–	–
Bank loans – current		13,132	22,187	1,984	10,000
Standby letters of credit		–	–	–	–
		15,005	24,252	1,984	10,000
Facilities not utilised at reporting date					
Bank overdrafts		2,005	5,697	2,000	2,000
Bank loans		26,956	10,000	18,016	10,000
Standby letters of credit		227	500	227	500
		29,188	16,197	20,243	12,500

Bank overdrafts

The bank overdrafts are payable on demand and are subject to annual review. Interest on bank overdrafts is variable and is charged at prevailing market rates. The average effective interest rate is 1.5% (2002: 1.57%) per annum.

Bank loans

The bank loans were secured by a letter of guarantee provided by the Company. The utilised facility bore interest at an average effective interest rate of 3.6% (2002: 5.1%) per annum.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$'000	2002 \$'000	2003 \$'000	2002 \$'000
18. COMMITMENTS					
Operating lease commitments					
Future non-cancellable operating lease rentals not provided for in the financial statements are payable as follows:					
Not later than one year		3,798	4,187	1,729	1,824
Later than one year but not later than five years		13,765	14,624	6,862	7,297
Later than five years		8,602	10,312	2,014	1,824
Total commitments		26,165	29,123	10,605	10,945
Capital expenditure commitments					
Contracted but not provided for and payable:					
Not later than one year		3,575	3,417	3,528	3,417
<p>The Consolidated Entity leases property under non-cancellable operating leases expiring from one to seven years. Leases generally provide the Consolidated Entity with a right of renewal at which time all terms are renegotiated. Lease payments comprise a base amount plus an incremental contingent rental. Contingent rentals are based on either movements in the Consumer Price Index or operating criteria.</p>					
19. PROVISIONS					
Current					
Dividends	7	—	15,750	—	15,750
Employee benefits*		8,478	8,295	6,106	5,579
Warranty		6,680	6,010	6,565	6,010
Other		3,680	4,094	3,684	3,314
Balance at end of financial year		18,838	34,149	16,355	30,653
Non-current					
Employee benefits*		1,820	1,640	902	759

* Employee benefits include entitlements measured at present values of future amounts expected to be paid, based on a 5% per annum projected weighted average increase in remuneration rates over an average period of eight years. Present values are calculated using a weighted average rate of 6% per annum based on national government securities with similar maturity terms.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	CONSOLIDATED	COMPANY
	2003 \$'000	2003 \$'000
Reconciliations		
Reconciliations of the carrying amounts of each class of provision, except for employee benefits provision, are set out below:		
Dividends – current		
Carrying amount at beginning of financial year:	15,750	15,750
Adjustment on adoption of AASB 1044 “Provisions, Contingent Liabilities and Contingent Assets”	(15,750)	(15,750)
Provisions made during financial year:		
Final dividend 2002	15,759	15,759
Interim dividend 2003	17,513	17,513
Payments made during financial year	(33,272)	(33,272)
Carrying amount at end of financial year	–	–
Warranty – current		
Carrying amount at beginning of financial year	6,010	6,010
Provisions made during financial year	1,115	1,000
Adjustment on adoption of AASB 1044 “Provisions, Contingent Liabilities and Contingent Assets”	(445)	(445)
Carrying amount at end of financial year	6,680	6,565
Other – current		
Carrying amount at beginning of financial year	4,094	3,314
Provisions made during financial year	(414)	1,277
Adjustment on adoption of AASB 1044 “Provisions, Contingent Liabilities and Contingent Assets”	–	(907)
Carrying amount at end of financial year	3,680	3,684

20. CONTINGENT LIABILITIES

The detail and estimated maximum amounts of contingent liabilities that may become payable are set out below. The Directors are not aware of any circumstance or information which would lead them to believe that these liabilities will crystallise and consequently no provisions are included in the financial statements in respect of these matters.

There are no contingent liabilities for termination benefits under service agreements with Directors or persons who take part in the management of the Company.

