

## PRELIMINARY FINAL REPORT

Cochlear Limited ACN 002 618 073

30 June 2011

### Results for announcement to the market

|  |    |     |    |         |
|--|----|-----|----|---------|
| Revenue A\$000s                            | up | 10% | to | 809,646 |
| EBIT A\$000s                               | up | 10% | to | 242,698 |
| Net profit attributable to members A\$000s | up | 16% | to | 180,114 |

|   |    |     |    |       |
|---|----|-----|----|-------|
| Net tangible assets per share at 30 June 2011 (cents) | up | 30% | to | 519.4 |
| Net tangible assets per share at 30 June 2010 (cents) |    |     |    | 400.5 |

| Dividends (distributions)                                | Amount per security | Franked amount per security | Conduit foreign income per security |
|--|---------------------|-----------------------------|-------------------------------------|
| Final dividend   | 120.0c              | 84.0c                       | 36.0c                               |
| Interim dividend   | 105.0c              | 63.0c                       | 42.0c                               |
| Total  | 225.0c              | 147.0c                      | 78.0c                               |
| Previous corresponding period                            | 105.0c              | 63.0c                       | 42.0c                               |
| Record date for determining entitlements to the dividend | 1 September 2011    |                             |                                     |
| Dividend payment date                                    | 22 September 2011   |                             |                                     |

### Annual General Meeting

The Annual General Meeting will be held as follows:

Place

The Menzies Sydney Hotel  
Australia Ballroom  
14 Carrington Street, Sydney

Date

18 October 2011

Time

10.00 am

Approximate date the Annual Report will be available

22 September 2011

# Financial Report

Cochlear Limited and its controlled entities for the year ended 30 June 2011  
ACN 002 618 073

## Contents

|                                   |    |
|-----------------------------------|----|
| Directors' Report                 | 1  |
| Income Statement                  | 17 |
| Statement of Comprehensive Income | 18 |
| Balance Sheet                     | 19 |
| Statement of Changes in Equity    | 20 |
| Statement of Cash Flows           | 21 |
| Notes to the Financial Statements | 22 |
| Directors' Declaration            | 70 |
| Independent Audit Report          | 71 |
| Additional Information            | 72 |

The directors present their report, together with the Consolidated Financial Report of the Consolidated Entity (Cochlear), being Cochlear Limited (the Company) and its controlled entities, for the year ended 30 June 2011, and the Auditor's Report thereon.

### Directors

The directors of the Company at any time during or since the end of the financial year were Mr R Holliday-Smith, Mrs YA Allen, Mr PR Bell, Prof E Byrne, AO, Mr A Denver, Mr DP O'Dwyer and Dr CG Roberts.

Information on the directors is presented in 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 |          | Audit Committee |          | Medical Science Committee |          | Nominations Committee |          | Remuneration Committee |          | Technology and Innovation Committee |          |
|---------------------|--------------------|----------|-----------------|----------|---------------------------|----------|-----------------------|----------|------------------------|----------|-------------------------------------|----------|
|                     | Held               | Attended | Held            | Attended | Held                      | Attended | Held                  | Attended | Held                   | Attended | Held                                | Attended |
| Mr R Holliday-Smith | 9                  | 9        | 5               | 5        | -                         | -        | 4                     | 4        | 3                      | 3        | 2                                   | 2        |
| Mrs YA Allen        | 8                  | 8        | 5               | 5        | -                         | -        | 3                     | 3        | -                      | -        | 2                                   | 2        |
| Mr PR Bell          | 9                  | 9        | -               | -        | -                         | -        | 4                     | 4        | 3                      | 3        | 2                                   | 2        |
| Prof E Byrne, AO    | 9                  | 9        | -               | -        | 2                         | 2        | 4                     | 4        | -                      | -        | 2                                   | 2        |
| Mr A Denver         | 9                  | 9        | 5               | 5        | -                         | -        | 4                     | 4        | 3                      | 2        | 2                                   | 2        |
| Mr DP O'Dwyer       | 9                  | 9        | 5               | 5        | 2                         | 2        | 4                     | 4        | 3                      | 3        | 2                                   | 2        |
| Dr CG Roberts       | 9                  | 9        | -               | -        | 2                         | 2        | -                     | -        | -                      | -        | 2                                   | 2        |

## Principal activities and review of operations and results

The principal activities and a review of the operations of Cochlear during the year ended 30 June 2011, and the results of these operations are set out in the CEO/President's Report and the Financial Discussion and Analysis sections of the Annual Report.

Other than as discussed in the CEO/President's Report and the Financial Discussion and Analysis, there were no significant changes in the nature of those activities during the year ended 30 June 2011.

## Consolidated results

The consolidated results for the financial year are:

|                                    | 2011    | 2010    |
|------------------------------------|---------|---------|
|                                    | \$000   | \$000   |
| Revenue                            | 809,646 | 734,803 |
| Profit before income tax           | 235,137 | 209,351 |
| Net profit                         | 180,114 | 155,152 |
| Basic earnings per share (cents)   | 318.2   | 275.7   |
| Diluted earnings per share (cents) | 316.1   | 274.2   |

## 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<br>\$000 | Date of payment   | Tax rate for<br>franking credit |
|--|-----------------|-----------------------|-------------------|---------------------------------|
| In respect of the previous financial year: |                 |                       |                   |                                 |
| Final - ordinary shares                    | 105.0           | 59,404                | 23 September 2010 | 30%                             |
| In respect of the current financial year:  |                 |                       |                   |                                 |
| Interim - ordinary shares                  | 105.0           | 59,544                | 15 March 2011     | 30%                             |

All the dividends paid or declared by the Company since the end of the previous financial year were 60% 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 2011. Since the end of the financial year, the directors declared a final 120.0 cents per share dividend, 70% franked at the tax rate of 30%, amounting to a total of \$68,233,774.

## Environmental regulations

Cochlear's operations are not subject to any significant environmental regulations under either Commonwealth of Australia or State/Territory legislation. However, the Board believes that Cochlear 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 Cochlear.

## Non-audit services

During the year, KPMG, the Company's auditor, has performed certain other services in addition to its statutory duties. The Board has considered the non-audit services provided during the year by the auditor and in accordance with written advice provided by resolution of the Audit Committee, is satisfied that the provision of those non-audit services during the year by the auditor is compatible with, and did not compromise, the auditor independence requirements of the Corporations Act 2001 for the following reasons:

- all non-audit services were subject to the corporate governance procedures adopted by the Company and have been reviewed by the Audit Committee to ensure that they do not impact the integrity and objectivity of the auditor; and
- the non-audit services provided do not undermine the general principles relating to auditor independence as set out in APES 110 Code of Ethics for Professional Accountants, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision-making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

Details of the amounts paid to the auditor of the Company, KPMG, and its related practices for audit and non-audit services during the year are set out below:

|   | Consolidated     |                  |
|---|------------------|------------------|
|   | 2011             | 2010             |
|   | \$               | \$               |
| <b>Audit services</b>                   |                  |                  |
| Auditors of the Company:                |                  |                  |
| KPMG Australia:                         |                  |                  |
| - audit and review of financial reports | 587,000          | 552,700          |
| - other audit services                  | 106,000          | -                |
| - other regulatory compliance services  | 21,400           | 6,978            |
| Overseas KPMG firms:                    |                  |                  |
| - audit and review of financial reports | 542,668          | 564,978          |
| - other regulatory compliance services  | 3,638            | 12,579           |
| <b>Total audit services</b>             | <b>1,260,706</b> | <b>1,137,235</b> |
| <b>Non-audit services</b>               |                  |                  |
| Auditors of the Company:                |                  |                  |
| KPMG Australia:                         |                  |                  |
| - taxation compliance services          | 1,017,013        | 589,651          |
| - other tax related services            | -                | 107,043          |
| Overseas KPMG firms:                    |                  |                  |
| - taxation compliance services          | 445,753          | 461,149          |
| <b>Total non-audit services</b>         | <b>1,462,766</b> | <b>1,157,843</b> |

#### State of affairs

There were no significant changes to the state of affairs of Cochlear during the financial year.

#### Likely developments

Further information as to likely developments in the operations of Cochlear 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 Cochlear.

## Remuneration Report – audited

Key management personnel have authority and responsibility for planning, directing and controlling the activities of Cochlear, including directors of the Company and other executives. Key management personnel comprise the directors of the Company and senior executives for Cochlear including the five most highly remunerated Company and Group executives.

### Remuneration Committee

The Remuneration Committee operates under delegated authority of the Board. The Remuneration Committee approves the remuneration policy and structure for senior executives (being the executive director and other executives named in this report) and makes recommendations to the Board on the total remuneration packages of each senior executive.

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

From 1 July 2011, all proposed remuneration consultancy contracts (within the meaning of section 206K of the Corporations Act 2001) will be subject to prior approval by the Board or the Remuneration Committee in accordance with the Corporations Act 2001.

### Remuneration policies

The Board recognises that Cochlear's performance is dependent on the quality of its people. To successfully achieve its financial and operating objectives in a complex and global environment, Cochlear must be able to attract, motivate and retain highly skilled senior executives who are dedicated to the interests of shareholders. Cochlear 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, motivate and retain senior executive talent;
- a significant proportion (up to 70% of total fixed remuneration) of total senior executive remuneration linked to financial performance and business objectives, under the Cochlear Management Short Term Incentive Plan (CMSTIP);
- a significant proportion (up to 70% of total fixed remuneration) of total senior executive remuneration linked to the creation of long-term value for shareholders under the Cochlear Executive Long Term Incentive Plan (CELTIP); and
- a requirement that all directors and senior executives achieve and then maintain a holding of shares or vested options equivalent to or greater than one year's fixed remuneration through direct acquisition of shares or by acquiring and retaining rights to vested options and performance shares.

The Remuneration Policy assists Cochlear 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

### Chief Executive Officer and other senior executives

Remuneration of the Chief Executive Officer and other senior executives is based on policies and programs under the following categories:

- total 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 a balance between fixed and variable remuneration. Variable remuneration is tied to performance and is at risk. The table below details the percentage remuneration components of the directors and senior executives at target levels of performance:

|   | Fixed       | Variable or at risk remuneration |                  |
|---|-------------|----------------------------------|------------------|
|   | Base salary | Short-term bonus                 | Long-term equity |
| <b>Directors</b>  |             |                                  |                  |
| Mr R Holliday-Smith<br>(Chairman)                                   | 100%        | -                                | -                |
| Mrs YA Allen  | 100%        | -                                | -                |
| Mr PR Bell  | 100%        | -                                | -                |
| Prof E Byrne, AO  | 100%        | -                                | -                |
| Mr A Denver   | 100%        | -                                | -                |
| Mr DP O'Dwyer   | 100%        | -                                | -                |
| Dr CG Roberts<br>(CEO/President)                                    | 42%         | 29%                              | 29%              |
| <b>Executives - Consolidated Entity</b>                             |             |                                  |                  |
| Mr R Brook<br>(President, European Region)                          | 62%         | 19%                              | 19%              |
| Mr NJ Mitchell*<br>(Chief Financial Officer and Company Secretary)  | 56%         | 22%                              | 22%              |
| Mr MD Salmon*<br>(President, Asia Pacific Region)                   | 52%         | 24%                              | 24%              |
| Mr CM Smith<br>(President, Americas Region)                         | 54%         | 23%                              | 23%              |
| Mr DN Morris*<br>(President, Bone Anchored Solutions)               | 56%         | 22%                              | 22%              |
| <b>Executives - Company</b>   |             |                                  |                  |
| Mr D Howitt<br>(Senior Vice President, Manufacturing and Logistics) | 56%         | 22%                              | 22%              |
| Mr J Janssen<br>(Senior Vice President, Design and Development)     | 56%         | 22%                              | 22%              |

\* Senior executive of Consolidated Entity and the Company.

