

# report

## FINANCIAL REPORT 2004

Cochlear Limited and its controlled entities Financial report for the year ended 30 June 2004

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## DIRECTORS' REPORT Cochlear Limited for the year ended 30 June 2004

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 2004, 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, Dr CG Roberts and Mr JH Veeneklaas. Information on the Directors is presented on page 26 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		Nominations Committee		Technology and Innovation Committee		Medical Science Committee	
	held <sup>(i)</sup>	attended <sup>(ii)</sup>	held <sup>(i)</sup>	attended <sup>(ii)</sup>	held <sup>(i)</sup>	attended <sup>(ii)</sup>	held <sup>(i)</sup>	attended <sup>(ii)</sup>	held <sup>(i)</sup>	attended <sup>(ii)</sup>	held <sup>(i)</sup>	attended <sup>(ii)</sup>
Prof BDO Anderson, AO	12	10			3	3	4	4	2	2		
Mr TCE Bergman	12	12	5	5	5	5	3	3				
Prof E Byrne	12	11					3	3	4	4	2	2
Ms EC Holley	12	12	5	5	5	5	3	3				
Mr PJ North	12	12			5	5	3	3	4	4		
Mr JJ O'Mahony <sup>(iii)</sup>	5	5	3	3	2	1			2	2	2	2
Dr JL Parker	12	12							4	4		
Dr CG Roberts <sup>(iii)</sup>	7	7	2	2	3	3			2	2	0	0
Mr JH Veeneklaas	12	12	5	3			3	3				

(i) Number of meetings held while in office.

(ii) Number of meetings attended.

(iii) Mr JJ O'Mahony retired on 31 January 2004. Dr CG Roberts was appointed 1 February 2004.

### 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 2004, and the results of those operations, are set out in the Chairman/CEO's Report.

Other than as discussed in the Chairman/CEO's Report, there were no significant changes in the nature of those activities during the year ended 30 June 2004 and the results of those operations are set out in the abovementioned report.

### Consolidated results

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

	2004	2003
	\$000	\$000
Revenue from ordinary activities	285,836	307,579
Profit from ordinary activities before related income tax expense	47,252	80,010
Net profit attributable to members of the Company	36,761	58,213
Basic earnings per share (cents)	68.2	110.0
Diluted earnings per share (cents)	68.2	110.0

## 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
<ul style="list-style-type: none"> <li>As proposed and provided in last year's report:</li> </ul> Final – ordinary shares	44.0	23,355	23 Sep 03	30%
<ul style="list-style-type: none"> <li>In respect of the current financial year:</li> </ul> Interim – ordinary shares	35.0	18,957	17 Mar 04	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 the financial report as it was not declared until after 30 June 2004. Since the end of the financial year, the Directors declared a final 44.0 cents per share dividend 100% franked at the tax rate of 30% amounting to a total of \$23,831,143.

## 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

Since 30 June 2004, the Consolidated Entity has acquired the assets of its Japanese distributor and 100% of the shares of its Belgian and French distributors. Total consideration paid for these transactions was \$23.3 million. The financial effects of these transactions have not been brought to account in the financial statements for the year ended 30 June 2004.

## State of affairs

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

- on 30 July 2003, options over 10,000 ordinary shares were exercised as part of the Executive Share Option Plan for a total consideration of \$150,000;
- on 23 September 2003, options over 1,038,000 ordinary shares were exercised as part of the Executive Share Option Plan for a total consideration of \$27,507,000;
- on 1 October 2003, the Company issued 43,140 ordinary shares to eligible employees of the Consolidated Entity under the Cochlear Employee Share Plan for nil consideration;
- Dr Chris Roberts was appointed as CEO effective 1 February 2004;
- on 11 March, 2004, the Company was informed by the United States Department of Justice that Cochlear Americas, a wholly-owned subsidiary, is subject to an inquiry under federal healthcare laws in the USA that deal with the Medicare and Medicaid programs, including some with potential criminal sanctions. The Department of Justice has made no specific allegations. The company is cooperating fully with the inquiry and has engaged a nationally recognised law firm with specialised expertise in US healthcare law. Legal costs incurred as a result of managing the information request have been provided in the current financial year. It is not possible to estimate the financial impact of this investigation;
- individually significant items totalling \$12.5 million were expensed to the statement of financial performance during the year; and
- the Company incurred capital expenditure of \$13.3 million. Major investments comprised \$7.1 million on leasehold improvements, \$4.1 million on plant and equipment and \$2.1 million on an Enterprise Resource Planning system.

## 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 Directors' 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.

## Remuneration Report

### Remuneration Committee

The Remuneration Committee operates under delegated authority of the Board of the Company. The Remuneration Committee approves the remuneration policy and structure for Executives and Executive Directors (senior executives) and makes recommendations to the Board on the total remuneration packages of each senior executive. Further information on the Remuneration Committee is available in the Corporate Governance section of this report.

External advice on remuneration matters is obtained and is made available for the Remuneration Committee.

### Remuneration policies

The Board recognises that the Consolidated Entity's performance is dependent on the quality of its people. To successfully achieve its financial and operating objectives in a complex and global environment, the Consolidated Entity must be able to attract, retain and motivate highly skilled senior executives who are dedicated to the interests of shareholders.

The Consolidated Entity adopts a total remuneration approach for senior executives. The key principles that underpin Cochlear's Remuneration Policy include:

- a competitive Total Remuneration Strategy provided to attract, retain and motivate senior executive talent;
- a significant proportion (up to 50% of base salary) of total senior executive remuneration linked to financial performance and business objectives, under the Cochlear Management Short Term Incentive Plan; and
- a significant proportion (up to 40% of base salary) of total senior executive remuneration linked to the creation of long-term value for shareholders under the Cochlear Executive Long Term Incentive Plan.

The Remuneration Policy assists the Consolidated Entity to achieve its business strategy and objectives. The Remuneration Committee recognises that, while remuneration is a key factor in recruiting the right people, it is not the only factor: Cochlear's corporate reputation, its ethical culture and values and its ability to provide interesting and challenging career opportunities, also play an important role.

### Remuneration structure

#### Senior executives

Remuneration of the senior executives is comprised of policies and programs under the following categories:

- fixed remuneration made up of base salary and superannuation, retirement benefits and other incidental benefits; and
- variable remuneration made up of an annual short-term incentive plan and long-term incentives.

The remuneration structure is designed to strike an appropriate balance between fixed and variable remuneration. Variable remuneration is tied to performance and is at risk.

#### Service contracts

The Consolidated Entity's philosophy is not to enter service contracts for senior executives, excluding the CEO/President. Senior executives operate under standard termination and redundancy conditions with the following exceptions. The President, Asia Pacific Region has a notice period of three months and the President, European Region has a notice period of six months. The President, European Region will receive a maximum of CHF30,000 for repatriation costs in the case of termination or resignation.

The CEO/President's conditions are set out separately in this Remuneration Report.

#### Base salary and benefits

Base salaries are determined by reference to appropriate benchmark information, taking into account an individual's responsibilities, performance, qualifications, experience and geographical location.

In addition to base salary, selected overseas-based executives receive additional benefits including health insurance, a car allowance and a relocation allowance.

In Australia, retirement benefits are paid in line with the statutory Superannuation Guarantee legislation levels. A legacy defined benefit fund (plan) remains, but this has been closed since 1995. Globally, retirement benefits are paid in line with local legislation and practice.

#### Variable remuneration

The Board believes that well designed and managed short-term and long-term incentive plans are important elements of employee remuneration, providing tangible incentives for senior executives to achieve the Consolidated Entity's short-term and long-term

performance goals. Participation in these plans encourages senior executives to enjoy a greater involvement and share in the future growth, prosperity and profitability of the Consolidated Entity in a way that gives them a community of interest with shareholders.

The proportions of variable remuneration opportunity vary for senior executives within the Consolidated Entity, reflecting an individual's responsibilities, performance and experience.

**Cochlear Management Short Term Incentive Plan**

Short-term incentives for senior executives are determined under the Cochlear Management Short Term Incentive Plan. The short-term incentive is structured in such a way that a significant part of the senior executive's package depends upon achievement of individual performance goals linked to the business objectives and the financial performance of the Consolidated Entity. Financial measures include revenue and earnings before interest and taxes (EBIT) targets. Short-term incentives are paid on both the half and full year results.

The percentage of total remuneration that is allocated to short-term incentives varies according to the senior executive's position, but can be as much as 50% of base salary.

The process of determining relevant performance measures and whether they are met is as follows:

- at the beginning of the financial year, the Remuneration Committee recommends to the Board the targets for the CEO/President and the senior executives. This is dependent on financial objectives and agreement between the CEO/President and the senior executive on individual performance goals based on the particular objectives of that part of the business; and
- the CEO/President and each senior executive and the CEO/President and Chairman assess progress towards the financial and individual performance goals. The Remuneration Committee reviews, and the Board approves, these assessments prior to any payment.

The Remuneration Committee also evaluates the proposed short-term incentive awards in aggregate and determines appropriateness having regard to the Consolidated Entity's overall financial results. After this assessment, the Remuneration Committee makes its recommendation for payment to the full Board.

Once approved by the Board, the short-term incentive awards are paid to participants. Based on the performance of the Consolidated Entity during the past year, the Board paid no incentives at half year, and the full year incentive awards were less than 15% of total potential.

**Cochlear Executive Long Term Incentive Plan**

The Cochlear Executive Long Term Incentive Plan (CELTIP) was approved by shareholders at the 2003 Annual General Meeting (AGM). The CELTIP is designed to reward senior executives for achieving long-term growth in shareholder value.

Senior executives are offered a mixture of options (being options to acquire ordinary shares in Cochlear Limited) and performance shares (being units of fully paid ordinary shares in Cochlear Limited).

The number of options and performance shares offered to a senior executive depends on their fixed remuneration and the Consolidated Entity's target remuneration package for the senior executive's position. The mixture of options and performance shares is determined at the discretion of the Board, having regard to the senior executive's role.

Each option is convertible to one ordinary share. The exercise price of the options is based on the weighted average price of Cochlear Limited's shares traded during the five business days following the date of the provision of the final preliminary report to the Australian Stock Exchange (ASX). Each performance share equates to one ordinary share.

Both the options and performance shares are subject to vesting restrictions, which will ultimately determine the final number of options that will be exercisable and the number of performance shares receivable by a senior executive. The relevant vesting restrictions are:

- a three year vesting period – during which time the senior executive will be unable to exercise the options or trade the performance shares; and
- the performance of the Consolidated Entity over the vesting period – measured by using growth in earnings per share (EPS) and total shareholder returns (TSR) as measured against the S&P/ASX 100 index. Half the offer will be assessed against EPS growth and the other half using TSR growth as follows:

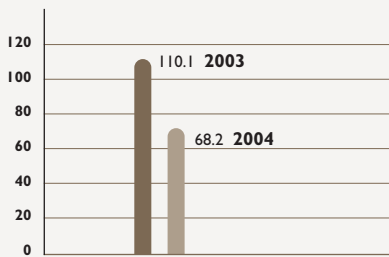
Compound annual growth rate of EPS over a three year period		TSR growth rate against S&P ASX 100 index comparator group over a three year period	
Performance	% of options and performance shares vesting	Performance	% of options and performance shares vesting
<10%	0%	<50th percentile	0%
10% to 20%	50% to 100% pro-rata	50th to 75th percentile	50% to 100% pro-rata
>20%	100%	>75th percentile	100%

Options and performance shares only vest if the performance hurdles and time qualifications are met.