Guarantees

Cochlear Americas, a wholly-owned subsidiary, has guaranteed Wells Fargo Bank West, NA US\$1 million for a finance facility. The facility was established to provide customer financing for purchases of ESPril 22 processors within the Americas Region. The bank administers the financing program. The outstanding balance on the consumer loans at reporting date was US\$20,000.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$000	2002 \$000	2003 \$000	2002 \$000
21. CONTRIBUTED EQUITY					
Share capital					
53,070,550 (2002: 52,500,145) Ordinary shares fully paid ⁽ⁱ⁾		23,089	14,959	23,089	14,959
Movements in ordinary share capital					
Balance at beginning of financial year		14,959	10,883	14,959	10,883
Shares issued:					
31,405 (2002: 24,786) shares issued for nil consideration under the Employee Share Plan ⁽ⁱⁱ⁾		–	–	–	–
539,000 (2002: 458,000) shares issued from the exercise of options ⁽ⁱⁱⁱ⁾		8,130	4,076	8,130	4,076
Balance at end of financial year		23,089	14,959	23,089	14,959

(i) Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings.

(ii) On 10 August 2002, the Company issued 31,405 shares to eligible employees of the Consolidated Entity under the Employee Share Plan for nil consideration.

(iii) Ordinary shares issued from the exercise of options granted under the Executive Share Option Plan.

22. RESERVES

General		81	89	–	–
Foreign currency translation		1,107	5,844	–	–
		1,188	5,933	–	–
Movements during financial year					
General					
Balance at beginning of financial year		89	86	–	–
Translation adjustment		(8)	3	–	–
Balance at end of financial year		81	89	–	–
Foreign currency translation					
Balance at beginning of financial year		5,844	3,337	–	–
Net translation adjustment		(4,737)	2,507	–	–
Balance at end of financial year		1,107	5,844	–	–

Nature and purpose of reserves

Foreign currency translation reserve

The foreign currency translation reserve records the foreign currency difference arising from the translation of self-sustaining foreign operations and the translation of transactions that hedge the Company's net investment in self-sustaining foreign operations. Refer to accounting policy Note 1(e).

23. RETAINED PROFITS

Retained profits at beginning of financial year		54,524	41,189	31,252	18,870
Net profit attributable to the members of the parent entity		58,213	40,110	53,889	39,157
Net effect of initial adoption of:					
Revised AASB 1028 "Employee Benefits"	2	(116)	–	(90)	–
AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets"	2	311	–	2,411	–
Net effect on dividends from:					
Initial adoption of AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets"	2	15,750	–	15,750	–
Dividends recognised during financial year	7	(33,272)	(26,775)	(33,272)	(26,775)
Retained profits at end of financial year		95,410	54,524	69,940	31,252

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

24. NOTES TO THE STATEMENTS OF CASH FLOWS

Cash assets

The Company's operating account received an average interest rate of 3.8% (2002: 3.56%) per annum.

Cash held on deposit for periods not exceeding 180 days received an average interest rate of 4.7% (2002: 4.42%) per annum.

(i) Reconciliation of cash

For the purposes of the statements of cash flows, cash includes cash on hand and at bank and term deposits, net of outstanding bank overdrafts. Cash as at reporting date as shown in the statements of cash flows is reconciled to the related items in the statements of financial position as follows:

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$000	2002 \$000	2003 \$000	2002 \$000
Cash on hand		23,541	8,750	5,060	3,597
Cash on deposit		20,350	1,789	18,601	101
		43,891	10,539	23,661	3,698
Bank overdrafts		1,873	2,065	–	–
		42,018	8,474	23,661	3,698
(ii) Reconciliation of profit from ordinary activities after income tax expense to net cash provided by operating activities					
Profit from ordinary activities after income tax expense		58,213	40,110	53,889	39,157
Add/(less) items classified as investing/financing activities:					
Loss/(gain) on disposal of non-current assets		2	393	(2)	–
Add non-cash items:					
Amounts set aside to provisions		10,302	5,650	8,251	4,736
Depreciation and amortisation		7,747	4,747	6,752	3,502
Net cash provided by operating activities before changes in assets and liabilities		76,264	50,900	68,890	47,395
Changes in assets and liabilities:					
(Increase)/decrease in receivables		12,417	(27,738)	(4,868)	(14,962)
(Increase) in inventories		(8,643)	(9,312)	(5,643)	(8,479)
(Increase) in prepayments and other debtors		(5,014)	(1,142)	(128)	(1,287)
(Increase)/decrease in deferred tax assets		(1,936)	(2,291)	144	30
(Decrease)/increase in payables		12,198	(9,374)	3,929	(6,761)
(Decrease)/increase in current tax liability		6,875	626	6,337	(423)
(Decrease) in provisions		(9,518)	(3,912)	(6,340)	(2,406)
Exchange rate adjustment		(3,826)	3,141	–	–
Net cash provided by operating activities		78,817	898	62,321	13,107