### Service contracts

Cochlear does not enter into service contracts for senior executives, other than 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; the President, European Region has a notice period of six months; and the President, Americas Region has a notice period of 60 calendar days;
- the President, European Region will receive a maximum of Swiss francs (CHF) 30,000 for repatriation costs in the case of termination or resignation; and
- the President, Americas Region will be entitled to 12 months' base pay if his employment is terminated for reasons other than serious misconduct.

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 including comparable Australian Securities Exchange (ASX) listed companies based on market capital and revenue, 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. In July 2005, members of the legacy defined benefit plan were given the opportunity to transfer to the accumulation fund. Ongoing contributions are based on the estimated required company contributions, using the plan actuarial assessments to ensure that employees are not adversely prejudiced by the move. The transfer of all executive members was completed in the first half of the 2006 financial year.

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 Cochlear's short-term and long-term performance goals. Participation in these plans encourages greater involvement by senior executives to share in the future growth, prosperity and profitability of Cochlear in a way that gives them a community of interest with shareholders.

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

## Cochlear Management Short Term Incentive Plan

Short-term incentives for senior executives are determined under the CMSTIP. 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 strategy and objectives and the financial performance of Cochlear. Financial measures include targets of revenue and earnings before interest and tax. 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 and the range is 30% to 70% of total fixed remuneration for achieving all budgeted targets. In years of exceptional performance, the short-term incentives could increase to 100% of total fixed remuneration.

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 other senior executives. These are dependent on financial objectives and agreement between the CEO/President and the senior executive on individual performance goals; and
- the CEO/President and the other senior executives and then 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 their appropriateness having regard to Cochlear's overall financial results. After this assessment, the Remuneration Committee makes its recommendation to the Board for payment. Once approved by the Board, the short-term incentive awards are paid to participants. This occurs on a half and full year basis.

## Cochlear Executive Long Term Incentive Plan

The 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 of Cochlear Limited) and performance shares (being fully paid ordinary shares of Cochlear Limited).

The number of options and performance shares offered to a senior executive depends on their fixed remuneration and Cochlear'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.

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 preliminary final report to the ASX in August each year. All options refer to options over ordinary shares of Cochlear Limited. Each option is convertible to one ordinary share. All performance shares are ordinary shares of Cochlear Limited. Each performance share equates to one ordinary share.

Options and performance shares granted under the CELTIP are subject to vesting conditions. Under these vesting conditions participants are restricted from any trading of performance shares or options until vesting conditions are met. Cochlear also prohibits CELTIP participants from hedging unvested options and performance shares. Additionally, Cochlear has general policy restricting all employees from "short selling" Cochlear securities.



Both the options and performance shares are subject to performance hurdles and 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 performance hurdles and vesting restrictions are:

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

| Compound annual growth rate of EPS over a three year period |   | Ranking of TSR against S&P/ASX 100 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 time qualifications and relevant performance hurdles are met or on death of the employee.

There are no voting or dividend rights attached to options. There are no voting rights attached to the unvested 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. Participants may direct the plan trustee to exercise votes attaching to shares held in trust for them.

Dividends paid to the trust in respect of performance shares are, in turn, paid to the relevant senior executives during the vesting period. Voting rights are not transferred but are attached to the performance shares once ownership is transferred. Dividends are no longer payable once shares are forfeited.

To comply with Long Term Incentive (LTI) obligations, the Board has discretion to issue new shares or purchase shares from the open market.

The following factors and assumptions were used in determining the fair value of options on grant date using the Black-Scholes model:

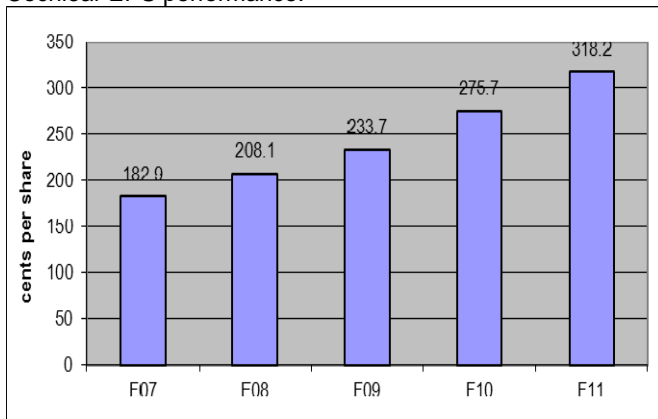
| Grant date     | Option life | Fair value per option | Exercise price | Price of shares on grant date | Expected volatility | Risk free interest rate per annum | Dividend yield per annum |
|----------------|-------------|-----------------------|----------------|-------------------------------|---------------------|-----------------------------------|--------------------------|
| 16 August 2010 | 3 – 5 years | \$9.86                | \$69.80        | \$69.31                       | 34.6%               | 4.49%                             | 2.60%                    |

Performance shares granted on 16 August 2010 have a fair value of \$41.26.

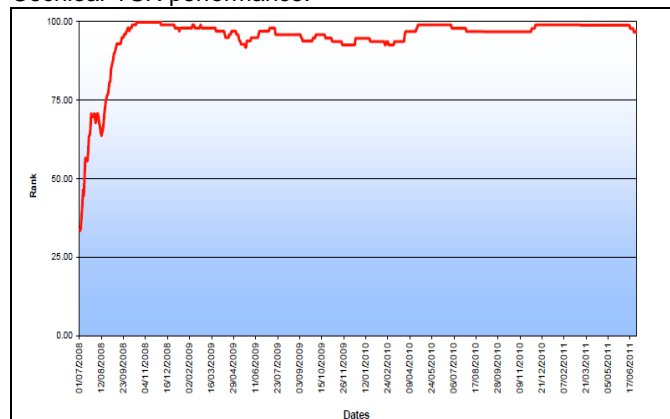
**Performance of Cochlear in current CELTIP cycle**

Depicted in the charts below is a comparison of basic EPS of Cochlear for the financial years 2007 to 2011 and the TSR performance of Cochlear relative to the S&P/ASX 100 for financial years 2009 to 2011:

Cochlear EPS performance:



Cochlear TSR performance:



For the year ended 30 June 2011, the growth in basic EPS was 15% and the decrease in total return to Cochlear Limited shareholders (as measured from the change in share price plus dividends paid) was 2%. Cochlear's TSR position for F11 is at number 58.

### Consequences of performance on shareholder wealth

In considering Cochlear's performance and benefits for shareholder wealth, the Remuneration Committee has regard to the following indices in respect of the current financial year and the previous four financial years:

| Amounts \$   | 2011   | 2010  | 2009  | 2008    | 2007  |
|--|--------|-------|-------|---------|-------|
| Net profit attributable to equity holders of the parent entity (million) | 180.1  | 155.2 | 130.5 | 115.2   | 100.1 |
| Dividends paid (million)   | 118.9  | 107.1 | 89.5  | 77.9    | 60.4  |
| Share price at 30 June   | 72.00  | 74.32 | 57.70 | 43.65   | 61.00 |
| Change in share price  | (2.32) | 16.62 | 14.05 | (17.35) | 6.37  |

### Executive director

At the date of this Remuneration Report, there is one executive director in office, Dr CG Roberts.

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

Dr CG Roberts' appointment has no fixed term and a notice period of six months. If Cochlear terminates Dr CG Roberts' employment without cause, he will be entitled to receive an amount equivalent to 12 months of his total fixed remuneration plus the amount of benefits under the CMSTIP pro-rated to the date of termination.

Dr CG Roberts participates in the CMSTIP at a value equal to 70% of total fixed remuneration.

Dr CG Roberts participates in the CELTIP at a value equal to 70% of total fixed remuneration. The proportion of CELTIP that is provided between options and performance shares is determined by the Board.

### Non-executive directors

Fees for non-executive directors are based on the nature of the directors' work and their responsibilities. The remuneration rates reflect the complexity of Cochlear and the extent of the geographical regions in which Cochlear operates. In determining the level of fees, survey data on comparable companies is considered. Non-executive directors' fees are recommended by the Remuneration Committee and determined by the Board. Shareholders approve the aggregate amount of non-executive director fees.

Fees are within the aggregate amount approved by shareholders at the AGM in October 2007 of \$1,500,000 a year.

At the date of this report, the Chairman of Cochlear is Mr R Holliday-Smith. His director's fees are set at three times the base fee for non-executive directors. He does not receive any additional fees for serving on committees of the Board.

From 2003, no new non-executive director was entitled to join the Cochlear Limited directors' retirement scheme. Non-executive directors appointed prior to this were members of the scheme, which provided directors with more than five years' service, retirement benefits of up to three times their annual remuneration over the previous three years.

On 23 October 2006, the Board determined that it should implement changes to non-executive director remuneration consistent with developing market practice and guidelines by discontinuing the ongoing accrual of benefits under the existing retirement scheme once the remaining members of the scheme reached their five year service period. The benefits accrued to that date will be indexed by reference to the bank bill rate.

All directors transitioned from the retirement scheme during the year ended 30 June 2007.

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 or the Consolidated Entity.

**Directors' and senior executives' remuneration details**

The following table provides the details of all the directors and the executives of the Company and the Consolidated Entity with the authority and responsibility for planning, directing and controlling the activities of the Company and the Consolidated Entity (key management personnel), including the five most highly remunerated executives of the Company and the Consolidated Entity.