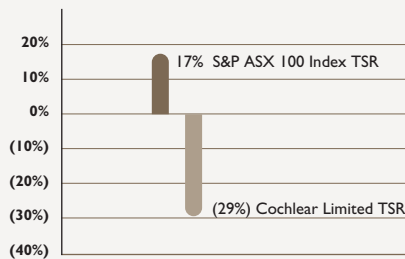
There are no voting or dividend rights attached to options. There are no voting rights attached to the unissued ordinary shares. Voting rights will be attached to the unissued ordinary shares when the options have been exercised. Performance shares are held in trust for the senior executives. Dividends paid to the trust are subsequently paid to the relevant senior executives. Voting rights are not transferred. Voting rights are attached to the performance shares once ownership is transferred. Any dividends paid on performance shares that are subsequently forfeited are not paid to the senior executive.

**Performance of the Consolidated Entity in current CELTIP cycle**

Depicted in the charts below is the performance of the Consolidated Entity against the CELTIP hurdles to the year ended 30 June 2004. They show a comparison of EPS for financial years 2003 and 2004 (EPS growth was a negative 38%) and the TSR performance of Cochlear relative to the S&P ASX 100 Index for 1 July 2003 to 30 June 2004.



**Comparison of the Consolidated Entity's EPS performance for financial years 2004 and 2003**



**TSR performance of Cochlear Limited relative to the S&P ASX 100 Index for financial year 2004**

**Executive Share Option Plan**

The Executive Share Option Plan (ESOP) was replaced by CELTIP in 2003. The ESOP covers all options granted to senior executives prior to the 2004 financial year. Under the ESOP, each option is convertible to one ordinary share. The exercise price of options is based on the opening price of Cochlear Limited's shares sold in the ordinary course of trading on the ASX on the date the offer of the options was made. Options have a three year vesting period, and must be exercised within a month of vesting (expiry date).

All options under the ESOP lapse on the earlier of the 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 EPS achieved by the Consolidated Entity over a three year period. Three levels of growth have been set which determine the number of options, which are exercisable in any particular year. If the minimum compound annual growth rate of 10% in EPS is not achieved, no options can be exercised. To achieve a 100% allocation, a compound annual growth rate of 18% in EPS over the three year period must be achieved.

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

### **Executive Directors**

At the date of this Remuneration Report, there are two Executive Directors in office.

Dr Chris Roberts was appointed to the Board on 1 February 2004 at the time of his appointment as CEO/President.

Dr John Parker was appointed to the Board on 19 March 2002. Dr Parker is the Company's Chief Technology Officer.

Mr Jack O'Mahony retired as CEO/President and Executive Director on 31 January 2004.

#### **Dr Chris Roberts**

Dr Roberts has been appointed for a fixed term of three years from the commencement date of 1 February 2004. If the Company terminates Dr Roberts' employment before the end of the term, he will be entitled to receive an amount equivalent to the total fixed remuneration he would have received during the balance of the term.

Dr Roberts participates in the Cochlear Management Short Term Incentive Plan at a value equal to 50% of total fixed remuneration. For the period to 30 June 2004, Dr Roberts was entitled to receive a minimum amount of \$137,709. After 30 June 2004, no further guarantees apply.

Dr Roberts participates to a value equal to 40% of total fixed remuneration under the CELTIP. This will be in the form of 75% share options and 25% performance shares subject to approval by the shareholders at the AGM in October 2004. For the period ending 30 June 2004, this will be for a minimum value of \$110,167.

#### **Dr John Parker**

Dr Parker is not subject to any service contract and operates under standard employment termination and redundancy conditions.

#### **Mr Jack O'Mahony**

Mr O'Mahony received all statutory leave entitlements and an ex gratia payment of \$300,000 on his retirement on 31 January 2004.

No short-term incentive awards were made to Mr O'Mahony for the year ended 30 June 2004.

Mr O'Mahony has retained 75,000 options awarded in October 2001 and 75,000 options awarded in October 2002 under the ESOP. These require a compound annual growth rate of 18% in EPS over the three year vesting period in 2004 and 2005 to achieve 100% allocation. The options have a strike price of \$37.62 and \$38.12 per share respectively.

### **Non-Executive Directors**

Fees for Non-Executive Directors are based on the nature of their work and their responsibilities. The remuneration rates reflect the complexity of the Company and the extent of the geographical regions in which the Consolidated Entity operates. In determining the level of fees, survey data on comparable companies has been considered. Non-Executive Directors' fees are recommended by the Remuneration Committee and determined by the Board. The aggregate amount of Non-Executive Director fees is approved by shareholders.

Fees for Non-Executive Directors were last adjusted for the year commencing 1 July 2002. There were no increases in fees during the financial year. Fees are within the aggregate amount approved by shareholders at the AGM in October 2001 of \$600,000 a year.

The Chairman of Cochlear is Mr Tommie Bergman. His Director's fees are set at three times the base fee for Non-Executive Directors. He does not receive any additional fees for chairing the Remuneration Committee and Nominations Committee.

From 2003, no new Non-Executive Director has been entitled to join the Cochlear Limited Directors' retirement scheme. Non-Executive Directors appointed prior to this are members of the scheme which provides Directors with more than five years service, retirement benefits in line with the conditions detailed in the Corporations Act 2001 and set out on page 71.

Non-Executive Directors do not receive any performance related remuneration, options or performance shares.

There are no commitments to Non-Executive Directors arising from non-cancellable contracts with the Company.

### Directors' and senior executives' remuneration details

Details of the nature and amount of each major element of remuneration of each Non-Executive Director and each of the five named officers of the Company and the Consolidated Entity receiving the highest remuneration are:

Amounts in \$	Salary or fees	Performance related bonus	Benefits <sup>(i)</sup>	Super-annuation	Leaving benefits	Total before options and performance shares	Estimated value of options and performance shares <sup>(iv)</sup>	Total
<b>Directors of the Company</b>								
Prof BDO Anderson, AO	73,500	–	–	6,615	36,500 <sup>(ii)</sup>	116,615	–	116,615
Mr TCE Bergman	180,000	–	–	11,002	89,064 <sup>(ii)</sup>	280,066	–	280,066
Prof E Byrne	73,500	–	–	6,615	36,368 <sup>(ii)</sup>	116,483	–	116,483
Ms EC Holley	90,000	–	–	8,100	47,000 <sup>(ii)</sup>	145,100	–	145,100
Mr PJ North	85,000	–	–	7,650	48,000 <sup>(ii)</sup>	140,650	–	140,650
Mr JH Veeneklaas	73,500	–	–	6,615	36,500 <sup>(ii)</sup>	116,615	–	116,615
Dr JL Parker	293,792	11,633	–	11,002	–	316,427	25,822	342,249
Dr CG Roberts	273,799	137,709	–	4,443	–	415,951	–	415,951
<b>Former Directors of the Company</b>								
Mr JJ O'Mahony	483,129	–	42,745	6,559	300,000	832,433	77,466	909,899
<b>Consolidated Entity executives</b>								
Mr R Brook <sup>(iii)</sup> President, European Region	295,733	24,178	97,872	11,711	–	429,494	–	429,494
Mr H Yoshikawa <sup>(iii)</sup> General Manager and Representative Director, Japan	299,145	30,102	14,333	38,267	–	381,847	–	381,847
Mr NJ Mitchell Chief Financial Officer and Company Secretary	271,906	11,023	–	30,788	–	313,717	20,658	334,375
Mr JF Patrick Senior Vice President, Chief Scientist	227,971	9,791	–	38,102	–	275,864	20,658	296,522
Mr J Miller <sup>(iii)</sup> President, Americas Region (resigned 1 March 2004)	243,543	–	45,170	5,463	–	294,176	–	294,176
<b>Company executives</b>								
Mr NJ Mitchell Chief Financial Officer and Company Secretary	271,906	11,023	–	30,788	–	313,717	20,658	334,375
Mr JF Patrick Senior Vice President, Chief Scientist	227,971	9,791	–	38,102	–	275,864	20,658	296,522
Mr V Marrant Senior Vice President, New Business Development	275,871	–	–	11,002	–	286,873	–	286,873
Mr M Kavanagh Senior Vice President, Global Marketing	255,373	11,037	–	11,002	–	277,412	–	277,412
Mr L Port Vice President, Business Systems	201,703	17,048	–	34,084	–	252,835	20,658	273,493

(i) Benefits include the provision of car allowances and health insurance.

(ii) Amounts accrued during the financial year to the Directors' retirement scheme. Refer to Note 29 for further information.

(iii) Denotes overseas based executive.

(iv) The value disclosed above is the portion of the fair value of the options and performance shares allocated to this reporting period. The ability to exercise the options and performance shares is conditional on the Consolidated Entity achieving certain performance hurdles. The estimated value of options for the 2004 financial year is calculated at the date of grant using a Black-Scholes model applying a 25% volatility, as reflected in historical volatility. Further details of options granted during the financial year are set out 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.

Vesting of performance shares is conditional upon the Consolidated Entity achieving the performance hurdles detailed earlier in the Remuneration Report. Performance shares have been purchased on-market and are held under a trust. They are amortised in the accounts on a pro-rata basis over the vesting period.

### Options granted to Directors and senior executives

During and since the end of the financial year, the Company granted options over unissued ordinary shares for nil consideration, at an exercise price of \$34.19 per share to an Executive Director of the Company, 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
<b>Directors</b>		
Mr JJ O'Mahony CEO/President (retired 31 January 2004)	—	—
Dr JL Parker Chief Technology Officer	20,584	Aug 2006 - Sep 2008
Dr CG Roberts CEO/President (appointed 1 February 2004)	—	—
<b>Executives</b>		
Mr R Brook President, European Region	26,046	Aug 2006 - Sep 2008
Mr H Yoshikawa General Manager and Representative Director, Japan	10,000	Aug 2006 - Sep 2008
Mr NJ Mitchell Chief Financial Officer and Company Secretary	18,961	Aug 2006 - Sep 2008
Mr JF Patrick Senior Vice President, Chief Scientist	17,325	Aug 2006 - Sep 2008
Mr J Miller President, Americas Region (resigned 1 March 2004)	30,999	Aug 2006 - Sep 2008
Mr V Marrant Senior Vice President, New Business Development	18,981	Aug 2006 - Sep 2008
Mr M Kavanagh Senior Vice President Global Marketing	17,836	Aug 2006 - Sep 2008
Mr L Port Vice President, Business Systems	15,497	Aug 2006 - Sep 2008

### Unissued shares under option

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

	Number of options	Exercise price per share	Exercise period
	936,000	\$37.62	Aug - Sep 2004
	1,020,000	\$38.12	Aug - Sep 2005
	192,761	\$34.19	Aug 2006 - Sep 2008

The share price at 30 June 2004 was \$22.72.