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	INTEREST HELD		COUNTRY OF INCORPORATION
		2003 %	2002 %	
25. CONTROLLED ENTITIES				
Particulars in relation to controlled entities				
The Company				
Cochlear Limited				Australia
Controlled entities				
Cochlear Europe Limited	a	100	100	United Kingdom
Cochlear Acoustics Ltd	a	75	–	United Kingdom
Cochlear AG	a	100	100	Switzerland
Cochlear (UK) Ltd	a	100	100	United Kingdom
Cochlear GmbH	a	100	100	Germany
Cochlear Americas	a	100	100	United States of America
Cochlear (HK) Limited	a	100	100	Hong Kong
Nihon Cochlear Co Limited	a	100	100	Japan
Neopraxis Pty Ltd		100	100	Australia

a) These entities are audited by other member firms of KPMG.

	CONSOLIDATED		COMPANY	
	2003 No.	2002 No.	2003 No.	2002 No.
26. DIRECTORS' REMUNERATION				
The number of Directors of the Company whose income from the Company or related parties falls within the following bands:				
\$30,000 - \$39,999			–	1
\$50,000 - \$59,999			–	2
\$60,000 - \$69,999			–	1
\$70,000 - \$79,999			1	1
\$110,000 - \$119,999			2	–
\$130,000 - \$139,999			1	1
\$140,000 - \$149,999			1	–
\$160,000 - \$169,999			1	–
\$320,000 - \$329,999			–	1
\$390,000 - \$399,999			1	–
\$420,000 - \$429,999			1	–
\$950,000 - \$959,999			–	1
\$1,160,000 - \$1,169,999			1	–
Total income paid or payable or otherwise made available to all Directors of the Company from the Company or any related party	\$2,720,554	\$1,705,485	\$2,720,554	\$1,705,485

Directors' income does not include insurance premiums paid by the Company or related parties in respect of Directors' and Officers' Liability and Supplementary Legal Expenses Insurance policies, as the insurance policies do not specify premiums paid in respect of individual Directors.

The remuneration bands are not consistent with the emoluments disclosed in the Directors' Report as the basis of calculation differs due to the differing requirements of the Corporations Act 2001 and the Accounting Standards. Included in the above remuneration are amounts that have been accrued during the financial year to the Directors' retirement scheme. Refer Note 28 for further information.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

27. EXECUTIVES' REMUNERATION

The number of executive officers of the Company, excluding Directors of the Company, and controlled entities whose remuneration from the Company or related parties, and from entities in the Consolidated Entity falls within the following bands:

	CONSOLIDATED		COMPANY	
	2003 No.	2002 No.	2003 No.	2002 No.
\$100,000 - \$109,999	5	—	4	—
\$110,000 - \$119,999	3	1	3	1
\$120,000 - \$129,999	3	2	3	2
\$130,000 - \$139,999	1	3	1	3
\$140,000 - \$149,999	1	2	1	—
\$150,000 - \$159,999	2	2	2	2
\$160,000 - \$169,999	5	3	4	2
\$170,000 - \$179,999	2	1	2	—
\$180,000 - \$189,999	3	1	3	—
\$190,000 - \$199,999	—	3	—	2
\$200,000 - \$209,999	3	5	2	3
\$210,000 - \$219,999	2	1	1	—
\$220,000 - \$229,999	1	2	—	1
\$230,000 - \$239,999	1	1	1	1
\$240,000 - \$249,999	2	1	1	—
\$250,000 - \$259,999	2	5	1	3
\$260,000 - \$269,999	1	2	1	2
\$270,000 - \$279,999	—	1	—	—
\$280,000 - \$289,999	3	2	—	1
\$290,000 - \$299,999	1	—	1	—
\$320,000 - \$329,999	2	—	2	—
\$330,000 - \$339,999	2	2	—	—
\$340,000 - \$349,999	—	1	—	—
\$350,000 - \$359,999	2	—	2	—
\$360,000 - \$369,999	1	1	—	—
\$450,000 - \$459,999	1	—	—	—
\$470,000 - \$479,999	2	1	—	—
\$540,000 - \$549,999	—	1	—	—
\$630,000 - \$639,999	—	1	—	—
\$650,000 - \$659,999	1	—	—	—
\$750,000 - \$759,999	1	—	—	—
\$850,000 - \$859,999	—	1	—	—
Total remuneration received or due and receivable by executive officers whose income is \$100,000 or more:				
From the Company or related parties			\$6,580,055	\$4,482,125
From entities in the Consolidated Entity or related parties	\$12,404,500	\$11,293,922		

Executive officers are those officers, involved in the strategic direction, general management or control of business at a company or operating divisional level.

Remuneration denominated in foreign currencies was converted at the exchange rates applicable for those financial years.

Executives' income does not include insurance premiums paid by the Company and related parties in respect of Directors' and Officers' Liability and Supplementary Legal Expenses Insurance policies, as the insurance policies do not specify premiums paid in respect of individual executives.

The remuneration bands are not consistent with the emoluments disclosed in the Directors' Report as the basis of calculation differs due to the differing requirements of the Corporations Act 2001 and the Accounting Standards.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

	NOTE	CONSOLIDATED		COMPANY	
		2003 \$000	2002 \$000	2003 \$000	2002 \$000
28. EMPLOYEE BENEFITS					
Employee benefits					
Aggregate liability for employee benefits including on-costs					
Current					
Employee benefits provision	19	8,478	8,295	6,106	5,579
Non-current					
Employee benefits provision	19	1,820	1,640	902	759
Directors' retirement scheme		879	–	879	–

The Cochlear Limited Directors' Retirement Scheme provides retiring Non-Executive Directors with the following benefit:

- more than five years' service – up to three times their average annual remuneration over the previous three years.

The Company's liability for Directors' retirement benefits, which is based on the number of years service provided at reporting date, is included in employee benefits and in Directors' remuneration.

Superannuation plans

In the Consolidated Entity, there are a number of superannuation plans including one defined benefit fund (plan) to which the Company contributes. Employer contributions are based on the advice of the plan's actuary. Contributions in excess of those specified in Superannuation Industry Supervision legislation are not legally enforceable. Employee contributions are based on various percentages of their gross salaries. After serving a qualifying period, eligible employees are entitled to benefits on retirement, disability or death.

The plan provides defined benefits based on years of service and final average salary.

An actuarial assessment of the plan was carried out by KPMG Actuaries Pty Ltd as at 30 June 2002 on behalf of the trustees. The actuary report, dated 16 June 2003, noted that the plan assets for the defined benefit members amounting to \$3,099,578 is greater than the total of defined benefit members' accrued benefits amounting to \$2,990,130 and is less than the total of members' vested benefits amounting to \$3,443,968. Based on the advice of the actuary, the Company increased the contribution rate during the current financial year to ensure members benefits will be adequately covered as they become due for payment in later years. It is expected that the plan will return to a fully funded position prior to 30 June 2005.

The amounts included in the table below are the total assets at net market value, accrued benefits and vested benefits of the plan. Accrued benefits are benefits which the plan is presently obliged to pay at some future date, as a result of membership of the plan. Vested benefits are benefits which are not conditional upon the continued membership of the plan or any factor, other than resignation from the plan.

The Directors, based on the advice of the trustees of the plan, are not aware of any changes in circumstances since the actuarial assessment of the plan, which have a material impact on the overall financial position of the plan.