Details of the nature and amount of each major element of remuneration are:

| Amounts \$                             | Year | Fixed remuneration |                                       |                          |                                       |                    | Total     | Variable remuneration |  |                  | Total     | Proportion of total remuneration |                        |                  |
|--|------|--------------------|---------------------------------------|--------------------------|---------------------------------------|--------------------|-----------|-----------------------|--|------------------|-----------|----------------------------------|------------------------|------------------|
|  |      | Short-term         |                                       | Long-term                |                                       |                    |           | Short-term            | Equity compensation <sup>(i), (iv)</sup> |                  |           | Total                            | Perform-ance related % | Equity related % |
|  |      | Salary and fees    | Non-monetary benefits <sup>(ii)</sup> | Super-annuation benefits | Termination benefits <sup>(iii)</sup> | Long service leave |           |                       | Bonus <sup>(i)</sup>                     | Value of options |           |                                  |                        |                  |
| <b>Directors</b>                       |      |                    |                                       |                          |                                       |                    |           |                       |  |                  |           |                                  |                        |                  |
| <b>Non-executive</b>                   |      |                    |                                       |                          |                                       |                    |           |                       |  |                  |           |                                  |                        |                  |
| Mr R Holliday-Smith (Chairman)         | 2011 | 439,943            | -                                     | 15,199                   | -                                     | -                  | 455,142   | -                     | -  | -                | -         | 455,142                          | -                      | -                |
|  | 2010 | 188,332            | -                                     | 14,544                   | -                                     | -                  | 202,876   | -                     | -  | -                | -         | 202,876                          | -                      | -                |
| Mrs YA Allen (Appointed 2 August 2010) | 2011 | 163,846            | -                                     | 13,657                   | -                                     | -                  | 177,503   | -                     | -  | -                | -         | 177,503                          | -                      | -                |
|  | 2010 | -                  | -                                     | -                        | -                                     | -                  | -         | -                     | -  | -                | -         | -                                | -                      | -                |
| Mr PR Bell                             | 2011 | 171,043            | -                                     | 14,703                   | -                                     | -                  | 185,746   | -                     | -  | -                | -         | 185,746                          | -                      | -                |
|  | 2010 | 167,563            | -                                     | 14,282                   | -                                     | -                  | 181,845   | -                     | -  | -                | -         | 181,845                          | -                      | -                |
| Mr TCE Bergman (Retired 30 June 2010)  | 2010 | 424,805            | -                                     | 14,461                   | 36,476                                | -                  | 475,742   | -                     | -  | -                | -         | 475,742                          | -                      | -                |
| Prof E Byrne, AO                       | 2011 | 166,135            | -                                     | 14,507                   | 18,288                                | -                  | 198,930   | -                     | -  | -                | -         | 198,930                          | -                      | -                |
|  | 2010 | 149,909            | -                                     | 13,492                   | 14,937                                | -                  | 178,338   | -                     | -  | -                | -         | 178,338                          | -                      | -                |
| Mr A Denver                            | 2011 | 180,620            | -                                     | 15,222                   | -                                     | -                  | 195,842   | -                     | -  | -                | -         | 195,842                          | -                      | -                |
|  | 2010 | 162,371            | -                                     | 14,178                   | -                                     | -                  | 176,549   | -                     | -  | -                | -         | 176,549                          | -                      | -                |
| Mr DP O'Dwyer                          | 2011 | 186,135            | -                                     | 15,263                   | -                                     | -                  | 201,398   | -                     | -  | -                | -         | 201,398                          | -                      | -                |
|  | 2010 | 170,678            | -                                     | 14,345                   | -                                     | -                  | 185,023   | -                     | -  | -                | -         | 185,023                          | -                      | -                |
| <b>Executive</b>                       |      |                    |                                       |                          |                                       |                    |           |                       |  |                  |           |                                  |                        |                  |
| Dr CG Roberts (CEO/President)          | 2011 | 1,200,388          | -                                     | 15,199                   | -                                     | 25,647             | 1,241,234 | 741,411               | 512,648                                  | -                | 1,254,059 | 2,495,293                        | 50.3%                  | 20.5%            |
|  | 2010 | 1,137,844          | -                                     | 14,461                   | -                                     | 28,398             | 1,180,703 | 490,951               | 461,393                                  | -                | 952,344   | 2,133,047                        | 44.6%                  | 21.6%            |

| Amounts \$   | Year | Fixed remuneration |                                       |                          |                    | Total          | Variable remuneration |  |                  | Total          | Proportion of total remuneration |                  |                             |
|--|------|--------------------|---------------------------------------|--------------------------|--------------------|----------------|-----------------------|--|------------------|----------------|----------------------------------|------------------|-----------------------------|
|  |      | Short-term         |                                       | Long-term                |                    |                | Short-term            | Equity compensation <sup>(i), (iv)</sup> |                  |                | Performance related %            | Equity related % |                             |
|  |      | Salary and fees    | Non-monetary benefits <sup>(ii)</sup> | Super-annuation benefits | Long service leave |                |                       | Bonus <sup>(i)</sup>                     | Value of options |                |                                  |                  | Value of performance shares |
| <b>Executives</b>  |      |                    |                                       |                          |                    |                |                       |  |                  |                |                                  |                  |                             |
| <b>Consolidated Entity</b>   |      |                    |                                       |                          |                    |                |                       |  |                  |                |                                  |                  |                             |
| Mr R Brook <sup>(v), (vi)</sup><br><small>(President, European Region)</small>                               | 2011 | 440,286            | 89,441                                | 37,659                   | -                  | <b>567,386</b> | 175,914               | 142,603                                  | -                | <b>318,517</b> | <b>885,903</b>                   | 36.0%            | 16.1%                       |
|  | 2010 | 422,945            | 66,293                                | 36,208                   | -                  | <b>525,446</b> | 141,396               | 142,283                                  | -                | <b>283,679</b> | <b>809,125</b>                   | 35.1%            | 17.6%                       |
| Mr NJ Mitchell <sup>(v), (vi), (vii)</sup><br><small>(Chief Financial Officer and Company Secretary)</small> | 2011 | 440,899            | -                                     | 116,532                  | 15,336             | <b>572,767</b> | 183,697               | 160,034                                  | -                | <b>343,731</b> | <b>916,498</b>                   | 37.5%            | 17.5%                       |
|  | 2010 | 425,506            | -                                     | 108,188                  | 16,898             | <b>550,592</b> | 140,589               | 146,475                                  | -                | <b>287,064</b> | <b>837,656</b>                   | 34.3%            | 17.5%                       |
| Mr MD Salmon <sup>(v), (vi), (vii)</sup><br><small>(President, Asia Pacific Region)</small>                  | 2011 | 474,221            | -                                     | 15,199                   | 9,279              | <b>498,699</b> | 211,141               | 154,437                                  | -                | <b>365,578</b> | <b>864,277</b>                   | 42.3%            | 17.9%                       |
|  | 2010 | 457,002            | -                                     | 14,461                   | 12,702             | <b>484,165</b> | 131,833               | 137,905                                  | -                | <b>269,738</b> | <b>753,903</b>                   | 35.8%            | 18.3%                       |
| Mr CM Smith <sup>(v), (vi)</sup><br><small>(President, Americas Region)</small>                              | 2011 | 468,875            | 21,948                                | 12,997                   | -                  | <b>503,820</b> | 182,804               | 111,084                                  | 69,149           | <b>363,037</b> | <b>866,857</b>                   | 41.9%            | 20.8%                       |
|  | 2010 | 486,021            | 23,969                                | 14,023                   | -                  | <b>524,013</b> | 196,218               | 136,739                                  | 39,690           | <b>372,647</b> | <b>896,660</b>                   | 41.6%            | 19.7%                       |
| Mr DN Morris <sup>(v), (vii)</sup><br><small>(President, Bone Anchored Solutions)</small>                    | 2011 | 422,213            | -                                     | 15,199                   | 10,526             | <b>447,938</b> | 152,106               | 119,033                                  | -                | <b>271,139</b> | <b>719,077</b>                   | 37.7%            | 16.6%                       |
|  | 2010 | 412,168            | -                                     | 14,461                   | 9,379              | <b>436,008</b> | 118,891               | 110,085                                  | -                | <b>228,976</b> | <b>664,984</b>                   | 34.4%            | 16.6%                       |
| <b>Company</b>   |      |                    |                                       |                          |                    |                |                       |  |                  |                |                                  |                  |                             |
| Mr D Howitt <sup>(v)</sup><br><small>(Senior Vice President, Manufacturing and Logistics)</small>            | 2011 | 411,962            | -                                     | 15,199                   | 17,031             | <b>444,192</b> | 148,048               | 114,342                                  | -                | <b>262,390</b> | <b>706,582</b>                   | 37.1%            | 16.2%                       |
|  | 2010 | 396,557            | -                                     | 14,461                   | 12,454             | <b>423,472</b> | 114,939               | 103,360                                  | -                | <b>218,299</b> | <b>641,771</b>                   | 34.0%            | 16.1%                       |
| Mr J Janssen <sup>(v), (vi)</sup><br><small>(Senior Vice President, Design and Development)</small>          | 2011 | 416,498            | -                                     | 15,199                   | 10,238             | <b>441,935</b> | 150,385               | 117,973                                  | -                | <b>268,358</b> | <b>710,293</b>                   | 37.8%            | 16.6%                       |
|  | 2010 | 404,345            | -                                     | 14,461                   | 8,984              | <b>427,790</b> | 117,415               | 112,279                                  | -                | <b>229,694</b> | <b>657,484</b>                   | 34.9%            | 17.1%                       |

- (i) Short-term and long-term incentive bonuses are granted annually. The grant date is tied to the performance appraisal, which for the current year was completed by 30 June 2011. The service and performance criteria are set out in this report.
- (ii) Benefits include the provision of car allowances, health insurance and relocation costs.
- (iii) Amounts accrued for interest during the financial year to the directors' retirement scheme.
- (iv) The value disclosed above is the proportion of the fair value of the options and performance shares allocated to the financial year. The ability to exercise the options and performance shares is conditional on Cochlear achieving certain performance hurdles. The estimated value of options for the current financial year is calculated at the date of grant using the Black-Scholes model. Further details of options granted during the financial year are set out below. The value of performance shares for the current financial year is calculated as the share price at the date of issue discounted for vesting probabilities.
- (v) Executive is included as one of the five named Company executives or Consolidated Entity executives who received the highest remuneration in the current financial year in accordance with section 300A of the Corporations Act 2001.
- (vi) Executive is included as a key management person in accordance with AASB 124 Related Party Disclosures.
- (vii) Denotes Consolidated Entity and Company executives.

### Exercise of options granted as remuneration

During the financial year, the following shares were issued on the exercise of options previously granted as compensation:

|                            | Number of shares | Amount paid \$/share |
|----------------------------|------------------|----------------------|
| <b>Executive director</b>  |                  |                      |
| Dr CG Roberts              | 64,718           | 49.43                |
| <b>Executives</b>          |                  |                      |
| <b>Consolidated Entity</b> |                  |                      |
| Mr R Brook                 | 36,469           | 55.13                |
| Mr NJ Mitchell             | 31,014           | 55.45                |
| Mr MD Salmon               | 16,929           | 49.43                |
| Mr CM Smith                | 21,512           | 52.63                |
| Mr DN Morris               | 14,848           | 49.43                |
| <b>Company</b>             |                  |                      |
| Mr D Howitt                | 23,435           | 55.65                |
| Mr J Janssen               | 31,120           | 54.56                |

During the previous financial year, 189,220 options were exercised. There are no amounts unpaid on the shares issued as a result of the exercise of the options in prior years.