During the financial year, the Company granted options over 243,296 unissued ordinary shares to employees under the CELTIP. The options are exercisable in the two years following lodgement with the ASX of the Company's preliminary financial report for the year ending 30 June 2006. The number of options which will be exercisable is dependent on the performance measures and retention requirements set out in the Remuneration Report.

The Company cancelled 569,535 share options during the financial year.

**Directors' interests**

The relevant interest of each Director in the share capital of the Company, as notified by the Directors to the 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	12,000	—
Prof E Byrne	1,000	—
Ms EC Holley	9,000	—
Mr PJ North	13,000	—
Dr JL Parker	25,000	120,584
Dr CG Roberts	162,000	—
Mr JH Veeneklaas	1,000	—

**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 the Directors' 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 the Directors' 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 17th day of August 2004.

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 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
Revenue from ordinary activities	3	285,836	307,579	210,410	219,569
Expenses	4(b)	237,773	226,773	158,303	145,635
Borrowing costs		811	796	99	153
<b>Profit from ordinary activities before related income tax expense</b>		<b>47,252</b>	<b>80,010</b>	<b>52,008</b>	<b>73,781</b>
Income tax expense relating to ordinary activities	6(a)	11,118	21,797	6,707	19,892
Net profit		36,134	58,213	45,301	53,889
Net loss attributable to outside equity interests	25	627	–	–	–
<b>Net profit attributable to members of the parent entity</b>		<b>36,761</b>	<b>58,213</b>	<b>45,301</b>	<b>53,889</b>
<b>Non-owner transaction changes in equity</b>					
Translation adjustment in general reserve	23	3	(8)	–	–
Net (decrease)/increase in retained profits on the initial adoption of:					
Revised AASB 1028 "Employee Benefits"	24	–	(116)	–	(90)
AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets"	24	–	311	–	2,411
Net exchange difference relating to self-sustaining foreign operations	23	(2,778)	(4,737)	–	–
<b>Total changes in equity from non-owner related transactions attributable to the members of the parent entity</b>		<b>33,986</b>	<b>53,663</b>	<b>45,301</b>	<b>56,210</b>
<b>Basic earnings per share (cents)</b>					
Ordinary shares	9	68.2	110.0		
Diluted earnings per share (cents)					
Ordinary shares	9	68.2	110.0		

The statements of financial performance are to be read in conjunction with the notes to the financial statements set out on pages 46 to 77.

STATEMENTS OF FINANCIAL POSITION Cochlear Limited and its controlled entities as at 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>Current assets</b>					
Cash assets	27(i)	75,946	43,891	58,526	23,661
Receivables	10	66,656	78,578	34,674	59,849
Inventories	11	44,837	45,023	33,429	32,901
Income tax receivable	6(b)	807	–	640	–
Other	12	12,156	11,990	4,408	3,998
<b>Total current assets</b>		<b>200,402</b>	<b>179,482</b>	<b>131,677</b>	<b>120,409</b>
<b>Non-current assets</b>					
Receivables	10	9,633	9,796	9,458	9,632
Other financial assets	13	–	–	6,444	3,944
Plant and equipment	14	29,523	27,336	26,947	24,599
Intangible assets	15	7,190	–	–	–
Deferred tax assets	6(c)	17,791	13,965	7,000	6,918
<b>Total non-current assets</b>		<b>64,137</b>	<b>51,097</b>	<b>49,849</b>	<b>45,093</b>
<b>Total assets</b>		<b>264,539</b>	<b>230,579</b>	<b>181,526</b>	<b>165,502</b>
<b>Current liabilities</b>					
Payables	16	31,657	28,461	17,156	12,568
Interest bearing liabilities	18	25,867	15,005	2,100	1,984
Current tax liabilities	6(b)	4,781	10,707	–	8,493
Provisions	20	22,352	18,838	14,386	16,355
Other	17	21,639	25,550	12,664	21,660
<b>Total current liabilities</b>		<b>106,296</b>	<b>98,561</b>	<b>46,306</b>	<b>61,060</b>
<b>Non-current liabilities</b>					
Provisions	20	3,256	2,699	2,087	1,781
Other	17	9,458	9,632	9,458	9,632
<b>Total non-current liabilities</b>		<b>12,714</b>	<b>12,331</b>	<b>11,545</b>	<b>11,413</b>
<b>Total liabilities</b>		<b>119,010</b>	<b>110,892</b>	<b>57,851</b>	<b>72,473</b>
<b>Net assets</b>		<b>145,529</b>	<b>119,687</b>	<b>123,675</b>	<b>93,029</b>
<b>Equity</b>					
Contributed equity	22	50,746	23,089	50,746	23,089
Reserves	23	(995)	1,188	–	–
Retained profits	24	89,267	95,410	72,929	69,940
<b>Total parent entity interest</b>		<b>139,018</b>	<b>119,687</b>	<b>123,675</b>	<b>93,029</b>
Outside equity interests	25	6,511	–	–	–
<b>Total equity</b>		<b>145,529</b>	<b>119,687</b>	<b>123,675</b>	<b>93,029</b>

The statements of financial position are to be read in conjunction with the notes to the financial statements set out on pages 46 to 77.

**STATEMENTS OF CASH FLOWS** Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>Cash flows from operating activities</b>					
Cash receipts in the course of operations		291,923	324,005	211,328	202,336
Cash payments in the course of operations		(223,570)	(228,387)	(152,047)	(127,468)
Dividends received		–	–	18,141	–
Grant received		451	422	451	422
Interest received		2,514	596	2,384	470
Borrowing costs paid		(811)	(796)	(99)	(153)
Income taxes paid		(21,537)	(17,023)	(15,922)	(13,286)
<b>Net cash provided by operating activities</b>	27(ii)	<b>48,970</b>	<b>78,817</b>	<b>64,236</b>	<b>62,321</b>
<b>Cash flows from investing activities</b>					
Payment for plant and equipment		(13,332)	(10,499)	(12,403)	(9,199)
Proceeds from sale of non-current assets		72	–	71	–
Payment for controlled entity		–	–	(2,500)	–
<b>Net cash used in investing activities</b>		<b>(13,260)</b>	<b>(10,499)</b>	<b>(14,832)</b>	<b>(9,199)</b>
<b>Cash flows from financing activities</b>					
Repayment of borrowings		–	(10,000)	–	(10,000)
Proceeds from borrowings		10,880	1,984	116	1,983
Proceeds from the issue of shares		27,657	8,130	27,657	8,130
Dividends paid by parent entity		(42,312)	(33,272)	(42,312)	(33,272)
<b>Net cash used in financing activities</b>		<b>(3,775)</b>	<b>(33,158)</b>	<b>(14,539)</b>	<b>(33,159)</b>
<b>Net increase in cash held</b>					
Cash at beginning of financial year		42,018	8,474	23,661	3,698
Effects of exchange fluctuation on the balances of cash held in foreign currencies		138	(1,616)	–	–
<b>Cash at end of financial year</b>	27(i)	<b>74,091</b>	<b>42,018</b>	<b>58,526</b>	<b>23,661</b>

The statements of cash flows are to be read in conjunction with the notes to the financial statements set out on pages 46 to 77.

### **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.

Outside interests in the equity and results of the entities that are controlled by the Company are shown as a separate item in the consolidated financial statements.

#### **(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.

##### **Sales of non-current assets**

The gross proceeds of non-current asset sales are recognised as revenue at the date control of the asset passes to the buyer, usually when an unconditional contract of sale is signed.

The gain or loss on disposal is calculated as the difference between the carrying amount of the asset at the time of disposal and the net proceeds on disposal (including incidental costs).

##### **Dividends**

Revenue from distributions from controlled entities is recognised by the parent entity when they are declared by the controlled entities.

#### **(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, except where:

- hedging specific anticipated transactions or net investments in self-sustaining operations; and
- relating to amounts receivable or payable in foreign currency forming part of a net investment in a self-sustaining foreign operation. In this case, the exchange difference, together with any related income tax expense/revenue, is transferred to the foreign currency translation reserve on consolidation.

**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 32.

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 as designated, the deferred gains and losses that arose 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 as designated, deferred gains and losses that arose on the foreign currency hedge prior to its termination are included in the statement of financial performance for the period.

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 for the period.

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. Equity items are translated at historical rates. 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 Dollars 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. Exchange differences arising on translation are brought to account in the statement of financial performance.

**(f) Borrowing costs**

Borrowing costs include interest, finance charges in respect of finance leases and foreign exchange differences net of the effect of hedges on borrowings.

**(g) 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 periods on hardware products extend for three years to 10 years.

Provisions for warranty claims are made for claims received and claims expected to be received in relation to sales made prior to reporting date, based on historical claim rates and respective product populations. The provision is determined on a discounted cash flow basis.

**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.

**(h) 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.

**(i) Research and development expenditure**

Research and development expenditure is expensed as incurred.

**(j) Intangible assets**

The fair value of intellectual property contributed by an outside equity interest holder to Cochlear Acoustics Limited, a 75% owned subsidiary, has been capitalised and recorded at fair value at the time of the contribution. The asset will be amortised on a straight line basis over a period of three years following the commercial release of the product to which the intellectual property relates.

**(k) 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.

**(l) Acquisition of assets**

All assets acquired, including plant and equipment and intangibles other than goodwill, 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.

**(m) 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, taking into account estimated residual values. 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:

	2004	2003
Leasehold improvements	12 - 20.0%	12 - 20.0%
Plant and equipment	13 - 33.3%	17 - 33.3%
Enterprise Resource Planning system	25 - 40.0%	25 - 40.0%

**(n) 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.

**(o) 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.

**(p) 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.

**(q) 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 as at reporting date including related on-costs, such as workers' compensation insurance and payroll tax.

**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 and the Cochlear Executive Long Term Incentive Plan (CELTIP). Further information is set out in the Directors' 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.

**Performance shares**

The Company has granted performance shares to certain employees under the CELTIP. The cost of shares purchased on market are expensed over the vesting period.

**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 vested benefits of defined benefit members exceeds the market value of plan assets. Further information is set out in Note 30.

**(r) 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 80 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.

**(s) 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.

**(t) 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, or if relating to tax losses when realisation is virtually certain.

**Tax consolidation**

The Company is the head entity in the tax consolidated group comprising all the Australian wholly-owned subsidiaries set out in Note 28. The implementation date for the tax consolidated group is 1 July 2003. The head entity recognises all the current and deferred tax assets and liabilities of the tax consolidated group (after elimination of intra-group transactions).

**(u) 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.

**(v) 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.

**(w) Comparatives**

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

**(x) 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 (other than ordinary shares) 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 of the Company adjusted for any bonus issue.

**2. Changes in accounting policies**

There were no changes in accounting policies in the Consolidated Entity in 2004.