	TOTAL ASSETS AT NET MARKET VALUE		TOTAL ACCRUED BENEFITS		EXCESS		TOTAL VESTED BENEFITS	
	2003 \$000	2002 \$000	2003 \$000	2002 \$000	2003 \$000	2002 \$000	2003 \$000	2002 \$000
Cochlear Superannuation Plan	10,334	8,200	10,231	8,102	103	98	10,685	8,079

Plan assets at net market value and vested benefits have been calculated at 30 June 2002, being the date of the most recent financial statements of the plan. Accrued benefits have been obtained from the most recent audited financial statements of the plan being 30 June 2002, and are based on actuarial reviews performed as at 30 June 2001.

Details of contributions to the plan during the year ended 30 June 2003 are as follows:

	CONSOLIDATED		COMPANY	
	2003	2002	2003	2002
Employer contributions to Cochlear Superannuation Plan	\$3,264,681	\$2,267,000	\$3,264,681	\$2,267,000
Number of employees				
Number of employees at reporting date	814	722	498	528

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

Equity based plans

Executive Share Option Plan

The Company has an Executive Share Option Plan originally approved and adopted at the annual general meeting on 20 October 1995 and subsequently amended 20 October 1997.

An Executive Share Option Plan is in place with offers determined by reference to the level of accountability and responsibility for development and implementation of corporate strategy.

Each option is convertible to one ordinary share. The exercise price of options is based on the opening price of the Company's shares sold in the ordinary course of trading on the Australian Stock Exchange on the date of the offer of the option. Options have a three year vesting period.

All options expire on the earlier of their expiry date or termination of the employee's employment. Options do not vest until three years after granting and thereafter the number of options exercisable depends on the compound annual growth rate of earnings per ordinary share achieved by the Consolidated Entity over a three year period from the date of issue. Three different levels of growth have been set which determine the number of options which are exercisable in any particular year. If the minimum compound growth rate of 10% per annum is not achieved, no ordinary shares will be issued. To achieve a 100% allocation, an annual compound growth rate of 18% over the three year period must be achieved.

There are no voting or dividend rights attached to the options.

Summary of options over unissued ordinary shares

Details of options over unissued ordinary shares as at beginning and ending reporting dates and movements during the financial year are set out below.

The amounts recognised in the financial statements of the Company and Consolidated Entity in relation to executive share options exercised during the financial year were:

Consolidated and Company 2003

GRANT YEAR	EXERCISE YEAR	EXPIRY YEAR	EXERCISE PRICE	NUMBER OF OPTIONS AT BEGINNING OF YEAR	OPTIONS GRANTED	OPTIONS LAPSED	OPTIONS EXERCISED	NUMBER OF OPTIONS AT END OF YEAR ON ISSUE	PROCEEDS RECEIVED	DATE ISSUED	NUMBER OF SHARES
1999	2002	2002	\$15.00	524,000			514,000	10,000	\$7,710,000	2002	514,000
1999	2002	2002	\$16.80	25,000			25,000	–	\$420,000	2002	25,000
2000	2003	2003	\$26.50	1,039,000				1,039,000			
2000	2003	2003	\$36.00	125,000		25,000		100,000			
2001	2004	2004	\$37.62	1,215,000		73,000		1,142,000			
2002	2005	2005	\$38.12		1,268,000	36,000		1,232,000			
				2,928,000	1,268,000	134,000	539,000	3,523,000			

Consolidated and Company 2002

1998	2001	2001	\$8.90	458,000			458,000	–	\$4,076,200	2001	458,100
1999	2002	2002	\$15.00	524,000				524,000			
1999	2002	2002	\$16.80	25,000				25,000			
2000	2003	2003	\$26.50	1,049,000		10,000		1,039,000			
2000	2003	2003	\$36.00	125,000				125,000			
2001	2004	2004	\$37.62		1,276,000	61,000		1,215,000			
				2,181,000	1,276,000	71,000	458,000	2,928,000			

The share price at the time the options were exercised was \$33.80 (2002 - \$42.49).