### Analysis of bonuses included in remuneration

Details of the vesting profile of the short-term incentive cash bonuses awarded as remuneration to each executive director of the Company and each of the five named Company executives and relevant Consolidated Entity executives are detailed below:

| Amounts \$                 | Included in remuneration | Short-term incentive bonus                |   |
|----------------------------|--------------------------|---|---|
|                            |                          | % vested in financial year <sup>(i)</sup> | % forfeited during financial year <sup>(ii)</sup> |
| <b>Executive director</b>  |                          |   |   |
| Dr CG Roberts              | 741,411                  | 87.2%                                     | 12.8%   |
| <b>Executives</b>          |                          |   |   |
| <b>Consolidated Entity</b> |                          |   |   |
| Mr R Brook                 | 175,914                  | 93.9%                                     | 6.1%  |
| Mr NJ Mitchell             | 183,697                  | 87.5%                                     | 12.5%   |
| Mr MD Salmon               | 211,141                  | 95.8%                                     | 4.2%  |
| Mr CM Smith                | 182,804                  | 85.1%                                     | 14.9%   |
| Mr DN Morris               | 152,106                  | 87.0%                                     | 13.0%   |
| <b>Company</b>             |                          |   |   |
| Mr D Howitt                | 148,048                  | 86.7%                                     | 13.3%   |
| Mr J Janssen               | 150,385                  | 86.9%                                     | 13.1%   |

(i) Amounts included in remuneration for the financial year represent the amounts that vested in the financial year based on achievement of personal goals and satisfaction of specified performance goals. No amounts vest in future financial years in respect of the CMSTIP for the 2011 financial year.

(ii) The amounts forfeited in short-term incentive bonuses are due to the personal and specified performance service goals not being met in the current financial year.

**Analysis of share based payments granted as remuneration**

Details of the vesting profile of the options and performance shares granted as remuneration to each director of the Company and each of the five named Company executives and relevant Consolidated Entity executives are set out below:

|                                       | Date of grant <sup>(i)</sup> | Options        |                            |  | Performance shares |                            |  |                                 |  |
|---------------------------------------|------------------------------|----------------|----------------------------|--|--------------------|----------------------------|--|---------------------------------|--|
|                                       |                              | Number granted | % vested in financial year | % forfeited in financial year <sup>(i)</sup> | Number granted     | % vested in financial year | % forfeited in financial year <sup>(i)</sup> | Value Min <sup>(ii)</sup><br>\$ | Yet to vest Max <sup>(iii)</sup><br>\$ |
| <b>Executive director</b>             |                              |                |                            |  |                    |                            |  |                                 |  |
| Dr CG Roberts                         | 20 August 2007               | 59,088         | 87%                        | 13%  | -                  | -                          | -  | -                               | -                                      |
|                                       | 18 August 2008               | 101,412        | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 17 August 2009               | 58,599         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 16 August 2010               | 86,272         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
| <b>Executives Consolidated Entity</b> |                              |                |                            |  |                    |                            |  |                                 |  |
| Mr R Brook                            | 20 August 2007               | 17,422         | 87%                        | 13%  | -                  | -                          | -  | -                               | -                                      |
|                                       | 18 August 2008               | 30,285         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 17 August 2009               | 19,663         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 16 August 2010               | 17,674         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
| Mr NJ Mitchell                        | 20 August 2007               | 15,644         | 87%                        | 13%  | -                  | -                          | -  | -                               | -                                      |
|                                       | 18 August 2008               | 35,824         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 17 August 2009               | 20,686         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 16 August 2010               | 21,302         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
| Mr MD Salmon                          | 20 August 2007               | 14,891         | 87%                        | 13%  | -                  | -                          | -  | -                               | -                                      |
|                                       | 18 August 2008               | 33,446         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 17 August 2009               | 19,344         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 16 August 2010               | 22,363         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
| Mr CM Smith                           | 20 August 2007               | 12,577         | 87%                        | 13%  | 2,377              | 87%                        | 13%  | -                               | -                                      |
|                                       | 18 August 2008               | 29,714         | -                          | -  | 1,726              | -                          | -  | -                               | 38,783                                 |
|                                       | 17 August 2009               | 22,379         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 16 August 2010               | -              | -                          | -  | 5,781              | -                          | -  | -                               | 238,177                                |
| Mr DN Morris                          | 20 August 2007               | 13,296         | 87%                        | 13%  | -                  | -                          | -  | -                               | -                                      |
|                                       | 18 August 2008               | 25,074         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 17 August 2009               | 14,505         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 16 August 2010               | 17,740         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
| <b>Company</b>                        |                              |                |                            |  |                    |                            |  |                                 |  |
| Mr D Howitt                           | 20 August 2007               | 12,211         | 87%                        | 13%  | -                  | -                          | -  | -                               | -                                      |
|                                       | 18 August 2008               | 24,032         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 17 August 2009               | 13,903         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 16 August 2010               | 17,312         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
| Mr J Janssen                          | 20 August 2007               | 13,396         | 87%                        | 13%  | -                  | -                          | -  | -                               | -                                      |
|                                       | 18 August 2008               | 24,819         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 17 August 2009               | 14,358         | -                          | -  | -                  | -                          | -  | -                               | -                                      |
|                                       | 16 August 2010               | 17,559         | -                          | -  | -                  | -                          | -  | -                               | -                                      |

(i) The percentage forfeited in the financial year represents the reduction from the maximum number of options and performance shares available to vest due to EPS, TSR or employee service periods not being met.

(ii) The minimum value of performance shares yet to vest is nil as the performance criteria may not be met and consequently, the performance shares may not vest.

(iii) The maximum value of performance shares yet to vest is not determinable as it depends on the market price of shares of the Company on the ASX at the date the performance shares vest. The maximum values disclosed above are based on the valuations as per this report.

(iv) Options and performance shares vest three years after their initial grant date.

### Analysis of movements in options

The movement in value during the financial year of options over ordinary shares of Cochlear Limited held by each Company director and each of the five named Company executives and relevant Consolidated Entity executives is detailed below:

|                            | Value of options               |                                   |                                   |
|----------------------------|--------------------------------|-----------------------------------|-----------------------------------|
|                            | Granted in year <sup>(i)</sup> | Exercised in year <sup>(ii)</sup> | Forfeited in year <sup>(ii)</sup> |
|                            | \$                             | \$                                | \$                                |
| <b>Executive director</b>  |                                |                                   |                                   |
| Dr CG Roberts              | 850,642                        | 1,737,372                         | 152,274                           |
| <b>Executives</b>          |                                |                                   |                                   |
| <b>Consolidated Entity</b> |                                |                                   |                                   |
| Mr R Brook                 | 174,266                        | 742,592                           | 44,891                            |
| Mr NJ Mitchell             | 210,038                        | 587,269                           | 40,320                            |
| Mr MD Salmon               | 220,499                        | 384,965                           | 38,375                            |
| Mr CM Smith                | -                              | 443,954                           | 32,404                            |
| Mr DN Morris               | 174,916                        | 364,518                           | 34,271                            |
| <b>Company</b>             |                                |                                   |                                   |
| Mr D Howitt                | 170,696                        | 302,423                           | 31,470                            |
| Mr J Janssen               | 173,132                        | 541,105                           | 34,524                            |

(i) The value of options granted in the year is the fair value of the options calculated at grant date using the Black-Scholes model. The total value of the options granted is included in the table above. This amount is allocated to remuneration over the vesting period (i.e. in years 30 June 2013 to 30 June 2015).

(ii) The value of options exercised and forfeited during the year is calculated as the market price of shares of the Company on the ASX as at close of trading on the date the options were exercised or forfeited after deducting the price paid or payable to exercise the option.

### Other items – unaudited

#### Unissued shares under option

At the date of this report, unissued ordinary shares of the Company under options are:

| Number of options | Plan   | Exercise price per share | Exercise period              |
|-------------------|--------|--------------------------|------------------------------|
| 168,756           | CELTIP | \$63.18                  | August 2010 – September 2012 |
| 696,113           | CELTIP | \$49.91                  | August 2011 – September 2013 |
| 418,905           | CELTIP | \$60.04                  | August 2012 – September 2014 |
| 435,677           | CELTIP | \$69.80                  | August 2013 – September 2015 |

These options do not entitle the holder to participate in any share issue of the Company or any other body corporate.

The closing share price at 30 June 2011 was \$72.00.

During the financial year, the Company granted 443,498 options over 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 final report for the year ending 30 June 2013. The number of options which will be exercisable is dependent on the performance measures and retention requirements set out in this Remuneration Report.

During the year, 70,728 options granted by the Company were forfeited.

### 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 |
|---------------------|----------------------------------|------------------------------|
| Mr R Holliday-Smith | 5,500                            | -                            |
| Mrs YA Allen        | 2,500                            | -                            |
| Mr PR Bell          | 2,500                            | -                            |
| Prof E Byrne, AO    | 2,000                            | -                            |
| Mr A Denver         | 2,500                            | -                            |
| Mr DP O'Dwyer       | 3,350                            | -                            |
| Dr CG Roberts       | 725,310                          | 297,542                      |

### Indemnification of officers

Under the terms of Article 35 of the Company's Constitution, and to the extent permitted by law, the Company has indemnified the directors of the Company named in this 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
- costs and expenses of successfully defending legal proceedings in which relief under the Corporations Act 2001 is granted to the relevant officer.

### Insurance premiums

During the financial year, the Company paid a premium for Directors' and Officers' Liability Insurance policy and a Supplementary Legal Expenses Insurance policy. The insurance provides a cover for the directors named in this Directors' Report, the Company Secretary, and officers and former directors and officers of the Company. The insurance also provides cover for present and former directors and officers of other companies in the Consolidated Entity. The directors have not included in this report 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.

### Events subsequent to the reporting date

Other than the matter noted below, there has not arisen in the interval between the end of the financial year and the date of this Directors' 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 Cochlear, the results of those operations, or the state of affairs of Cochlear in future financial years:

### Dividends

For dividends declared after 30 June 2011, see Note 9 to the financial statements.



**Lead auditor's independence declaration**

The lead auditor's independence declaration is set out on page 16 and forms part of the Directors' Report for the financial year ended 30 June 2011.

**Rounding off**

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

Dated at Sydney this 9th day of August 2011.

Signed in accordance with a resolution of the directors:



Director



Director

AUDITOR'S INDEPENDENCE DECLARATION

**Lead auditor's independence declaration under section 307C of the Corporations Act 2001**

To: the directors of Cochlear Limited

I declare that, to the best of my knowledge and belief, in relation to the audit for the year ended 30 June 2011 there have been:

- (i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the audit.



KPMG

Kevin Leighton, Partner

Sydney, 9 August 2011

|  |      | 2011           | 2010            |
|--|------|----------------|-----------------|
|  | Note | \$000          | \$000           |
| Revenue                                  | 5(a) | 809,646        | 734,803         |
| Cost of sales                            | 5(b) | (228,486)      | (202,191)       |
| <b>Gross profit</b>                      |      | <b>581,160</b> | <b>532,612</b>  |
| Other income                             | 5(c) | 7,906          | 9,064           |
| Selling and general expenses             |      | (196,237)      | (183,705)       |
| Administration expenses                  |      | (43,699)       | (43,722)        |
| Research and development expenses        | 5(b) | (108,935)      | (94,897)        |
| <b>Results from operating activities</b> |      | <b>240,195</b> | <b>219,352</b>  |
| Finance income                           | 6    | 3,608          | 2,406           |
| Finance expense                          | 6    | (8,666)        | (12,407)        |
| <b>Net finance expense</b>               |      | <b>(5,058)</b> | <b>(10,001)</b> |
| <b>Profit before income tax</b>          |      | <b>235,137</b> | <b>209,351</b>  |
| Income tax expense                       | 8    | (55,023)       | (54,199)        |
| <b>Net profit</b>                        |      | <b>180,114</b> | <b>155,152</b>  |
| Basic earnings per share (cents)         | 11   | 318.2          | 275.7           |
| Diluted earnings per share (cents)       | 11   | 316.1          | 274.2           |

The notes on pages 22 to 69 are an integral part of these consolidated financial statements.