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>3. Revenue from ordinary activities</b>					
Sale of goods revenue from operating activities before hedging		249,981	286,011	157,620	203,909
Foreign exchange gains on hedged sales		30,287	17,534	31,650	14,525
Revenue from the sale of goods		280,268	303,545	189,270	218,434
Rendering of services revenue from operating activities		2,506	2,565	76	98
Other revenue:					
From operating activities:					
Dividends from related parties		–	–	18,141	–
Interest received or due and receivable from other persons		2,602	657	2,472	525
Grant received or due and receivable		451	422	451	422
Other income		9	390	–	90
Total other revenue		3,062	1,469	21,064	1,037
<b>Total revenue from ordinary activities</b>		<b>285,836</b>	<b>307,579</b>	<b>210,410</b>	<b>219,569</b>
<b>4. Profit from ordinary activities before related income tax expense</b>					
<b>(a) Individually significant items included in profit from ordinary activities before related income tax expense</b>					
Increase in other and legal provision		7,373	–	–	–
Organisational restructuring costs		2,631	–	2,631	–
Write-off of leasehold improvements		1,286	–	1,286	–
Write-off of inventory on discontinued product line		1,229	–	1,229	–
<b>(b) Expenses</b>					
Cost of sales:					
Cost of goods sold		75,873	72,568	74,759	72,594
Warranty expense		4,934	7,103	660	1,572
Write-down in value of inventory		4,153	2,966	4,149	2,633
		84,960	82,637	79,568	76,799
Distribution, marketing and field clinical support		87,358	89,045	16,878	18,081
Research and development		44,452	37,030	40,164	32,696
Administration and systems development		21,003	18,061	21,693	18,059
		<b>237,773</b>	<b>226,773</b>	<b>158,303</b>	<b>145,635</b>

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>(c) Profit from ordinary activities before related income tax expense has been arrived at after charging/(crediting) the following items:</b>					
Borrowing costs:					
Related parties		–	–	80	–
Other parties		811	796	19	153
Net bad and doubtful debts expense including movements in allowance for doubtful debts					
		734	1,189	261	–
Amortisation of leasehold improvements					
		2,897	2,228	2,812	2,134
Depreciation of plant and equipment					
		4,735	3,667	3,850	2,766
Depreciation of Enterprise Resource Planning system					
		1,820	1,852	1,820	1,852
Net expense/(income) from movements in provisions for:					
Employee benefits		3,452	9,729	1,788	5,980
Warranty		–	1,115	–	1,000
Other and legal		6,788	(430)	(684)	1,272
Directors' retirement scheme		294	879	294	879
Operating lease rental expense					
		4,886	4,387	2,767	2,397
Net foreign exchange loss					
		1,455	105	45	105
Loss/(gain) on disposal of plant and equipment					
		1,645	2	1,502	(2)

	Note	Consolidated		Company	
		2004 \$	2003 \$	2004 \$	2003 \$
<b>5. Auditors' remuneration</b>					
<b>Audit services</b>					
Auditors of the Company:					
KPMG Australia:					
– audit and review of financial reports		165,560	165,300	155,000	155,700
– other regulatory audit services		16,925	21,300	16,925	21,300
Overseas KPMG firms:					
– audit and review of financial reports		180,627	143,000	24,027	16,700
		<b>363,112</b>	<b>329,600</b>	<b>195,952</b>	<b>193,700</b>
<b>Other services</b>					
Auditors of the Company:					
KPMG Australia:					
– international taxation services		56,035	199,449	56,035	199,449
– other assurance services		35,474	70,370	22,860	70,370
– taxation services		298,921	261,883	298,921	261,883
Overseas KPMG firms:					
– taxation services		185,963	108,948	77,246	–
– international taxation services		44,074	–	44,074	–
		<b>620,467</b>	<b>640,650</b>	<b>499,136</b>	<b>531,702</b>

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>6. Taxation</b>					
<b>(a) Income tax expense</b>					
Prima facie income tax expense calculated at 30% (2003: 30%) on the profit from ordinary activities					
		14,176	24,003	15,602	22,134
Increase in income tax expense due to:					
Net higher overseas tax rate					
		905	802	477	231
Decrease in income tax expense due to:					
(Assessable)/non-allowable permanent differences					
		(295)	1,112	(18)	(73)
Overseas share options deductions					
		–	(681)	–	–
Research and development allowance					
		(3,178)	(2,684)	(3,178)	(2,502)
Non-assessable dividend from subsidiary					
		–	–	(5,442)	–
Income tax expense on profit from ordinary activities					
		11,608	22,552	7,441	19,790
Income tax (over)/under provided in prior financial year					
		(490)	(755)	(734)	102
<b>Income tax expense attributable to profit from ordinary activities</b>					
		<b>11,118</b>	<b>21,797</b>	<b>6,707</b>	<b>19,892</b>
Income tax expense attributable to profit from ordinary activities is made up of:					
Current income tax provision					
		15,058	24,899	7,359	20,630
Future income tax benefit					
		(3,450)	(2,347)	82	(840)
(Over)/under provision in prior financial year					
		(490)	(755)	(734)	102
<b>(b) Current tax liabilities</b>					
<b>Provision for current income tax</b>					
Movements during financial year:					
Balance at beginning of financial year					
		10,707	3,835	8,493	2,155
Income taxes paid					
		(21,537)	(17,023)	(15,922)	(13,286)
Current year's income tax expense on profit from ordinary activities					
		15,058	24,899	7,359	20,630
(Over)/under provision in prior financial year					
		(494)	(755)	(570)	102
Tax loss transferred from a controlled entity					
		–	–	–	(1,108)
Net foreign currency difference on translation of foreign operations					
		240	(249)	–	–
<b>3,974 10,707 (640) 8,493</b>					
Comprising:					
Current tax liabilities					
		4,781	10,707	–	8,493
Income tax receivable					
		(807)	–	(640)	–
<b>3,974 10,707 (640) 8,493</b>					
<b>(c) Deferred tax assets</b>					
Future income tax benefit comprises the estimated future benefit at the applicable local taxation rate on the following items:					
<b>Provisions and other timing differences not currently deductible</b>					
		<b>17,791</b>	<b>13,965</b>	<b>7,000</b>	<b>6,918</b>

The implementation of tax consolidation had no impact on the income tax expense of the Company for the 2004 year.

## NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Cents per share	Total amount \$000	Franked/unfranked	Date of payment
<b>7. Dividends</b>				
Dividends recognised in the current financial year by the Company are:				
<b>2004</b>				
Interim 2004 ordinary	35.0	18,957	Franked	17 Mar 2004
Final 2003 ordinary	44.0	23,355	Franked	23 Sep 2003
<b>Total amount</b>		<b>42,312</b>		
<b>2003</b>				
Interim 2003 ordinary	33.0	17,513	Franked	19 Mar 2003
Final 2002 ordinary	30.0	15,759	Franked	24 Sep 2002
<b>Total amount</b>		<b>33,272</b>		
Franked dividends declared or paid during the financial year were franked at the tax rate of 30%.				
<b>Subsequent events</b>				
Since the end of the financial year, the Directors declared the following dividends:				
Final 2004 ordinary	44.0	23,831	Franked	23 Sep 2004
<b>Total amount</b>		<b>23,831</b>		

The financial effect of the 2004 final dividend has not been brought to account in the financial statements for the year ended 30 June 2004 and will be recognised in the subsequent financial period.

	Company	
	2004 \$000	2003 \$000
<b>Dividend franking account</b>		
30% franking credits available to shareholders of Cochlear Limited for subsequent financial periods	6,144	17,489

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.

### Tax consolidation legislation

On 1 July 2003, Cochlear Limited and its wholly-owned Australian subsidiaries adopted the tax consolidation legislation which requires a tax consolidated group to keep a single franking account. The amount of franking credits available to shareholders of the parent entity (being the head entity in the tax consolidated group) disclosed at 30 June 2004 has been measured under the new legislation as those available from the tax consolidated group. The franking credit balance would have been the same if it had been measured under the previous legislation.

### 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	
	2004 \$000	2003 \$000	2004 \$000	2003 \$000	2004 \$000	2003 \$000	2004 \$000	2003 \$000	2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>Revenue</b>												
Revenue outside the Consolidated Entity	109,075	142,479	93,282	98,342	50,590	48,567	30,287	17,534	–	–	283,234	306,922
Inter-segment sales revenue	–	–	–	–	–	–	133,406	181,111	(133,406)	(181,111)	–	–
<b>Profit</b>												
Profit from ordinary activities before interest and income tax expense	8,901	36,405	21,167	29,333	9,639	10,651	5,754	3,761	–	–	45,461	80,150
Net interest											1,791	(140)
Profit from ordinary activities before related income tax expense											47,252	80,010
Income tax expense relating to ordinary activities											(11,118)	(21,797)
Profit from ordinary activities after related income tax expense											36,134	58,213
Depreciation and amortisation	434	500	470	370	192	196	8,356	6,681	–	–	9,452	7,747
Non-cash expenses other than depreciation and amortisation	8,822	1,773	291	998	306	551	1,398	7,252	–	–	10,817	10,574
Inventory write-down	47	210	(227)	112	5	11	4,328	2,633	–	–	4,153	2,966
Total assets	48,410	52,057	52,193	50,754	25,102	18,214	174,517	158,385	(35,683)	(48,831)	264,539	230,579
Total liabilities	37,002	25,109	26,655	33,594	16,941	14,495	56,407	70,836	(17,995)	(33,142)	119,010	110,892
Acquisition of non-current assets	234	709	592	447	274	145	12,232	9,198	–	–	13,332	10,499

Included in unallocated profit from ordinary activities before interest and income tax expense is a foreign exchange profit amounting to \$30,287,000 (2003: \$17,534,000) which has not been allocated to the regions.