Employee Share Plan

The Company's Employee Share Plan was approved by special resolution at the annual general meeting of the Company held on 19 October 1999. Under this plan, the Directors, at their discretion can allocate, at nil consideration up to a maximum of \$2,000 worth of shares per eligible employee in any one year. The fair value of shares issued during the reporting period is the market price of the Company's shares on the Australian Stock Exchange as at the start of trading on the issue date. Shares under the plan vest with the employee immediately but are non-transferable for a period of up to three years.

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

29. RELATED PARTIES

Directors

The names of each person holding the position of Director of Cochlear Limited during the financial year are Prof. BDO Anderson, AO, Mr TCE Bergman, Prof. E Byrne, Ms EC Holley, Mr PJ North, Mr JJ O'Mahony, Dr JL Parker, AC, Mr JH Veeneklaas, and Prof. DG Penington.

Details of Directors' remuneration are set out in Note 26.

Apart from the details disclosed in this Note, no Director has entered into a material contract with the Company or the Consolidated Entity since the end of the previous financial year and there were no material contracts involving Directors' interests existing at reporting date.

Directors' holdings of shares and share options

The relevant interests of Directors of the Company and their Director related entities in shares and share options of Cochlear Limited are set out below:

	CONSOLIDATED NUMBER HELD	
	2003	2002
Ordinary shares	50,286	62,000
Options over ordinary shares	475,000	355,000

During the financial year, the Company granted options to the CEO/President and Senior Vice President and Chief Technology Officer over 100,000 and 50,000 unissued ordinary shares respectively under the Executive Share Option Plan on the same terms and conditions as those granted to other employees.

Non-Director related parties

The Company engages in purchases and sales with its controlled entities. These transactions are in the ordinary course of business and normal terms and conditions apply.

The aggregate amounts receivable from wholly-owned controlled entities by the Company at reporting date and the value of sales transactions between the parent entity and the wholly-owned controlled entities were:

	2003	2002
	\$000	\$000
Revenue from sale of goods	181,111	167,919
Current receivables	33,123	29,103

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

30. FOREIGN EXCHANGE RISK

The Consolidated Entity is exposed to changes in foreign exchange rates from its activities. It is the Consolidated Entity's policy to use derivative financial instruments to hedge these risks using a combination of forward exchange contracts and foreign currency options. The Consolidated Entity does not enter, hold or issue derivative financial instruments for trading purposes.

The Company enters into forward exchange contracts and foreign currency options contracts to hedge anticipated sales and purchases in US Dollars, euro, Japanese Yen, Hong Kong Dollars and Great British Pounds.

These amounts of forward cover taken are in accordance with approved policy and internal budgets.

The following table sets out the gross value to be received under forward exchange contracts and the weighted average contracted exchange rates of outstanding contracts:

	FOREIGN EXCHANGE RATES		COMPANY	
	2003	2002	2003 \$000	2002 \$000
Sell United States Dollar				
Not later than one year			73,299	56,069
Later than one year but not later than two years			34,647	40,980
Later than two years but not later than three years			5,247	5,669
Weighted average exchange rates contracted	0.54	0.51		
Sell euro				
Not later than one year			66,711	55,383
Later than one year but not later than two years			32,578	28,457
Later than two years but not later than three years			14,947	10,261
Weighted average exchange rates contracted	0.56	0.57		
Sell Japanese Yen				
Not later than one year			16,039	18,762
Later than one year but not later than two years			8,361	6,079
Later than two years but not later than three years			–	1,205
Weighted average exchange rates contracted	54.74	57.46		
Sell Hong Kong Dollar				
Not later than one year			16,394	12,288
Later than one year but not later than two years			8,093	3,039
Later than two years but not later than three years			–	–
Weighted average exchange rates contracted	4.19	3.93		
Sell Great British Pound				
Not later than one year			17,779	11,580
Later than one year but not later than two years			6,028	8,315
Later than two years but not later than three years			1,325	–
Weighted average exchange rates contracted	0.36	0.36		

The forward exchange contracts which total \$301 million (2002: \$258 million) as at 30 June 2003 are held specifically to hedge anticipated foreign currency sales and purchases. As these contracts are hedging anticipated sales and purchases in future financial years, any unrealised gains and losses on the contracts, together with the costs of the contracts, will be recognised in the financial statements at the time the underlying transaction occurs. The net unrecognised gain on hedges of anticipated foreign currency purchases and sales at 30 June 2003 was \$31.3 million (2002: \$10.3 million).