STATEMENT OF COMPREHENSIVE INCOME Cochlear Limited and its controlled entities for the year ended 30 June 2011

|  | Note | 2011<br>\$000  | 2010<br>\$000  |
|--|------|----------------|----------------|
| <b>Net profit</b>  |      | <b>180,114</b> | <b>155,152</b> |
| <b>Other comprehensive income</b>  |      |                |                |
| Foreign currency translation differences   | 6    | (15,073)       | (28,562)       |
| Effective portion of changes in fair value of cash flow hedges, net of tax                   | 6    | 64,923         | 52,921         |
| Net change in fair value of cash flow hedges transferred to the income statement, net of tax | 6    | (54,188)       | (27,056)       |
| <b>Total other comprehensive income</b>  |      | <b>(4,338)</b> | <b>(2,697)</b> |
| <b>Total comprehensive income</b>  |      | <b>175,776</b> | <b>152,455</b> |

The notes on pages 22 to 69 are an integral part of these consolidated financial statements.

|   | Note   | 2011<br>\$000  | 2010<br>\$000  |
|---|--------|----------------|----------------|
| <b>Assets</b>   |        |                |                |
| Cash and cash equivalents                                 | 22(a)  | 72,423         | 42,808         |
| Trade and other receivables                               | 12     | 238,276        | 210,690        |
| Capitalised building costs – construction of Headquarters | 28     | -              | 74,326         |
| Inventories   | 13     | 106,126        | 104,407        |
| Current tax assets  | 16     | 3,936          | 7,695          |
| Prepayments   |        | 9,123          | 7,962          |
| <b>Total current assets</b>                               |        | <b>429,884</b> | <b>447,888</b> |
| Trade and other receivables                               | 12     | 17,184         | 25,143         |
| Property, plant and equipment                             | 14     | 69,357         | 49,597         |
| Intangible assets   | 15     | 208,550        | 211,839        |
| Deferred tax assets                                       | 16     | 16,072         | 17,252         |
| <b>Total non-current assets</b>                           |        | <b>311,163</b> | <b>303,831</b> |
| <b>Total assets</b>                                       |        | <b>741,047</b> | <b>751,719</b> |
| <b>Liabilities</b>  |        |                |                |
| Trade and other payables                                  |        | 85,047         | 70,763         |
| Loans and borrowings – operations                         | 17     | 60,000         | -              |
| Loans and borrowings – construction of Headquarters       | 17, 28 | -              | 73,811         |
| Current tax liabilities                                   | 16     | 17,288         | 12,630         |
| Provisions  | 19     | 42,393         | 36,896         |
| Deferred revenue  |        | 18,732         | 19,048         |
| <b>Total current liabilities</b>                          |        | <b>223,460</b> | <b>213,148</b> |
| Trade and other payables                                  |        | -              | 5,724          |
| Loans and borrowings – operations                         | 17     | 3,040          | 82,934         |
| Provisions  | 19     | 11,264         | 11,605         |
| <b>Total non-current liabilities</b>                      |        | <b>14,304</b>  | <b>100,263</b> |
| <b>Total liabilities</b>                                  |        | <b>237,764</b> | <b>313,411</b> |
| <b>Net assets</b>   |        | <b>503,283</b> | <b>438,308</b> |
| <b>Equity</b>   |        |                |                |
| Share capital   |        | 119,737        | 117,016        |
| Reserves  |        | 23,357         | 22,269         |
| Retained earnings   |        | 360,189        | 299,023        |
| <b>Total equity</b>                                       |        | <b>503,283</b> | <b>438,308</b> |

The notes on pages 22 to 69 are an integral part of these consolidated financial statements.

## STATEMENT OF CHANGES IN EQUITY Cochlear Limited and its controlled entities for the year ended 30 June 2011

| Amounts \$000  | Issued capital | Treasury reserve | Translation reserve | Hedging reserve | Share based payment reserve | Retained earnings | Total equity   |
|--|----------------|------------------|---------------------|-----------------|-----------------------------|-------------------|----------------|
| <b>2010</b>  |                |                  |                     |                 |                             |                   |                |
| Balance at 1 July 2009   | 99,427         | (1,992)          | (22,214)            | 19,779          | 18,274                      | 250,960           | 364,234        |
| <b>Total comprehensive income</b>  |                |                  |                     |                 |                             |                   |                |
| Net profit   | -              | -                | -                   | -               | -                           | 155,152           | 155,152        |
| <b>Other comprehensive income</b>  |                |                  |                     |                 |                             |                   |                |
| Foreign currency translation differences   | -              | -                | (28,562)            | -               | -                           | -                 | (28,562)       |
| Effective portion of changes in fair value of cash flow hedges, net of tax                   | -              | -                | -                   | 52,921          | -                           | -                 | 52,921         |
| Net change in fair value of cash flow hedges transferred to the income statement, net of tax | -              | -                | -                   | (27,056)        | -                           | -                 | (27,056)       |
| <b>Total other comprehensive income</b>  | -              | -                | <b>(28,562)</b>     | <b>25,865</b>   | -                           | -                 | <b>(2,697)</b> |
| <b>Total comprehensive income</b>  | -              | -                | <b>(28,562)</b>     | <b>25,865</b>   | -                           | <b>155,152</b>    | <b>152,455</b> |
| <b>Transactions with owners, recorded directly in equity</b>                                 |                |                  |                     |                 |                             |                   |                |
| Shares issued  | 20,415         | (834)            | -                   | -               | -                           | -                 | 19,581         |
| Share based payment transactions   | -              | -                | -                   | -               | 9,127                       | -                 | 9,127          |
| Dividends to shareholders  | -              | -                | -                   | -               | -                           | (107,089)         | (107,089)      |
| <b>Balance at 30 June 2010</b>   | <b>119,842</b> | <b>(2,826)</b>   | <b>(50,776)</b>     | <b>45,644</b>   | <b>27,401</b>               | <b>299,023</b>    | <b>438,308</b> |
| <b>2011</b>  |                |                  |                     |                 |                             |                   |                |
| Balance at 1 July 2010   | 119,842        | (2,826)          | (50,776)            | 45,644          | 27,401                      | 299,023           | 438,308        |
| <b>Total comprehensive income</b>  |                |                  |                     |                 |                             |                   |                |
| Net profit   | -              | -                | -                   | -               | -                           | 180,114           | 180,114        |
| <b>Other comprehensive income</b>  |                |                  |                     |                 |                             |                   |                |
| Foreign currency translation differences   | -              | -                | (15,073)            | -               | -                           | -                 | (15,073)       |
| Effective portion of changes in fair value of cash flow hedges, net of tax                   | -              | -                | -                   | 64,923          | -                           | -                 | 64,923         |
| Net change in fair value of cash flow hedges transferred to the income statement, net of tax | -              | -                | -                   | (54,188)        | -                           | -                 | (54,188)       |
| <b>Total other comprehensive income</b>  | -              | -                | <b>(15,073)</b>     | <b>10,735</b>   | -                           | -                 | <b>(4,338)</b> |
| <b>Total comprehensive income</b>  | -              | -                | <b>(15,073)</b>     | <b>10,735</b>   | -                           | <b>180,114</b>    | <b>175,776</b> |
| <b>Transactions with owners, recorded directly in equity</b>                                 |                |                  |                     |                 |                             |                   |                |
| Shares issued  | 3,384          | (663)            | -                   | -               | -                           | -                 | 2,721          |
| Share based payment transactions   | -              | -                | -                   | -               | 5,426                       | -                 | 5,426          |
| Dividends to shareholders  | -              | -                | -                   | -               | -                           | (118,948)         | (118,948)      |
| <b>Balance at 30 June 2011</b>   | <b>123,226</b> | <b>(3,489)</b>   | <b>(65,849)</b>     | <b>56,379</b>   | <b>32,827</b>               | <b>360,189</b>    | <b>503,283</b> |

The notes on pages 22 to 69 are an integral part of these consolidated financial statements.

STATEMENT OF CASH FLOWS Cochlear Limited and its controlled entities for the year ended 30 June 2011

|  | Note  | 2011<br>\$000    | 2010<br>\$000    |
|--|-------|------------------|------------------|
| <b>Cash flows from operating activities</b>                    |       |                  |                  |
| Cash receipts from customers                                   |       | 724,443          | 704,205          |
| Cash paid to suppliers and employees                           |       | (468,257)        | (474,824)        |
| Grant and other income received                                |       | 1,742            | 9,064            |
| Interest received  |       | 821              | 1,510            |
| Interest paid  |       | (6,879)          | (9,373)          |
| Income taxes paid  |       | (50,593)         | (51,036)         |
| <b>Net cash provided by operating activities</b>               | 22(b) | <b>201,277</b>   | <b>179,546</b>   |
| <b>Cash flows from investing activities</b>                    |       |                  |                  |
| Acquisition of property, plant and equipment                   |       | (39,918)         | (17,506)         |
| Acquisition of enterprise resource planning system             |       | (5,426)          | (4,385)          |
| Acquisition of other intangible assets                         |       | (4,213)          | (6,786)          |
| Payments for construction of Headquarters                      |       | (40,957)         | (63,696)         |
| Proceeds from sale of construction of Headquarters             | 28    | 130,302          | -                |
| <b>Net cash provided by/(used in) investing activities</b>     |       | <b>39,788</b>    | <b>(92,373)</b>  |
| <b>Cash flows from financing activities</b>                    |       |                  |                  |
| Proceeds of borrowings – multi-option credit facility          |       | 129,000          | 64,500           |
| Repayments of borrowings – multi-option credit facility        |       | (149,000)        | (158,500)        |
| Proceeds of borrowings – construction of Headquarters          |       | 24,533           | 61,814           |
| Repayments of borrowings – construction of Headquarters        |       | (98,344)         | -                |
| Proceeds from issue of share capital                           |       | 2,721            | 19,581           |
| Dividends paid by the parent entity                            | 9     | (118,948)        | (107,089)        |
| <b>Net cash used in financing activities</b>                   |       | <b>(210,038)</b> | <b>(119,694)</b> |
| <b>Net increase/(decrease) in cash and cash equivalents</b>    |       | <b>31,027</b>    | <b>(32,521)</b>  |
| Cash and cash equivalents, net of overdrafts at 1 July         |       | 42,808           | 80,016           |
| Effects of exchange fluctuation on cash held                   |       | (1,412)          | (4,687)          |
| <b>Cash and cash equivalents, net of overdrafts at 30 June</b> | 22(a) | <b>72,423</b>    | <b>42,808</b>    |

The notes on pages 22 to 69 are an integral part of these consolidated financial statements.