#### Secondary reporting

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

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Consolidated	
	2004	2003
<b>9. Earnings per share</b>		
Net profit attributable to members of the parent entity used in the calculation of:		
Basic earnings per share	\$36,761,000	\$58,213,100
Diluted earnings per share	\$36,761,000	\$58,213,100
Weighted average number of ordinary shares used as the denominator:		
Number for basic earnings per share	53,919,572	52,944,555
Number for diluted earnings per share	53,919,572	52,944,555

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>10. Receivables</b>					
<b>Current</b>					
Trade debtors		57,614	60,379	4,789	5,226
Allowance for doubtful trade debtors		(3,622)	(3,461)	(160)	(160)
		53,992	56,918	4,629	5,066
Amount receivable from controlled entities	31	–	–	17,381	33,123
Deferred foreign exchange receivable		12,664	21,660	12,664	21,660
<b>Total receivables</b>		<b>66,656</b>	<b>78,578</b>	<b>34,674</b>	<b>59,849</b>
<b>Non-current</b>					
Deferred foreign exchange receivable		9,458	9,632	9,458	9,632
Other amounts receivable		175	164	–	–
		<b>9,633</b>	<b>9,796</b>	<b>9,458</b>	<b>9,632</b>
<b>11. Inventories</b>					
Raw materials and stores, at net realisable value		26,043	21,489	26,043	21,501
Work in progress, at net realisable value		5,897	5,366	5,897	5,357
Finished goods, at net realisable value		12,897	18,168	1,489	6,043
<b>Total inventories</b>		<b>44,837</b>	<b>45,023</b>	<b>33,429</b>	<b>32,901</b>
<b>12. Other current assets</b>					
<b>Prepayments and other debtors</b>		<b>12,156</b>	<b>11,990</b>	<b>4,408</b>	<b>3,998</b>
<b>13. Other financial assets</b>					
<b>Non-current</b>					
<b>Shares in controlled entities, unlisted, at cost</b>	28	–	–	<b>6,444</b>	<b>3,944</b>

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>14. Plant and equipment</b>					
<b>Leasehold improvements</b>					
At cost		19,778	16,597	18,892	15,904
Accumulated amortisation		(5,731)	(5,578)	(5,312)	(5,262)
		14,047	11,019	13,580	10,642
<b>Plant and equipment</b>					
At cost		31,743	28,525	24,882	21,942
Accumulated depreciation		(21,698)	(17,662)	(16,946)	(13,439)
		10,045	10,863	7,936	8,503
<b>Enterprise Resource Planning system</b>					
At cost		9,477	7,374	9,477	7,374
Accumulated depreciation		(4,046)	(1,920)	(4,046)	(1,920)
		5,431	5,454	5,431	5,454
<b>Total plant and equipment, at net book value</b>		<b>29,523</b>	<b>27,336</b>	<b>26,947</b>	<b>24,599</b>
<b>Reconciliations</b>					
Reconciliations of the carrying amounts of each class of plant and equipment are set out below:					
<b>Leasehold improvements</b>					
Carrying amount at beginning of financial year		11,019	10,704	10,642	10,184
Additions		7,185	2,594	7,036	2,592
Disposals		(1,286)	–	(1,286)	–
Amortisation		(2,897)	(2,228)	(2,812)	(2,134)
Net foreign currency difference on translation of self-sustaining foreign operations		26	(51)	–	–
Carrying amount at end of financial year		14,047	11,019	13,580	10,642
<b>Plant and equipment</b>					
Carrying amount at beginning of financial year		10,863	9,418	8,503	7,169
Additions		4,084	5,402	3,304	4,104
Disposals		(165)	(18)	(21)	(4)
Depreciation		(4,735)	(3,667)	(3,850)	(2,766)
Net foreign currency difference on translation of self-sustaining foreign operations		(2)	(272)	–	–
Carrying amount at end of financial year		10,045	10,863	7,936	8,503
<b>Enterprise Resource Planning system</b>					
Carrying amount at beginning of financial year		5,454	4,803	5,454	4,803
Additions		2,063	2,503	2,063	2,503
Disposals		(266)	–	(266)	–
Depreciation		(1,820)	(1,852)	(1,820)	(1,852)
Carrying amount at end of financial year		5,431	5,454	5,431	5,454
<b>Total carrying amount at end of financial year</b>		<b>29,523</b>	<b>27,336</b>	<b>26,947</b>	<b>24,599</b>

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>15. Intangible assets</b>					
<b>Intellectual property capitalised, at cost</b>		<b>7,190</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>16. Payables</b>					
<b>Trade creditors and other creditors</b>		<b>31,657</b>	<b>28,461</b>	<b>17,156</b>	<b>12,568</b>
<b>17. Other liabilities</b>					
<b>Current</b>					
Deferred foreign exchange gain		12,664	21,660	12,664	21,660
Deferred revenue		8,975	3,890	–	–
		<b>21,639</b>	<b>25,550</b>	<b>12,664</b>	<b>21,660</b>
<b>Non-current</b>					
<b>Deferred foreign exchange gain</b>		<b>9,458</b>	<b>9,632</b>	<b>9,458</b>	<b>9,632</b>
<b>18. Interest bearing liabilities</b>					
Bank overdrafts		1,855	1,873	–	–
Bank loans, secured		24,012	13,132	2,100	1,984
		<b>25,867</b>	<b>15,005</b>	<b>2,100</b>	<b>1,984</b>
<b>Financing arrangements</b>					
The Consolidated Entity has access to the following lines of credit at reporting date:					
Bank overdrafts		3,855	3,878	2,000	2,000
Bank loans		49,155	40,088	20,000	20,000
Standby letters of credit		227	227	227	227
Bank guarantee facility		280	–	280	–
		<b>53,517</b>	<b>44,193</b>	<b>22,507</b>	<b>22,227</b>
Facilities utilised at reporting date:					
Bank overdrafts		1,855	1,873	–	–
Bank loans		24,012	13,132	2,100	1,984
Standby letters of credit		212	–	212	–
Bank guarantee facility		279	–	279	–
		<b>26,358</b>	<b>15,005</b>	<b>2,591</b>	<b>1,984</b>
Facilities not utilised at reporting date:					
Bank overdrafts		2,000	2,005	2,000	2,000
Bank loans		25,143	26,956	17,900	18,016
Standby letters of credit		15	227	15	227
Bank guarantee facility		1	–	1	–
		<b>27,159</b>	<b>29,188</b>	<b>19,916</b>	<b>20,243</b>

**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 1.7% (2003: 1.5%) per annum.

**Bank loans**

The bank loans were secured by a letter of guarantee provided by the Company and are payable within one year. The utilised facilities bore interest at an average effective interest rate of 3.2% (2003: 3.6%) per annum.

**Non-cash financing and investment activities**

During the financial year, intellectual property with an aggregate fair value of \$7,190,000 was contributed to Cochlear Acoustics Limited, a 75% owned subsidiary, as part consideration for a 25% share in Cochlear Acoustics Limited. This transaction is not reflected in the statement of cash flows.

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>19. Commitments</b>					
<b>Operating lease commitments</b>					
Future non-cancellable operating lease rentals not provided for in the financial statements are payable as follows:					
Not later than one year		4,258	3,798	1,782	1,729
Later than one year but not later than five years		14,723	13,765	7,044	6,862
Later than five years		5,079	8,602	327	2,014
<b>Total commitments</b>		<b>24,060</b>	<b>26,165</b>	<b>9,153</b>	<b>10,605</b>
<b>Capital expenditure commitments</b>					
Contracted but not provided for and payable:					
Not later than one year		394	3,575	394	3,528

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.

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>20. Provisions</b>					
<b>Current</b>					
Employee benefits <sup>(i)</sup>		6,005	8,478	4,821	6,106
Warranty		6,616	6,680	6,565	6,565
Other and legal		9,731	3,680	3,000	3,684
		<b>22,352</b>	<b>18,838</b>	<b>14,386</b>	<b>16,355</b>
<b>Non-current</b>					
Employee benefits <sup>(i)</sup>		2,083	1,820	914	902
Directors' retirement scheme		1,173	879	1,173	879
		<b>3,256</b>	<b>2,699</b>	<b>2,087</b>	<b>1,781</b>
<b>Reconciliations</b>					
Reconciliations of the carrying amounts of each class of provision, except for employee benefits provision, are set out below:					
<b>Warranty – current</b>					
Carrying amount at beginning of financial year		6,680	7,103	6,565	6,010
Provisions made during financial year		4,934	1,115	660	1,572
Adjustment on adoption of AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets"		–	(445)	–	(445)
Applied to provision during financial year		(4,998)	(5,988)	(660)	(572)
<b>Carrying amount at end of financial year</b>		<b>6,616</b>	<b>6,680</b>	<b>6,565</b>	<b>6,565</b>
<b>Other and legal – current</b>					
Carrying amount at beginning of financial year		3,680	4,094	3,684	3,314
Provisions made during financial year		6,788	–	–	1,277
Adjustment on adoption of AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets"		–	–	–	(907)
Applied to provision during financial year		–	(414)	–	–
Amounts paid		(737)	–	(684)	–
<b>Carrying amount at end of financial year</b>		<b>9,731</b>	<b>3,680</b>	<b>3,000</b>	<b>3,684</b>
<b>Directors' retirement scheme</b>					
Carrying amount at beginning of financial year		879	–	879	–
Provisions made during financial year		294	879	294	879
<b>Carrying amount at end of financial year</b>		<b>1,173</b>	<b>879</b>	<b>1,173</b>	<b>879</b>

(i) 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.

## 21. Contingent liabilities

The detail and estimated maximum amounts of contingent liabilities are set out below. The Directors are of the opinion that provisions are not required in respect of these matters, as it is either not probable that a future sacrifice of economic benefits will be required, or the amount is not capable of reliable measurement.

### US Department of Justice Inquiry

In March 2004, the Company was informed by the United States Department of Justice that Cochlear Americas, a wholly-owned subsidiary, is subject to an inquiry under federal healthcare laws in the USA that deal with the Medicare and Medicaid programs, including some with potential criminal sanctions. The Department of Justice has made no specific allegations. The Company is cooperating fully with the inquiry and has engaged a nationally recognised law firm with specialised expertise in the USA healthcare law. Legal costs incurred as a result of managing the information request have been provided for in the financial year. It is not possible to estimate the financial impact of this investigation.

In the Directors' opinion, disclosure of any further information of the above matter would be prejudicial to the interests of the Company.

### Assessment from the Tokyo Regional Tax Bureau (TRTB) relating to transfer pricing matters

On 23 May 2003, Nihon Cochlear Co Limited (NCC), a wholly-owned subsidiary, received a notice of assessment of \$3,282,850 from the TRTB. The assessment resulted from a transfer pricing audit conducted by the TRTB. The Company vigorously disputes the assessment and the matter is currently in mutual agreement proceedings between the ATO and the Japan National Tax Authority.

NCC has paid the full amount owing under the assessment. This payment has been recognised as an asset on the statement of financial position, included within other assets.

### 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 ESPrit 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.

Cochlear Limited has provided guarantees to Westpac Institutional Bank for loan facilities provided to Cochlear Americas and Cochlear Europe Limited, both wholly-owned subsidiaries.

The Cochlear Americas facility is for US\$12.0 million. The outstanding balance of the loan at reporting date was US\$7.0 million.

The Cochlear Europe Limited facility is for GBP7.5 million. The outstanding balance of the loan at reporting date was GBP4.5 million.

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>22. Contributed equity</b>					
<b>Share capital</b>					
54,161,690 (2003: 53,070,550) Ordinary shares fully paid <sup>(i)</sup>					
		<b>50,746</b>	<b>23,089</b>	<b>50,746</b>	<b>23,089</b>
<b>Movements in ordinary share capital</b>					
Balance at beginning of financial year					
		23,089	14,959	23,089	14,959
Shares issued:					
43,140 (2003: 31,405) shares issued for nil consideration under the Employee Share Plan <sup>(ii)</sup>					
		—	—	—	—
1,048,000 (2003: 539,000) shares issued from the exercise of options <sup>(iii)</sup>					
		27,657	8,130	27,657	8,130
<b>Balance at end of financial year</b>					
		<b>50,746</b>	<b>23,089</b>	<b>50,746</b>	<b>23,089</b>

(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 1 October 2003, the Company issued 43,140 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.