NOTES TO THE FINANCIAL STATEMENTS

Cochlear Limited and its controlled entities for the year ended 30 June 2003

The net deferred foreign exchange receivable and deferred foreign exchange gain on hedges of anticipated foreign currency purchases and sales is recognised in other assets (Note 10) and other liabilities (Note 16) and the timing of their anticipated recognition as part of purchases and sales are:

	2003 \$000	2002 \$000
Not later than one year	21,660	8,854
Later than one year but not later than two years	8,671	1,983
Later than two years but not later than three years	961	(515)
	31,292	10,322

31. EVENTS SUBSEQUENT TO REPORTING DATE

There has not arisen in the interval between reporting date and the date of this financial report, any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the Consolidated Entity, the results of those operations, or the state of affairs of the Consolidated Entity in future financial years.

DIRECTORS' DECLARATION

Cochlear Limited and its controlled entities for the year ended 30 June 2003

In the opinion of the Directors of Cochlear Limited:

- (a) the financial statements and notes, as set out on pages 35 to 63, are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of the Company and Consolidated Entity as at 30 June 2003 and of their performance, as represented by the results of their operations and their cash flows, for the financial year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
- (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Dated at Sydney this 19th day of August 2003.

Signed in accordance with a resolution of the Directors:



Director



Director

INDEPENDENT AUDIT REPORT

To the members of Cochlear Limited

SCOPE

The financial report and directors' responsibility

The financial report comprises the statement of financial performance, statement of financial position, statement of cash flows, accompanying notes to the financial statements, and the Directors' Declaration for both Cochlear Limited (the Company) and Cochlear Group (the Consolidated Entity), for the year ended 30 June 2003. The Consolidated Entity comprises both the Company and the entities it controlled during that year.

The Directors of the Company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

AUDIT APPROACH

We conducted an independent audit in order to express an opinion to the members of the Company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement. 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, Australian Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Company's and the Consolidated Entity's financial position, and of their performance as represented by the results of their operations and cash flows.

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.

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

INDEPENDENCE

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

AUDIT OPINION

In our opinion, the financial report of Cochlear Limited is in accordance with:

- (a) the Corporations Act 2001, including:
 - (i) giving a true and fair view of the Company's and Consolidated Entity's financial position as at 30 June 2003 and of their performance for the financial year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
- (b) other mandatory professional reporting requirements in Australia.

KPMG

John Wigglesworth, Partner

Sydney, 19 August 2003

ADDITIONAL INFORMATION

Additional information required by Australian Stock Exchange Listing Rules and not disclosed elsewhere in this Annual Report; the information presented is as at 8 August 2003.

SHAREHOLDINGS

Substantial shareholders

NAME	NUMBER OF ORDINARY SHARES HELD	%
Commonwealth Bank Group	5,627,282	10.6
Credit Suisse First Boston Australia (Holdings) Ltd	3,781,670	7.1
The Capital Group Companies, Inc	4,385,587	8.3
Total	13,794,539	26.0

Distribution of shareholders

NUMBER OF SHARES HELD	NUMBER OF ORDINARY SHAREHOLDERS
1 - 1,000	12,212
1,001 - 5,000	2,598
5,001 - 10,000	187
10,001 - 100,000	123
100,001 - over	42
Total	15,162

Non-marketable parcels – 56 shareholders held less than a marketable parcel.