## 1. Reporting entity

Cochlear Limited (the Company) is a company domiciled in Australia. The consolidated financial statements of the Company as at and for the year ended 30 June 2011 comprise the Company and its controlled entities (together referred to as Cochlear or the Consolidated Entity). Cochlear operates in the implantable hearing device industry.

## 2. Basis of preparation

### (a) Statement of compliance

The Financial Report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards (AASBs) (including Australian Accounting Interpretations) adopted by the Australian Accounting Standards Board (AASB) and the Corporations Act 2001. The Financial Report of the Consolidated Entity and the Financial Report of the Company comply with International Financial Reporting Standards (IFRS) and Interpretations adopted by the International Accounting Standards Board (IASB).

The consolidated financial statements were approved by the Board of directors on 9 August 2011.

### (b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments which are measured at fair value. The method used to measure the fair value of derivative instruments is discussed further in Note 3(e).

### (c) Functional and presentation currency

These consolidated financial statements are presented in Australian dollars, which is the Company's functional currency.

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, all financial information presented in Australian dollars has been rounded to the nearest one thousand dollars unless otherwise stated.

### (d) Use of judgements and estimates

The preparation of financial statements in conformity with AASBs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and then reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Management discussed with the Audit Committee the development, selection and disclosure of Cochlear's critical accounting policies and estimates and the application of these policies and estimates.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year is included in the following notes:

Note 15 – Intangible assets

Note 19 – Provisions

Note 20 – Contingent liabilities

Note 25 – Employee benefits

Note 26 – Financial instruments.

## 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and have been applied consistently by all entities in Cochlear.

### (a) Basis of consolidation

#### **Controlled entities**

Controlled entities are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of controlled entities are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of controlled entities have been changed when necessary to align them with the policies adopted by the Consolidated Entity.

Acquisitions of a minority interest in a controlled entity are treated as a transaction with owners. Consequently, the difference between the purchase consideration and the carrying amount of Cochlear's interest in the net assets of the controlled entity is treated as goodwill.



***Transactions eliminated on consolidation***

Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

***Special purpose entities***

Cochlear has established special purpose entities (SPEs) for trading and investment purposes. An SPE is consolidated if, based upon an evaluation of the substance of its relationship with Cochlear and the SPE's risks and rewards, Cochlear concludes that it controls the SPE. SPEs controlled by Cochlear were established under terms that impose strict limitations on decision-making powers of the SPE's management.

**(b) Income 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. Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due or if there is a risk of return of goods or there is continuing management involvement with the goods. 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.

The accounting policy for foreign exchange gains/losses arising from hedges of forecast sales transactions is set out in accounting policy (e).

***Other income***

Other income, including government grants, is recognised on a systematic basis over the periods necessary to match it with the related costs for which it is intended to compensate or, if the costs have already been incurred, in the period in which it becomes receivable. The income is deemed to be receivable when the entitlement is confirmed. Dividend income from subsidiaries is recognised by the parent entity when the dividends are declared by the subsidiary.

**(c) 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 taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the relevant taxation authority is included as a current asset or liability in the balance sheet.

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 relevant taxation authority are classified as operating cash flows.

**(d) Foreign currency**

***Foreign currency transactions***

Transactions in foreign currencies are translated to the respective functional currencies of controlled entities at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities denominated in foreign currencies that are stated at historical cost are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the functional currency at the foreign exchange rates ruling at the date the fair value was determined.

Foreign exchange differences arising on translation are recognised in the income statement.

***Financial statements of foreign operations***

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, generally are translated to the functional currency at foreign exchange rates ruling at the reporting date.

The revenues and expenses of foreign operations are translated to the functional currency at rates approximating the foreign exchange rates ruling at the dates of transactions.

Foreign currency differences arising from translation of controlled entities with a different functional currency to that of Cochlear are recognised in the foreign currency translation reserve (translation reserve). When a foreign operation is disposed of, in part or in full, the relevant amount of its translation reserve is transferred to the income statement and reported as part of the gain or loss on disposal.

Foreign exchange gains and losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future, are considered to form part of a net investment in a foreign operation and are recognised directly in equity in the translation reserve.

## **(e) Financial instruments**

### ***Derivative financial instruments***

Cochlear holds derivative financial instruments to hedge its exposure to foreign exchange risk and interest rate risk arising from operating, investing and financing activities. In accordance with its treasury policy, Cochlear does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

On initial designation of the hedge, Cochlear formally documents the relationship between the hedging instrument and hedged item, including the risk management objectives and strategy in undertaking the hedge transaction, together with the methods that will be used to assess the effectiveness of the hedging relationship. Cochlear makes an assessment, both at inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80% to 125%. For a cash flow hedge of a forecast transaction, the transaction should be highly probable to occur and should present an exposure to variations in cash flows that could ultimately occur.

Derivative financial instruments are recognised initially at fair value. Attributable transaction costs are recognised in the income statement when incurred. Subsequent to initial recognition, derivative financial instruments are measured at fair value with changes in fair value accounted for as described below.

### ***Non-derivative financial assets***

Cochlear initially recognises loans and receivables and deposits on the date that they are originated. All other financial assets (including assets designated at fair value through profit or loss) are recognised initially on the trade date at which Cochlear becomes a party to the contractual provisions of the instrument.

Cochlear derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by Cochlear is recognised as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the balance sheet when, and only when, Cochlear has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Cochlear has the following non-derivative financial assets: financial assets at fair value through profit or loss and loans and receivables.

#### *Financial assets at fair value through profit or loss*

A financial asset is classified as at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if Cochlear manages such investments and makes purchase and sale decisions based on their fair value in accordance with Cochlear's documented risk management or investment strategy. Attributable transaction costs are recognised in profit or loss when incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

#### *Loans and receivables*

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest rate method, less any impairment losses.

Loans and receivables comprise cash and cash equivalents, and trade and other receivables, including service concession receivables.

### ***Non-derivative financial liabilities***

Cochlear initially recognises debt securities issued and subordinated liabilities on the date that they are originated. All other financial liabilities (including liabilities designated at fair value through profit or loss) are recognised initially on the trade date at which Cochlear becomes a party to the contractual provisions of the instrument.

Cochlear derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

Financial assets and liabilities are offset and the net amount presented in the balance sheet when, and only when, Cochlear has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Cochlear classified non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest rate method.

Other financial liabilities comprise loans and borrowings, bank overdrafts and trade and other payables.

Bank overdrafts that are repayable on demand and form an integral part of Cochlear's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Accounting for finance income and expense is discussed in accounting policy (q).

***Determination of fair values***

The fair value of forward exchange contracts is based upon the listed market price, if available. If a listed market price is not available, the fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk free interest rate based upon government bonds.

The fair value of interest rate swaps is based upon broker quotes which are then tested for reasonableness by discounting future estimated cash flows based upon the terms and maturity of each contract and using market interest rates for similar instruments.

***Other***

Other non-derivative financial instruments are measured at amortised cost using the effective interest rate method, less any impairment losses.

***Cash flow hedges***

Changes in the fair value of a derivative financial instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in the income statement.

If the derivative financial instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs or when cash flows arising from the transaction are received.

When the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated cumulative gain or loss is removed from equity and transferred to the carrying amount of the non-financial asset or liability. If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, then the associated gains and losses that were previously recognised directly in equity are reclassified into the income statement in the same period or periods during which the asset acquired or liability assumed affects the income statement.

For cash flow hedges, other than those covered by the preceding statement, the associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period or periods during which the hedged forecast transaction affects the income statement and on the same line item as that hedged forecast transaction. The ineffective part of any gain or loss is recognised immediately in the income statement.

***Hedges of net investment in foreign operations***

Foreign currency differences arising on the retranslation of a financial liability designated as a hedge of a net investment in a foreign operation are recognised in other comprehensive income to the extent that the hedge is effective, and are presented within equity in the translation reserve. To the extent that the hedge is ineffective, such differences are recognised in the income statement. When the hedged part of a net investment is disposed of, the relevant amount in the translation reserve is transferred to the income statement as part of the profit or loss on disposal.

**(f) Cash and cash equivalents**

Cash and cash equivalents comprise cash balances and call deposits with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of Cochlear's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

**(g) Provisions**

A provision is recognised in the balance sheet when Cochlear has a present legal or constructive obligation as a result of a past event that can be measured reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the liability. The unwinding of the discount rate is recognised as a finance cost.

***Warranties***

Provisions for warranty claims are made for claims in relation to sales made prior to the reporting date, based on historical claim rates and respective product populations. Warranty periods on hardware products extend for three to 10 years.

***Onerous contracts***

A provision for onerous contracts is recognised when expected benefits to be derived by Cochlear from a contract are lower than the unavoidable cost of meeting contractual obligations. The provision is measured at the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, Cochlear recognises any impairment loss on the assets associated with the contract.

### **Self-insurance**

Cochlear self-insures to manage certain risks associated with operating in its line of business. Claims are recognised when an incident occurs that may give rise to a claim and are measured at the cost that Cochlear expects to incur in settling the claims, discounted using a rate that reflects current market assessments of the time value of money and the risks specific to the liability.

### **Make good lease costs**

Cochlear has a number of operating leases over its offices that require the premises to be returned to the lessor in its original condition. The operating lease payments do not include an element for the repairs/overhauls.

A provision for make good lease costs is recognised at the time it is determined that it is probable that such costs will be incurred in a future period, measured at the expected cost of returning the asset to the lessor in its original condition. An offsetting asset of the same value is also recognised and is classified in property, plant and equipment. This asset is amortised to the income statement over the life of the lease.

## **(h) Intangible assets**

### **Goodwill**

All business combinations are accounted for by applying the purchase method. Goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash generating units and is tested annually for impairment (see accounting policy (i)). Negative goodwill arising on an acquisition is recognised directly in the income statement.

### **Enterprise resource planning system**

The expenditure incurred on hardware and software and the costs necessary for the implementation of the system are recognised as an intangible asset, to the extent that Cochlear controls future economic benefits as a result of the costs incurred, and are stated at cost less accumulated amortisation. Costs include expenditure that is directly attributable to the development and implementation of the system and includes direct labour.

### **Research and development expenditure**

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense as incurred.

Development activities involve a plan or design for production of new or substantially improved products or processes before the start of commercial production or use. Development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable and Cochlear intends to and has sufficient resources to complete development and use or sell the asset.

The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation (see below) and impairment losses (see accounting policy (i)).

### **Other intangible assets**

Other intangible assets, comprising acquired technology, patents and licences, customer relationships and intellectual property, are acquired individually or through business combinations and are stated at cost less accumulated amortisation (see below) and impairment losses (see accounting policy (i)). Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

### **Subsequent expenditure**

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

### **Amortisation**

Amortisation is calculated over the cost of the asset, or an other amount substituted for cost, less its residual value.