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>23. Reserves</b>					
General		84	81	–	–
Foreign currency translation		(1,079)	1,107	–	–
		<b>(995)</b>	<b>1,188</b>	<b>–</b>	<b>–</b>
<b>Movements during financial year</b>					
<b>General</b>					
Balance at beginning of financial year		81	89	–	–
Translation adjustment		3	(8)	–	–
<b>Balance at end of financial year</b>		<b>84</b>	<b>81</b>	<b>–</b>	<b>–</b>
<b>Foreign currency translation</b>					
Balance at beginning of financial year		1,107	5,844	–	–
Net translation adjustment		(2,778)	(4,737)	–	–
Transfer to retained profits		592	–	–	–
<b>Balance at end of financial year</b>		<b>(1,079)</b>	<b>1,107</b>	<b>–</b>	<b>–</b>
<b>Nature and purpose of reserves</b>					
<b>Foreign currency translation reserve</b>					
The foreign currency translation reserve records the foreign currency difference arising from the translation of self-sustaining foreign operations. Refer to accounting policy Note 1(e).					
<b>24. Retained profits</b>					
Retained profits at beginning of financial year		95,410	54,524	69,940	31,252
Net profit attributable to the members of the parent entity		36,761	58,213	45,301	53,889
Transfer from foreign currency translation reserve		(592)	–	–	–
Net effect of initial adoption of:					
Revised AASB 1028 "Employee Benefits"		–	(116)	–	(90)
AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets"		–	311	–	2,411
Net effect on dividends from:					
Initial adoption of AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets"		–	15,750	–	15,750
Dividends recognised during financial year	7	(42,312)	(33,272)	(42,312)	(33,272)
<b>Retained profits at end of financial year</b>		<b>89,267</b>	<b>95,410</b>	<b>72,929</b>	<b>69,940</b>

**NOTES TO THE FINANCIAL STATEMENTS** Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>25. Outside equity interests</b>					
Outside equity interests in controlled entities comprise:					
Interest in retained profits at beginning of financial year after adjusting for outside equity interests in entities acquired during financial year		–	–	–	–
Interest in loss from ordinary activities after income tax expense		(627)	–	–	–
Interest in retained profits at end of financial year		(627)	–	–	–
Interest in share capital		7,190	–	–	–
Interest in reserves		(52)	–	–	–
<b>Total outside equity interests</b>		<b>6,511</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>26. Total equity reconciliation</b>					
Total equity at beginning of financial year		119,687	75,416	93,029	46,211
Total changes in parent entity interest in equity recognised in statement of financial performance		33,986	53,663	45,301	56,210
Transactions with owners as owners:					
Movement in contributed equity	22	27,657	8,130	27,657	8,130
Dividends	7	(42,312)	(33,272)	(42,312)	(33,272)
Net effect on dividends from initial adoption of AASB 1044 "Provisions, Contingent Liabilities and Contingent Assets"		–	15,750	–	15,750
Total changes in outside equity interests	25	6,511	–	–	–
<b>Total equity at end of financial year</b>		<b>145,529</b>	<b>119,687</b>	<b>123,675</b>	<b>93,029</b>

**27. Notes to the statements of cash flows**

**Cash assets**

The Company's operating account received an average interest rate of 4.3% (2003: 3.8%) per annum.

Cash held on deposit for periods not exceeding 180 days received an average interest rate of 4.95% (2003: 4.7%) 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	
		2004 \$'000	2003 \$'000	2004 \$'000	2003 \$'000
Cash on hand		32,886	23,541	15,508	5,060
Cash on deposit		43,060	20,350	43,018	18,601
		75,946	43,891	58,526	23,661
Bank overdrafts		1,855	1,873	–	–
		<b>74,091</b>	<b>42,018</b>	<b>58,526</b>	<b>23,661</b>
<b>(ii) Reconciliation of profit from ordinary activities after income tax expense to net cash provided by operating activities</b>					
Profit from ordinary activities after income tax expense		36,134	58,213	45,301	53,889
<b>Add/(less) items classified as investing/financing activities</b>					
Loss/(gain) on disposal of non-current assets		1,645	2	1,502	(2)
<b>Add non-cash items</b>					
Amounts set aside to provisions		10,817	11,181	1,398	9,130
Depreciation and amortisation		9,452	7,747	8,482	6,752
Net cash provided by operating activities before changes in assets and liabilities		58,048	77,143	56,683	69,769
<b>Changes in assets and liabilities</b>					
Decrease/(increase) in receivables		2,632	12,417	16,179	(4,868)
Decrease/(increase) in inventories		186	(8,643)	(528)	(5,643)
(Increase) in prepayments and other debtors		(166)	(5,014)	(410)	(128)
(Increase)/decrease in deferred tax assets		(3,826)	(1,936)	(82)	144
Increase in payables		8,281	11,319	4,588	3,050
(Decrease)/increase in current tax liability		(6,733)	6,875	(9,133)	6,337
(Decrease) in provisions		(6,463)	(9,518)	(3,061)	(6,340)
Exchange rate adjustment		(2,989)	(3,826)	–	–
<b>Net cash provided by operating activities</b>		<b>48,970</b>	<b>78,817</b>	<b>64,236</b>	<b>62,321</b>

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Interest held		Country of incorporation
		2004 %	2003 %	
<b>28. Controlled entities</b>				
<b>Particulars in relation to controlled entities</b>				
<b>The Company</b>				
Cochlear Limited				Australia
<b>Controlled entities</b>				
Cochlear Europe Limited	i	100	100	United Kingdom
Cochlear Acoustics Limited	i	75	75	United Kingdom
Cochlear AG	i	100	100	Switzerland
Cochlear (UK) Limited	i	100	100	United Kingdom
Cochlear GmbH	i	100	100	Germany
Cochlear Americas	i	100	100	United States of America
Cochlear (HK) Limited	i	100	100	Hong Kong
Nihon Cochlear Co Limited	i	100	100	Japan
Neopraxis Pty Limited		100	100	Australia
Cochlear Technologies Pty Limited	ii	100	–	Australia
Medical Insurance Pte Limited	iii	100	–	Singapore

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

(ii) Incorporated on 21 August 2003.

(iii) Incorporated on 7 October 2003.

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

**29. Director and executive remuneration**

Remuneration levels are competitively set to attract and retain appropriately qualified and experienced Directors and senior executives. Details of the remuneration policy and structure are contained in the Remuneration report in the Directors' Report.

The following table provides the details of all Directors of the Company (specified Directors) and the executives of the Consolidated Entity with the greatest authority (specified executives) and the nature and amount of the elements of their remuneration for the year ended 30 June 2004:

		Primary			Post-employment		Equity compensation		Other compensation	Total
		Salary and fees	Bonus <sup>(i)</sup>	Non-monetary	Super-annuation benefits	Leaving benefits	Value of options <sup>(ii)</sup>	Value of shares	Termination benefits	
<b>Amounts in \$</b>										
<b>Specified Directors</b>										
<b>Non-Executive</b>										
Mr TCE Bergman Chairman	2004	180,000	–	–	11,002	89,064	–	–	–	280,066
	2003	152,927	–	–	9,861	112,922	–	–	–	275,710
Prof BDO Anderson, AO	2004	73,500	–	–	6,615	36,500	–	–	–	116,615
	2003	70,454	–	–	6,341	36,500	–	–	–	113,295
Prof E Byrne	2004	73,500	–	–	6,615	36,368	–	–	–	116,483
	2003	70,454	–	–	6,341	46,110	–	–	–	122,905
Ms EC Holley	2004	90,000	–	–	8,100	47,000	–	–	–	145,100
	2003	86,193	–	–	7,757	47,000	–	–	–	140,950
Mr PJ North	2004	85,000	–	–	7,650	48,000	–	–	–	140,650
	2003	79,923	–	–	7,193	48,000	–	–	–	135,116
Mr JH Veeneklaas	2004	73,500	–	–	6,615	36,500	–	–	–	116,615
	2003	70,454	–	–	6,341	36,500	–	–	–	113,295
<b>Executive</b>										
Mr JJ O'Mahony Chief Executive Officer (retired 31 January 2004)	2004	483,129	–	42,745	6,559	–	77,466	–	300,000	909,899
	2003	661,511	416,845	65,879	87,141	–	648,318	–	–	1,879,694
Dr JL Parker Chief Technology Officer	2004	293,792	11,633	–	11,002	–	25,822	–	–	342,249
	2003	249,845	131,835	–	10,520	–	330,710	–	–	722,910
Dr CG Roberts Chief Executive Officer (appointed 1 February 2004)	2004	273,799	137,709	–	4,443	–	–	–	–	415,951
<b>Total, all specified Directors</b>	<b>2004</b>	<b>1,626,220</b>	<b>149,342</b>	<b>42,745</b>	<b>68,601</b>	<b>293,432</b>	<b>103,288</b>	<b>–</b>	<b>300,000</b>	<b>2,583,628</b>
	<b>2003</b>	<b>1,441,761</b>	<b>548,680</b>	<b>65,879</b>	<b>141,495</b>	<b>327,032</b>	<b>979,028</b>	<b>–</b>	<b>–</b>	<b>3,503,875</b>

(i) Cash and long-term incentive bonuses are granted annually, before the end of the financial year. The grant date is tied to the performance appraisal, which, for the current year was completed by 30 June 2004. The specific service and performance criteria are set out in the Directors' Report.

(ii) The fair value of the options is calculated at the date of grant using a Black-Scholes model. The value disclosed above is the portion of the fair value of the options allocated to the financial reporting period. The Company discloses in each reporting period during the vesting period the pro-rata amount based on the best available estimate of the number of equity instruments expected to vest.

NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

		Primary			Post-employment		Equity compensation		Other compensation	Total
		Salary and fees	Bonus <sup>(i)</sup>	Non-monetary	Super-annuation benefits	Leaving benefits	Value of options <sup>(ii)</sup>	Value of shares	Termination benefits	
<b>Amounts in \$</b>										
<b>Specified executives</b>										
Mr R Brook	2004	295,733	24,178	97,872	11,711	–	–	–	–	429,494
President, European Region	2003	33,017	–	–	–	–	–	–	–	33,017
Mr D Howitt	2004	212,705	9,175	4,127	11,002	–	12,911	–	–	249,920
Vice President, Manufacturing	2003	177,937	47,507	–	10,520	–	161,175	–	–	397,139
Mr J Miller <sup>(iii)</sup>	2004	243,543	–	45,170	5,463	–	–	–	–	294,176
President, Americas Region (resigned 1 March 2004)	2003	421,922	210,552	11,609	30,818	–	280,452	–	–	955,353
Mr NJ Mitchell	2004	271,906	11,023	–	30,788	–	20,658	–	–	334,375
Chief Financial Officer and Company Secretary	2003	202,094	114,345	10,648	25,175	–	313,004	–	–	665,266
Mr P Nicholl <sup>(iii)</sup>	2004	175,196	–	–	9,309	–	–	–	–	184,505
President, Asia Pacific Region (resigned 30 April 2004)	2003	194,164	104,580	13,597	10,520	–	280,452	–	–	603,313
<b>Total, all specified executives</b>	<b>2004</b>	<b>1,199,083</b>	<b>44,376</b>	<b>147,169</b>	<b>68,273</b>	<b>–</b>	<b>33,569</b>	<b>–</b>	<b>–</b>	<b>1,492,470</b>
	<b>2003</b>	<b>1,029,134</b>	<b>476,984</b>	<b>35,854</b>	<b>77,033</b>	<b>–</b>	<b>1,035,083</b>	<b>–</b>	<b>–</b>	<b>2,654,088</b>

(i) Cash and long-term incentive bonuses are granted annually, before the end of the financial year. The grant date is tied to the performance appraisal, which, for the current year was completed by 30 June 2004. The specific service and performance criteria are set out in the Directors' Report.