TWENTY LARGEST SHAREHOLDERS

NAME	NUMBER OF ORDINARY SHARES HELD	%
JP Morgan Nominees Australia Ltd	9,038,757	17.05
Westpac Custodian Nominees Limited	7,011,493	13.23
National Nominees Limited	4,294,438	8.10
Commonwealth Custodial Services Limited	1,333,158	2.52
Citicorp Nominees Pty Ltd (CFS WSLE Imputation Fund a/c)	1,157,232	2.18
Queensland Investment Corporation	1,093,789	2.06
AMP Life Limited	1,065,512	2.01
HSBC Custody Nominees (Australia) Ltd	1,000,706	1.89
ANZ Nominees Limited	990,089	1.87
Citicorp Nominees Pty Ltd	833,302	1.57
Citicorp Nominees Pty Ltd (CFS WSLE Aust Share Fund a/c)	784,387	1.48
Zurich Investment Management Ltd (Zurich Aust Equities a/c)	734,334	1.39
Citicorp Nominees Pty Ltd (CFS WSLE Geared Share Fund a/c)	712,447	1.34
Citicorp Nominees Pty Ltd (CFS Imputation Fund a/c)	666,848	1.26
RBC Global Services Australia Nominees Pty Ltd (JBEMEP a/c)	635,714	1.20
Cogent Nominees Pty Ltd	631,348	1.19
Citicorp Nominees Pty Ltd (CFS WSLE Industrial Share a/c)	555,059	1.05
Suncorp Custodian Services Pty Ltd (AET)	520,783	0.98
Cogent Nominees Pty Ltd (SMP accounts)	412,632	0.78
RBC Global Services Australia Nominees Pty Ltd (RA a/c)	374,616	0.71

The 20 largest shareholders held 63.86% of the ordinary shares of the Company.

ON MARKET BUY-BACK

There is no current on market buy-back.

GLOSSARY

ACE (Advanced Combination Encoders) A speech coding strategy.

ADRO (Adaptive Dynamic Range Optimisation) A speech coding algorithm used with speech coding strategies to improve the intelligibility for soft speech and in noisy environments.

BTE Behind-the-ear worn speech processor.

Channel/Multi-channel Pairs of electrodes that stimulate the cochlea. A multi-channel implant that has multiple pairs of electrodes that give implant recipients more options for choosing the most responsive hearing nerve fibres, providing richer pitch information and improving hearing in noisy environments.

CTC Cochlear Technology Centre in Mechelen, Belgium.

FY02 Financial Year 2002: 1 July 2001 to 30 June 2002

FY03 Financial Year 2003: 1 July 2002 to 30 June 2003

FY04 Financial Year 2004: 1 July 2003 to 30 June 2004

Indications A medical term meaning a medical device or drug is approved for use as specified.

Nucleus NRT (Neural Response Telemetry) A tool used by audiologists to directly measure how the hearing nerve fibres respond to stimulation.

Nucleus RI26 Clinical programming software.

R&D Research and development.

SARS Severe Acute Respiratory Syndrome.

Speech coding strategy Software programs used by speech processors to translate the pitch, loudness and timing of sound into electrical signals that the cochlear implant then sends to the cochlea.

Speech processor The externally worn part of the cochlear implant.

For more information, please visit our website: www.cochlear.com

COMPANY INFORMATION

Stock Exchange Listing

Australian Stock Exchange ASX code COH

Share Registrar

Computershare Investor Services Pty Limited
60 Carrington Street, Sydney NSW 2000, Australia
Tel: 61 2 8234 5000

Solicitors

Clayton Utz

Auditors

KPMG Chartered Accountants

Bankers

Australia	Westpac Banking Corporation
United States	Wells Fargo Bank West, NA
United Kingdom	NatWest Bank
Japan	The Bank of Tokyo-Mitsubishi Limited

ANNUAL GENERAL MEETING

The Annual General Meeting will be held at 2pm on Tuesday 21 October 2003 in the Coles Theatre, Powerhouse Museum, 500 Harris Street, Ultimo.

A Notice of Meeting and Proxy Form are enclosed with this Annual Report.

FINANCIAL CALENDAR

2003

Dividend record date	2 September
Payment of final dividend	23 September
Annual General Meeting	21 October

2004

Interim profit announcement	17 February
Payment of interim dividend	17 March
Final profit announcement	17 August