Amortisation is recognised in the income statement on a straight-line basis over the estimated useful lives of the intangible assets from the date they are available for use unless such lives are indefinite. Goodwill and intangible assets with an indefinite useful life are systematically tested for impairment annually. The estimated useful lives for the current and comparative periods are as follows:

|   |               |
|---|---------------|
| Acquired technology, patents and licences | 4 – 15 years  |
| Enterprise resource planning system       | 2.5 – 5 years |
| Customer relationships                    | 4 years       |
| Capitalised development expenditure       | 1 – 3 years.  |

**(i) Impairment**

***Non-financial assets***

The carrying amounts of Cochlear's non-financial assets, other than inventories (see accounting policy (k)), employee benefit assets (see accounting policy (l)), and deferred tax assets (see accounting policy (n)), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated (see below).

For goodwill and intangible assets that have indefinite useful lives, and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date.

The recoverable amount of an asset or cash generating unit is the greater of its value in use, and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets or groups of assets (cash generating unit). The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to cash generating units that are expected to benefit from the processes, intellectual property acquired and synergies of the combination.

An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement unless the asset has previously been revalued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation, with any excess recognised through the income statement.

Impairment losses recognised in respect of cash generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash generating unit or a group of units and then, to reduce the carrying amount of the other assets in the unit or a group of units on a pro-rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

***Financial assets***

Cochlear's financial assets (cash and cash equivalents, trade and other receivables, and investments in controlled entities) are assessed at each reporting date to determine whether there is any objective evidence of impairment. A financial asset is considered impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

The recoverable amount of financial assets is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets). Financial assets with a short duration are not discounted. An impairment loss of a financial asset is measured as the difference between the asset's carrying amount and its recoverable amount.

Impairment of financial assets is not recognised until objective evidence is available that a loss event has occurred. Individual significant financial assets are individually assessed for impairment. Impairment testing of financial assets not assessed individually is performed by placing them into portfolios of similar risk profiles and undertaking a collective assessment of impairment based on objective evidence from historical experience adjusted for any effects of conditions existing at the balance date.

All impairment losses are recognised in the income statement. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. The reversal of impairment losses on financial assets is recognised in the income statement.

In assessing collective impairment, Cochlear uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

**(j) Property, plant and equipment**

***Owned assets***

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses (see accounting policy (i)). An asset's cost is determined as the consideration provided plus incidental costs directly attributable to the acquisition.

The cost of self-constructed assets includes the cost of material and direct labour, an appropriate share of fixed and variable overheads, and capitalised interest and any other costs directly attributable to bringing the asset to a working condition for its intended use.

Subsequent costs in relation to replacing a part of property, plant and equipment are recognised in the carrying amount of the item if it is probable that future economic benefits embodied within the part will flow to Cochlear and its cost can be measured reliably. All other costs are recognised in the income statement as incurred.

In respect of borrowing costs relating to qualifying assets, Cochlear capitalises borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.

#### **Leased assets**

##### **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. Minimum lease payments include fixed rate increases.

##### **Depreciation**

Depreciation is calculated over the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is recognised in the income statement on a straight-line basis. Items of property, plant and equipment, including leasehold assets, are depreciated using the straight-line method over their estimated useful lives, taking into account estimated residual values. Assets are depreciated from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and held ready for use. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that Cochlear will obtain ownership by the end of the lease term.

Depreciation rates and methods, useful lives and residual values are reviewed at each balance sheet date. When changes are made, adjustments are reflected prospectively in current and future financial periods only. The estimated useful lives in the current and comparative periods are as follows:

|                        |               |
|------------------------|---------------|
| Leasehold improvements | 2 – 15 years  |
| Plant and equipment    | 3 – 14 years. |

#### **(k) Inventories**

Inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less estimated costs of completion and selling, marketing and distribution expenses.

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.

#### **(l) Employee benefits**

##### **Defined contribution plans**

A defined contribution plan is a post-employment benefit plan under which the entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts.

Prepaid contributions are recognised as an asset. Contributions to a defined contribution plan that are due more than 12 months after the end of the period in which the employees render the service are discounted to their present value.

Obligations for contributions to defined contribution plans are recognised as an expense in the income statement as incurred.

##### **Defined benefit plans**

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan.

A liability or asset in respect of defined benefit plans is recognised in the balance sheet, and is measured as the present value of the defined benefit obligation at the reporting date adjusted for unrecognised actuarial gains or losses less the fair value of the plan's assets at that date and any unrecognised past service cost. The present value of the defined benefit obligation is based on expected future payments which arise from membership of the plan to the reporting date, calculated by independent actuaries using the projected unit credit method.

When the calculation results in plan assets exceeding liabilities to Cochlear, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

Past service cost is the increase in the present value of the defined benefit obligation for employee services in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service costs may either be positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).

Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currency that match the estimated future cash flows.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in the income statement.

The full amount of actuarial gains and losses that arise are recognised directly in equity.

***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 the reporting date, calculated at undiscounted amounts based on remuneration wage and salary rates that Cochlear expects to pay as at the reporting date including related on-costs, such as workers' compensation insurance and payroll tax.

***Long service leave***

The provision for employee benefits for 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 the 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 the reporting date, which most closely match the terms to maturity of the related liabilities. The unwinding of the discount is treated as a long service leave expense.

***Share based payments***

The Company has granted options and performance shares to certain employees under the Cochlear Executive Long Term Incentive Plan (CELTIP).

The fair value of options and performance shares granted is recognised as an employee benefits expense with a corresponding increase in equity. The fair value is measured at the date the options or shares are granted taking into account market based criteria and expensed over the vesting period after which the employees become unconditionally entitled to the options and shares. The fair value of the options granted is measured using the Black-Scholes method, taking into account the terms and conditions attached to the options.

The fair value of the performance shares granted is measured using the weighted average share price of ordinary shares in the Company, taking into account the terms and conditions attached to the shares.

The amount recognised as an expense is adjusted to reflect the actual number of options and shares that vest except where forfeiture is due to market related conditions.

When the Company grants options over its shares to employees of controlled entities, the fair value at grant date is recognised as an increase in the investment in subsidiaries, with a corresponding increase in equity over the vesting period of the grant.

***Treasury shares***

The Company operates the Cochlear Executive Long Term Incentive Plan (Performance Shares) Trust (Trust). The main purpose of the Trust is to hold unvested performance shares as part of the CELTIP. Under IFRS, the Trust qualifies as an equity compensation plan special purpose entity and its results are included in those for the Company and the Consolidated Entity.

Any shares held by the Trust are accounted for as treasury shares and treated as a reduction in the share capital of the Company and the Consolidated Entity.

**(m) Receivables**

Trade and other receivables are stated at amortised cost less impairment losses (see accounting policy (i)).

**(n) Taxation**

Income tax expense comprises current and deferred tax. Current and deferred tax are recognised in the income statement except to the extent that it relates to a business combination, or items recognised directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax payable also includes any tax liability arising from the declaration of dividends.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in controlled entities and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future; and
- taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional income tax expenses that arise from the distribution of cash dividends are recognised at the same time that the liability to pay the related dividend is recognised. Cochlear does not distribute non-cash assets as dividends to its shareholders.

Cochlear and its wholly-owned Australian resident entities are part of a tax-consolidated group. As a consequence, all members of the tax-consolidated group are taxed as a single entity. The head entity within the tax-consolidated group is Cochlear Limited.

#### **(o) Payables**

Trade and other payables are stated at amortised cost.

#### **(p) Loans and borrowings**

Loans and borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, loans and borrowings are stated at amortised cost, with any difference between amortised cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis.

#### **(q) Finance income and expense**

Interest income is recognised as it accrues in the income statement using the effective interest rate method. Borrowing costs are recognised as they accrue in the income statement as a finance expense except to the extent that borrowing costs relate to the purchase of qualifying assets in which case they are capitalised into the purchase cost of the qualifying asset as permitted by AASB 123 Borrowing Costs (2007). Debt establishment costs are capitalised and recognised as a reduction in loans and borrowings. They are calculated based on the effective interest rate method and are amortised over the period of the loan. Foreign exchange differences net of the effect of hedges on borrowings, are recognised in net finance income/(expense).

#### **(r) Earnings per share**

Cochlear presents basic and diluted earnings per share (EPS) for its ordinary shares. Basic EPS is calculated by dividing the net profit attributable to equity holders 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 using the basic EPS earnings as the numerator. The weighted average number of shares used as the denominator is 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 adjusted for any bonus issue.

#### **(s) Segment reporting**

##### ***Determination and presentation of operating segments***

An operating segment is a component of Cochlear that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of Cochlear's other components if separately reported and monitored. An operating segment's operating results are reviewed regularly by the CEO/President to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Segment results that are reported to the CEO/President include items directly attributable to a segment, as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly corporate head office results.

#### **(t) Share capital**

##### ***Ordinary shares***

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any income tax benefit.

##### ***Repurchase of share capital (treasury shares)***

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a deduction from equity, net of any tax effects. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are subsequently sold or reissued, the amount received is recognised as an increase in equity, and the surplus or deficit on the transaction is transferred to or from retained earnings.



### **Dividends**

A liability for dividends payable is recognised in the financial period in which the dividends are declared.

### **(u) Construction contracts**

Construction contract revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, construction contract revenue and expenses are recognised in the income statement.

Construction contract revenue and expenses are estimated and recognised in accordance with the percentage of completion method which is assessed by reference to surveys of work performed.

When the outcome of a construction contract cannot be reliably estimated, construction contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in the income statement.

Construction activities are not part of the ordinary course of Cochlear's business. Cochlear is exposed to the usual risks associated with construction.

### **(v) New standards and interpretations not yet adopted**

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 July 2010, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of Cochlear, except for AASB 9 Financial Instruments, which becomes mandatory for Cochlear's 2014 consolidated financial statements and could change the classification and measurement of financial assets. Cochlear does not plan to adopt this standard early and the extent of the impact has not been determined.

## **4. Financial risk management**

### **Overview**

Cochlear has exposure to the following risks from the use of financial instruments:

- Credit risk;
- Liquidity risk;
- Market risk; and
- Operational risk.

This note presents information about Cochlear's exposure to each of the above risks, its objectives, policies and processes for measuring and managing risk, and the management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The Board of directors has overall responsibility for the establishment and oversight of the risk management framework. The fundamentals of risk management are set by the risk policy. Under instruction of the Board, management has established a Risk Management Committee which is responsible for monitoring operational and financial risk management throughout Cochlear. Monitoring risk management includes ensuring appropriate policies and procedures are published and adhered to. The Risk Management Committee reports to the Audit Committee on a regular basis.

A Treasury Management Committee has been established to administer aspects of risk management involving currency exposure and cash and funding management in accordance with the treasury risk policy. The treasury risk policy aims to manage the impact of short-term fluctuations on Cochlear's earnings. Over the longer term, permanent changes in market rates will have an impact on earnings.

Cochlear is exposed to risks from movements in exchange rates and interest rates that affect revenues, expenses, assets, liabilities and forecast transactions. Financial risk management aims to limit these market risks through ongoing operational and finance activities. Selected derivative and non-derivative hedging instruments are used for this purpose.

Exposure to credit, foreign exchange and interest rate risks arises in the normal course of Cochlear's business. Derivative financial instruments are used to hedge exposure to fluctuations in foreign exchange rates and interest rates.