(ii) The fair value of the options is calculated at the date of grant using a Black-Scholes model. The value disclosed above is the portion of the fair value of the options allocated to the financial reporting period. The Company discloses in each reporting period during the vesting period the pro-rata amount based on the best available estimate of the number of equity instruments expected to vest.

(iii) These positions remained unfilled at 30 June 2004.

### Equity instruments

All options refer to options over ordinary shares of Cochlear Limited. All performance shares are ordinary shares of Cochlear Limited. The options are exercisable on a one-for-one basis under the CELTIP.

### Options and performance shares granted as remuneration

During the year ended 30 June 2004, options and performance shares were granted as equity compensation benefits to certain specified Directors and specified executives as disclosed below. The options and shares were issued free of charge.

	Number of performance shares granted under CELTIP during the year	Number of options granted under CELTIP during the year	Number of options vested under ESOP during the year
<b>Specified Directors</b>			
<b>Executive</b>			
Mr JJ O'Mahony	–	–	150,000
Dr JL Parker	2,648	20,584	50,000
Dr CG Roberts	–	–	–
<b>Specified executives</b>			
Mr R Brook	3,350	26,046	–
Mr D Howitt	2,008	15,613	25,000
Mr J Miller	3,988	30,999	–
Mr NJ Mitchell	2,439	18,961	40,000
Mr P Nicholl	2,513	19,536	–

## NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

All options and performance shares granted in the current financial year were granted on 1 December 2003 and vest in August 2006. Options have an expiration date of 30 September 2008. No options or performance shares have been granted since the end of the financial year. The options and performance shares were provided at no cost to the recipients.

All options granted during the financial year have an exercise price of \$34.19 per share and a fair value of \$3.93 per share at grant date. The performance shares granted during the financial year had a fair value of \$28.15 at grant date.

Further details, including grant dates and exercise dates, regarding options granted to executives are in Note 30. Details of service and performance criteria are set out in the Remuneration Report in the Directors' Report.

### Exercise of options granted as remuneration

During the current financial year, the following shares were issued on the exercise of options granted as remuneration.

There were no amounts unpaid on the shares issued as a result of the exercise of the options.

	Number of shares	Amount paid \$/share
<b>Specified Directors</b>		
<b>Executive</b>		
Mr JJ O'Mahony	150,000	26.50
Dr JL Parker	50,000	26.50
Dr CG Roberts	–	–
<b>Specified executives</b>		
Mr R Brook	–	–
Mr D Howitt	25,000	26.50
Mr J Miller	–	–
Mr NJ Mitchell	40,000	26.50
Mr P Nicholl	–	–

During the year ended 30 June 2004, options issued in September 2000 vested. These options were granted under the shareholder approved ESOP.

### Option holdings

The movement during the financial year in the number of options over ordinary shares of Cochlear Limited held, directly, indirectly or beneficially, by each specified Director and specified executive including their personally related entities, is as follows:

	Held at 1 July 2003	Granted as remuneration	Vested and exercised	Other changes <sup>(i)</sup>	Held at 30 June 2004
<b>Specified Directors</b>					
<b>Executive</b>					
Mr JJ O'Mahony	325,000	–	150,000	–	175,000
Dr JL Parker	150,000	20,584	50,000	–	120,584
Dr CG Roberts	–	–	–	–	–
<b>Specified executives</b>					
Mr R Brook	–	26,046	–	–	26,046
Mr D Howitt	75,000	15,613	25,000	–	65,613
Mr J Miller	125,000	30,999	–	155,999	–
Mr NJ Mitchell	140,000	18,961	40,000	–	118,961
Mr P Nicholl	125,000	19,536	–	144,536	–

(i) Other changes represent options that expired or were forfeited during the financial year.

No options held by specified Directors or specified executives are vested but not exercisable.

### Performance share holdings

The movement during the financial year in the number of performance shares over ordinary shares of Cochlear Limited held, in trust, on behalf of each specified Director and specified executive including their personally related entities, is as follows:

	Held at 1 July 2003	Granted as remuneration	Vested	Other changes <sup>(i)</sup>	Held at 30 June 2004
<b>Specified Directors</b>					
<b>Executive</b>					
Mr JJ O'Mahony	–	–	–	–	–
Dr JL Parker	–	2,648	–	–	2,648
Dr CG Roberts	–	–	–	–	–
<b>Specified executives</b>					
Mr R Brook	–	3,350	–	–	3,350
Mr D Howitt	–	2,008	–	–	2,008
Mr J Miller	–	3,988	–	3,988	–
Mr NJ Mitchell	–	2,439	–	–	2,439
Mr P Nicholl	–	2,513	–	2,513	–

(i) Other changes represent performance shares that were forfeited during the financial year.

### Equity holdings and transactions

The movement during the financial year in the number of ordinary shares of Cochlear Limited held, directly, indirectly or beneficially, by each specified Director and specified executive, including their personally related entities, is as follows:

	Held at 1 July 2003	Purchases	Received on exercise of options	Sales	Held at 30 June 2004
<b>Specified Directors</b>					
<b>Non-executive</b>					
Mr TCE Bergman	8,000	4,000	–	–	12,000
Prof BDO Anderson, AO	4,000	–	–	–	4,000
Prof E Byrne	1,000	–	–	–	1,000
Ms EC Holley	9,000	–	–	–	9,000
Mr PJ North	12,000	1,000	–	–	13,000
Mr JH Veeneklaas	–	1,000	–	–	1,000
<b>Executive</b>					
Mr JJ O'Mahony (retired 31 January 2004)	11,286	–	150,000	11,286	N/A <sup>(i)</sup>
Dr JL Parker	25,000	–	50,000	50,000	25,000
Dr CG Roberts (appointed 1 February 2004)	N/A <sup>(i)</sup>	50,000	–	–	162,000
<b>Specified executives</b>					
Mr R Brook	–	–	–	–	–
Mr D Howitt	–	–	25,000	15,000	10,000
Mr J Miller	–	–	–	–	–
Mr NJ Mitchell	30,000	–	40,000	55,000	15,000
Mr P Nicholl	–	–	–	–	–

(i) Holdings at date of appointment of 1 February 2004 were 112,000.

(ii) Holdings at date of retirement of 31 January 2004 were 150,000.

### Loans and other transactions with specified Directors and specified executives

There were no loans outstanding at the reporting date to specified Directors and specified executives.

No other transactions occurred between specified Directors, specified executives or their personally related entities and the Company in the reporting period.

**NOTES TO THE FINANCIAL STATEMENTS** Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Note	Consolidated		Company	
		2004 \$000	2003 \$000	2004 \$000	2003 \$000
<b>30. Employee benefits</b>					
<b>Employee benefits</b>					
Aggregate liability for employee benefits including on-costs:					
Current:					
Employee benefits provision	20	6,005	8,478	4,821	6,106
Non-current:					
Employee benefits provision	20	2,083	1,820	914	902
Directors' retirement scheme	20	1,173	879	1,173	879

The Cochlear Limited Directors' retirement scheme provides retiring Non-Executive Directors with more than five years' service the benefit of up to three times their average annual remuneration over the previous three years. The Directors' retirement scheme was closed to new Directors effective from 2003.

**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. Employees' 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 PricewaterhouseCoopers as at 31 May 2004 on behalf of the trustees. The actuary report, dated 23 July 2004, noted that the plan assets for the defined benefit members amounting to \$3,860,527 are less than the total of defined benefit members' accrued benefits amounting to \$3,955,265 and are less than the total of members' vested benefits amounting to \$4,186,305. Based on the advice of the actuary, the Company will increase the contribution rate 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. An amount has been accrued in the financial statements at 30 June 2004 for the difference in value between the plan assets and vested benefits.

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.

**NOTES TO THE FINANCIAL STATEMENTS** Cochlear Limited and its controlled entities for the year ended 30 June 2004

	Total assets at net market value		Total accrued benefits		(Shortfall)/excess		Total vested benefits	
	2004 \$000	2003 \$000	2004 \$000	2003 \$000	2004 \$000	2003 \$000	2004 \$000	2003 \$000
Cochlear Superannuation Plan	17,439	10,334	17,534	10,231	(95)	103	17,765	10,685

Plan assets at net market value and vested benefits have been calculated at 31 May 2004, being the date of the most recent valuation of the plan. Accrued benefits are based on actuarial reviews performed as at 31 May 2004.

Details of contributions to the plan during the year ended 30 June 2004 are as follows:

	Note	Consolidated		Company	
		2004 \$	2003 \$	2004 \$	2003 \$
Employer contributions to Cochlear Superannuation Plan		3,296,617	3,264,681	3,296,617	3,264,681
<b>Number of employees</b>					
Number of employees at reporting date		816	814	491	498

**Equity based plans**

**Cochlear Executive Long-Term Incentive Plan**

The Cochlear Executive Long Term Incentive Plan (CELTIP) was approved at the Annual General Meeting held on 21 October 2003. This provides for the grant of performance shares, and, in the case of the most senior executives, options. For the years prior to 2003, grants were made under the Executive Share Option Plan (ESOP) and consisted of options only.

Details of the Company's equity based plans are set out in the Remuneration Report in the Directors' Report.

### Summary of options over unissued ordinary shares

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

#### Consolidated and Company 2004

Grant year	Exercise year	Expiry year	Exercise price per option	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	10,000	–	–	10,000	–	\$150,000	2002	10,000
2000	2003	2003	\$26.50	1,039,000	–	1,000	1,038,000	–	\$27,507,000	2003	1,038,000
2000	2003	2003	\$36.00	100,000	–	100,000	–	–	–	–	–
2001	2004	2004	\$37.62	1,142,000	–	206,000	–	936,000	–	–	–
2002	2005	2005	\$38.12	1,232,000	–	212,000	–	1,020,000	–	–	–
2003	2006	2008	\$34.19	–	243,296	50,535	–	192,761	–	–	–
<b>Total</b>				<b>3,523,000</b>	<b>243,296</b>	<b>569,535</b>	<b>1,048,000</b>	<b>2,148,761</b>			

#### Consolidated and Company 2003

Grant year	Exercise year	Expiry year	Exercise price per option	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	–	–	–
<b>Total</b>				<b>2,928,000</b>	<b>1,268,000</b>	<b>134,000</b>	<b>539,000</b>	<b>3,523,000</b>			

The share price at the time the 2000 options were exercised in September 2003 was \$31.91 (2003: \$33.80). The exercise of 10,000 options from the 1999 grant was made when the share price was \$33.98.

#### Employee Share Plan

The Company's Employee Share Plan was approved by special resolution at the Annual General Meeting 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 ASX 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.

**31. Related parties**

**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 included in the profit from ordinary activities before related income tax expense for the Company that resulted from transactions with non-Director related parties are:

	Company	
	2004 \$000	2003 \$000
Revenue from sale of goods	133,406	181,111
Dividend revenue	18,141	—
Interest expense	80	—
The aggregate amounts receivable from wholly-owned controlled entities by the Company at reporting date are:		
Current receivables	17,381	33,123

### 32. 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		Consolidated	
	2004	2003	2004 \$000	2003 \$000
<b>Sell United States Dollar</b>				
Not later than one year			62,682	73,299
Later than one year but not later than two years			37,312	34,647
Later than two years but not later than three years			23,307	5,247
Weighted average exchange rates contracted	0.59	0.54		
<b>Sell euro</b>				
Not later than one year			47,082	66,711
Later than one year but not later than two years			23,793	32,578
Later than two years but not later than three years			3,557	14,947
Weighted average exchange rates contracted	0.55	0.56		
<b>Sell Japanese Yen</b>				
Not later than one year			8,893	16,039
Later than one year but not later than two years			8,246	8,361
Later than two years but not later than three years			4,536	–
Weighted average exchange rates contracted	50.86	54.74		
<b>Sell Hong Kong Dollar</b>				
Not later than one year			16,202	16,394
Later than one year but not later than two years			7,300	8,093
Later than two years but not later than three years			2,056	–
Weighted average exchange rates contracted	4.45	4.19		
<b>Sell Great British Pound</b>				
Not later than one year			5,855	17,779
Later than one year but not later than two years			5,717	6,028
Later than two years but not later than three years			5,477	1,325
Weighted average exchange rates contracted	0.36	0.36		

The forward exchange contracts which total \$262 million (2003: \$301 million) as at 30 June 2004 are held specifically to hedge anticipated foreign currency sales. As these contracts are hedging anticipated sales 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 sale occurs. The net unrecognised gain on hedges of anticipated foreign currency sales at 30 June 2004 was \$22.1 million (2003: \$31.3 million).

## NOTES TO THE FINANCIAL STATEMENTS Cochlear Limited and its controlled entities for the year ended 30 June 2004

The net deferred foreign exchange receivable and deferred foreign exchange gain on hedges of anticipated foreign currency sales is recognised in receivables (Note 10) and other liabilities (Note 17) and the timing of their anticipated recognition as part of sales are:

	Consolidated	
	2004 \$000	2003 \$000
Not later than one year	12,664	21,660
Later than one year but not later than two years	5,101	8,671
Later than two years but not later than three years	4,357	961
	<b>22,122</b>	<b>31,292</b>

### 33. Events subsequent to reporting date

Other than the matters noted below, 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:

#### Acquisition of distributors

Since 30 June 2004, the Consolidated Entity has acquired the assets of its Japanese distributor and 100% of the shares of its Belgian and French distributors. Total consideration paid for these transactions was \$23.3 million. The financial effects of these transactions have not been brought to account in the financial statements for the year ended 30 June 2004.

#### International Financial Reporting Standards

The Company will be required to prepare financial statements using Australian Standards that comply with International Financial Reporting Standards (IFRS), beginning with the half year ending 31 December 2005.

The Company has established a formal project monitored by a steering committee to achieve transition to IFRS. The Company's implementation project consists of three phases as described below:

##### Assessment and planning phase

This phase aims to identify the key conversion impacts on the financial statements, policies and procedures, systems and processes and staff.

This phase includes:

- identification of the key differences in accounting policies and disclosures expected to arise from adopting IFRS;
- assessment of new requirements for capturing information in the Company's systems;
- impact on staff, including training; and
- identification of the likely impact on financial statements as a result of adopting IFRS.

The Company considers this phase to be substantially complete at 30 June 2004.

##### Design phase

This phase aims to effect the changes required to existing accounting policies and procedures and systems in order to transition to IFRS.

This phase includes:

- preparing new accounting policies and procedures for compliance with IFRS requirements;
- designing business processes and accounting systems to support the capture of information required to conform with IFRS disclosures;
- updating disclosures to comply with IFRS; and
- educating staff on new requirements.

The Company has commenced the design phase and work is continuing on the above areas. This phase is expected to be complete during the 2005 financial year.

**Implementation phase**

This phase will include implementation of those changes to business procedures and accounting systems identified. This phase will also include operational training for staff.

This phase has not yet commenced. However, the Company expects this phase to be substantially complete by 30 June 2005.

**Significant differences between Australian Accounting Standards and IFRS**

This financial report has been prepared in accordance with Australian Accounting Standards and other financial reporting requirements (Australian GAAP). The differences between Australian GAAP and IFRS identified to date as potentially having a significant effect on the Consolidated Entity's financial performance and financial position are summarised below:

**Hedge accounting**

All derivatives financial instruments used to hedge foreign exchange risk will be carried at fair value on the Consolidated Entity's statement of financial position. IFRS recognise fair value hedge accounting, which can only be considered where effectiveness tests are met. To the extent that hedges are considered ineffective, differences between the fair value of the hedge and cost must be taken to the statement of financial performance. The Consolidated Entity expects its hedges to meet effectiveness testing and as such, earnings volatility arising from this standard is not expected to be material.

**Cost of employment benefits**

The Consolidated Entity does not currently recognise the net position of its defined benefit superannuation plans on the statement of financial position by using the Projected Unit Credit method to value the defined benefit obligation. IFRS require that this net position be recognised on the statement of financial position with a corresponding entry to the statement of financial performance. An initial adjustment will be made against retained profits at 1 July 2004, based on plan valuations at that date. Future movements in the net position of the plans will be recognised in the statement of financial performance. This may result in increased earnings volatility to the Consolidated Entity.

**Research and development costs**

The Consolidated Entity currently expenses all development expenditures as incurred through the statement of financial performance. IFRS require that development costs be capitalised to the statement of financial position to the extent they meet certain recognition criteria including the ability to demonstrate the technical feasibility of developing an asset so that it will be available for use or sale and whether the development costs will generate probable economic benefits.

An initial adjustment will be made against retained profits at 1 July 2004 for development costs which satisfy the requirements for deferral. After the transitional adjustment, development costs that satisfy the criteria for deferral will be capitalised to the statement of financial position and amortised to net profit over the period that the benefits are expected to be realised.

The Consolidated Entity expects earnings volatility to be impacted only to the extent that development costs capitalised in a given period are higher or lower than those costs capitalised in the preceding financial years.

**Options and share based payments**

The Consolidated Entity does not currently recognise an expense for options issued to executives or shares issued under the employee share plan.

On adoption of IFRS, the Consolidated Entity will recognise the cost of all options and share based payments as an expense over the relevant vesting period. This treatment will result in an increase in expenses in the statement of financial performance.

Share based payments, whether purchased on open market or issued, are held in the name of CELTIP trust until such time as they vest with employees. The trust does not currently form part of the Consolidated Entity as it is not controlled by the Company. Under IFRS, the trust will form part of the Consolidated Entity and as such, the shares held by the trust will need to be accounted for as treasury stock and as a reduction in share capital. The fair value of treasury stock will be recognised as an expense on a straight line basis over the vesting period.

**Income tax**

The Consolidated Entity currently applies the "income statement" approach to account for income tax. Under IFRS, a "balance sheet" approach will be adopted, whereby deferred tax balances are recognised in the statement of financial position when there is a difference between the carrying value of an asset or liability and its tax cost base. This treatment will likely result in higher levels of deferred tax balances on the statement of financial position. The impact on earnings is not expected to be material.

**DIRECTORS' DECLARATION** Cochlear Limited and its controlled entities for the year ended 30 June 2004

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In the opinion of the Directors of Cochlear Limited:

- (a) the financial statements and notes, as set out on pages 43 to 77, 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 2004 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 17th day of August 2004.

Signed in accordance with a resolution of the Directors:

  
Director

  
Director

## Scope

### The financial report and Directors' responsibility

The financial report comprises the statements of financial performance, statements of financial position, statements of cash flows, accompanying notes to the financial statements (Notes 1 - 33), the Remuneration Report included within the Directors' Report (pages 36 - 39), and the Directors' Declaration for both Cochlear Limited (the Company) and Cochlear Limited and its controlled entities (the Consolidated Entity), for the year ended 30 June 2004. 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 2004 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

Sydney, 17 August 2004

John Wigglesworth, Partner

## 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 6 August 2004:

### Shareholdings

#### Substantial shareholders

Name	Number of ordinary shares held	%
The Capital Group Companies, Inc	6,177,124	11.4
Schroder Investment Management (Group)	4,657,429	8.6
Commonwealth Bank Group	3,070,065	5.7
<b>Total</b>	<b>13,904,618</b>	<b>25.7</b>

#### Distribution of shareholders

Number of shares held	Number of ordinary shareholders
1 - 1,000	18,774
1,001 - 5,000	3,978
5,001 - 10,000	221
10,001 - 100,000	134
100,001 - over	33
<b>Total</b>	<b>23,140</b>

Non-marketable parcels – 193 shareholders held less than a marketable parcel.

#### Twenty largest shareholders

Name	Number of ordinary shares held	%
JP Morgan Nominees Australia Ltd	8,107,096	14.97
Westpac Custodian Nominees Ltd	7,657,298	14.14
National Nominees Ltd	4,659,185	8.60
ANZ Nominees Ltd	3,217,890	5.94
Citicorp Nominees Pty Ltd	1,359,304	2.51
Queensland Investment Corporation c/-National Nominees Ltd	876,209	1.62
Cogent Nominees Pty Ltd	831,502	1.54
Citicorp Nominees Pty Ltd (CFS WSLE Geared Share Fund a/c)	606,397	1.12
Health Super Pty Ltd c/-National Nominees Limited	594,622	1.10
Cogent Nominees Pty Ltd (SMP Accounts)	557,569	1.03
AMP Life Ltd	451,321	0.83
Fortis Clearing Nominees (Settlement a/c)	328,723	0.61
UBS Private Clients Australia Nominees Pty Ltd	308,263	0.57
Citicorp Nominees Pty Ltd (CFS WSLE Imputation Fund a/c)	303,191	0.56
HSBC Custody Nominees (Australia) Ltd	244,538	0.45
Westpac Financial Services Ltd c/-Westpac Custodian Nominees Ltd	204,218	0.38
Citicorp Nominees Pty Limited (CFSIL CWLTH AUST SHS 2 a/c)	199,976	0.37
Citicorp Nominees Pty Limited (CFS WSLE AUST Share Fund a/c)	190,348	0.35
Citicorp Nominees Pty Limited (CFS Imputation Fund a/c)	190,218	0.35
The Australian National University Investment Section	190,000	0.35

The 20 largest shareholders held 57.39% of the ordinary shares of the Company.

#### On market buy-back

There is no current on market buy-back.