The Company only hedges the risks that affect the cash flows between the parent entity and the controlled entities. Cochlear does not enter, hold or issue derivative financial instruments for trading purposes. Hedging transactions are only concluded with leading financial institutions whose credit rating is at least A on the Standard & Poor's rating index.

The Audit Committee oversees how management monitors compliance with Cochlear's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by Cochlear. The Audit Committee is assisted in its oversight by Internal Audit. Internal Audit undertakes regular reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

## **Credit risk**

Credit risk is the risk of financial loss to Cochlear if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from Cochlear's receivables from customers.

### ***Trade and other receivables***

Cochlear's exposure to credit risk is influenced mainly by the geographical location and characteristics of individual customers. Cochlear does not have a significant concentration of credit risk with a single customer.

Policies and procedures of credit management and administration of receivables are established and executed at a regional level. Individual regions deliver reports to management and the Board on debtor ageing and collection activities on a monthly basis.

In monitoring customer credit risk, the ageing profile of total receivables balances and individually significant debtors is reported by geographic region to the Board of directors on a monthly basis. Regional management is responsible for identifying high risk customers and placing restrictions on future trading, including suspending future shipments and administering dispatches on a prepayment basis. These actions are also reported to the Board on a monthly basis.

Cochlear has established an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance are a specific loss component that relates to individually significant exposures and a collective loss component established for groups of assets meeting certain ageing profiles and customer types.

### ***Guarantees***

Details of guarantees provided by Cochlear are provided in Note 20.

## **Liquidity risk**

Liquidity risk is the risk that Cochlear will not be able to meet its financial obligations as they fall due. Cochlear's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to Cochlear's reputation.

Cochlear monitors cash flow requirements and produces cash flow projections for the short and long term with a view to optimising return on investments. Typically, Cochlear ensures that it has sufficient funds on demand to meet expected operational net cash flows for a period of at least 30 days, including the servicing of financial obligations. This excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. In addition, Cochlear maintains lines of credit which are set out in Note 17.

## **Market risk**

Market risk is the risk that changes in market prices such as foreign exchange rates, interest rates and equity prices will affect Cochlear's net profit or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Cochlear buys and sells derivatives in accordance with the treasury risk policy, and also incurs financial liabilities, in order to manage market risks. All such transactions are carried out within the guidelines set out by the treasury risk policy. Generally, Cochlear seeks to apply hedge accounting in order to manage volatility in earnings.

### ***Currency risk***

Cochlear is exposed to currency risk on sales, purchases and borrowings that are denominated in a currency other than the respective functional currencies of the controlled entities, primarily Australian dollars (AUD), but also United States dollars (USD), Euros (EUR), Sterling (GBP), Swedish kroner (SEK), Japanese yen (JPY) and Swiss francs (CHF). The currencies in which these transactions primarily are denominated are AUD, USD, EUR, GBP, SEK and JPY.

Over 90% of Cochlear's revenues and over 50% of costs are denominated in currencies other than AUD. Currency risk is hedged in accordance with the treasury risk policy. Risk resulting from the translation of assets and liabilities of foreign operations into Cochlear's reporting currency is generally not hedged.

### ***Interest rate risk***

Cochlear is exposed to interest rate risks in Australia and Japan. See Note 26 for effective interest rates, repayment and repricing analysis of outstanding debt.

Interest rate risk is hedged on a case-by-case basis by assessing the term of borrowings and the purpose for which the funds are obtained. Hedging against interest rate risk is achieved by entering into interest rate swaps.

## **Operational risk**

Operational risk is the risk of direct and indirect loss arising from a wide variety of causes associated with Cochlear's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of Cochlear's operations.

Cochlear's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to Cochlear's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to the Risk Management Committee. This responsibility is supported by the development of standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;
- development of contingency plans;
- training and professional development;
- ethical and business standards; and
- risk mitigation, including insurance where this is effective.

Compliance with standards is supported by a program of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of Cochlear.

#### **Capital management**

Cochlear's objectives when managing capital are to safeguard its ability to continue as a going concern, to provide returns to shareholders, to provide benefits to other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The Board aims to maintain and develop a capital base appropriate to Cochlear's objectives and monitors a number of qualitative metrics as follows:

- net debt to equity ratio – defined as net debt as a proportion of net debt plus total equity;
- dividend payout ratio – defined as dividends as a proportion of net profit after tax for a given period;
- growth in EPS – defined as the compound annual growth percentage in EPS over a three year period; and
- total shareholder return (TSR) – defined as the percentage growth in share price over a three year period plus the cumulative three year dividend return calculated against the opening share price in the same three year period.

In order to maintain or adjust the capital structure, Cochlear may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

Senior management tracks, manages and reports against these capital management metrics periodically as part of broader corporate governance responsibilities. In addition, the Board of directors undertakes periodic reviews of Cochlear's capital management position to assess whether the metrics continue to be appropriate and to assess whether the capital management structure is appropriate to meet Cochlear's medium and long-term strategic requirements.

Neither Cochlear nor any of its subsidiaries is subject to externally imposed capital requirements.

There were no significant changes in Cochlear's approach to capital management during the year.

Cochlear's net debt to equity ratio was as follows:

|  | Note | 2011<br>\$000  | 2010<br>\$000 |
|--|------|----------------|---------------|
| Total loans and borrowings                               |      | 63,040         | 156,745       |
| Less: Cash and cash equivalents                          |      | (72,423)       | (42,808)      |
| Group net (cash)/debt                                    |      | (9,383)        | 113,937       |
| Loans and borrowings – construction of Headquarters      | 28   | -              | (73,811)      |
| Cash and cash equivalents – construction of Headquarters |      | -              | 994           |
| <b>Net (cash)/debt</b>                                   |      | <b>(9,383)</b> | <b>41,120</b> |
| Total equity   |      | 503,283        | 438,308       |
| <b>Net (cash)/debt to equity ratio at 30 June</b>        |      | <b>(2%)</b>    | <b>9%</b>     |

|   | 2011           | 2010           |
|---|----------------|----------------|
|   | Note           | \$000          |
| <b>5. Revenue and expenses</b>  |                |                |
| <b>(a) Revenue</b>  |                |                |
| Sale of goods before hedging  | 726,010        | 690,538        |
| Foreign exchange gains on hedged sales  | 77,411         | 38,652         |
| <b>Revenue from the sale of goods</b>   | <b>803,421</b> | <b>729,190</b> |
| Rendering of services   | 6,225          | 5,613          |
| <b>Revenue</b>  | <b>809,646</b> | <b>734,803</b> |
| <b>(b) Expenses</b>   |                |                |
| <b>Cost of sales</b>  |                |                |
| Carrying amount of inventories recognised as an expense                                     | 221,753        | 196,055        |
| Write-down in value of inventories  | 6,733          | 6,136          |
| <b>Total cost of sales</b>  | <b>228,486</b> | <b>202,191</b> |
| <b>Research and development expenses</b>  |                |                |
| Research and development expenditure  | 108,935        | 94,881         |
| Capitalised development expenditure – amortisation expense                                  | -              | 16             |
| <b>Total research and development expenses</b>  | <b>108,935</b> | <b>94,897</b>  |
| <b>(c) Other income</b>   |                |                |
| Grant received or due and receivable  | 828            | 760            |
| Construction profit net of relocation expense   | 28             | -              |
| Other income  | 948            | 8,304          |
| <b>Total other income</b>   | <b>7,906</b>   | <b>9,064</b>   |
| <b>(d) Employee benefits expense</b>  |                |                |
| Wages and salaries  | 179,641        | 167,667        |
| Contributions to superannuation plans   | 12,928         | 11,745         |
| Increase in leave liabilities   | 3,050          | 150            |
| Equity settled share based payment transactions   | 5,426          | 5,068          |
| <b>Total employee benefits expense</b>  | <b>201,045</b> | <b>184,630</b> |
| <b>(e) Profit before income tax has been arrived at after charging the following items:</b> |                |                |
| Operating lease rental expense  | 17,036         | 11,289         |
| Increase in provisions  | 1,444          | 4,499          |
| Loss on disposal of property, plant and equipment   | 857            | 470            |

|  | 2011           | 2010            |
|--|----------------|-----------------|
|  | \$000          | \$000           |
| <b>6. Net finance expense</b>  |                |                 |
| <b>Recognised in the income statement</b>  |                |                 |
| Interest income  | 1,105          | 1,248           |
| Net foreign exchange income  | 2,503          | 1,158           |
| <b>Finance income</b>  | <b>3,608</b>   | <b>2,406</b>    |
| Interest expense   | (8,666)        | (12,407)        |
| <b>Finance expense</b>   | <b>(8,666)</b> | <b>(12,407)</b> |
| <b>Net finance expense recognised in the income statement</b>                                | <b>(5,058)</b> | <b>(10,001)</b> |
| <b>Recognised in other comprehensive income</b>  |                |                 |
| Foreign currency translation differences   | (15,073)       | (28,562)        |
| Effective portion of changes in fair value of cash flow hedges, net of tax                   | 64,923         | 52,921          |
| Net change in fair value of cash flow hedges transferred to the income statement, net of tax | (54,188)       | (27,056)        |
| <b>Net finance expense recognised in other comprehensive income, net of tax</b>              | <b>(4,338)</b> | <b>(2,697)</b>  |

|   | 2011             | 2010             |
|---|------------------|------------------|
|   | \$               | \$               |
| <b>7. Auditors' remuneration</b>        |                  |                  |
| <b>Audit services</b>                   |                  |                  |
| Auditors of the Company                 |                  |                  |
| KPMG Australia:                         |                  |                  |
| - audit and review of financial reports | 587,000          | 552,700          |
| - other audit services                  | 106,000          | -                |
| - other regulatory compliance services  | 21,400           | 6,978            |
| Overseas KPMG firms:                    |                  |                  |
| - audit and review of financial reports | 542,668          | 564,978          |
| - other regulatory compliance services  | 3,638            | 12,579           |
| <b>Total audit services</b>             | <b>1,260,706</b> | <b>1,137,235</b> |
| <b>Non-audit services</b>               |                  |                  |
| Auditors of the Company                 |                  |                  |
| KPMG Australia:                         |                  |                  |
| - taxation compliance services          | 1,017,013        | 589,651          |
| - other tax related services            | -                | 107,043          |
| Overseas KPMG firms:                    |                  |                  |
| - taxation compliance services          | 445,753          | 461,149          |
| <b>Total non-audit services</b>         | <b>1,462,766</b> | <b>1,157,843</b> |

|  | Note | 2011<br>\$000  | 2010<br>\$000  |
|--|------|----------------|----------------|
| <b>8. Income tax expense</b>   |      |                |                |
| <b>Recognised in the income statement</b>  |      |                |                |
| Current tax expense  |      |                |                |
| Current year   |      | 63,406         | 61,122         |
| Adjustment for prior years   |      | (3,858)        | (3,329)        |
|  |      | <b>59,548</b>  | <b>57,793</b>  |
| <b>Deferred tax benefit</b>  |      |                |                |
| Origination and reversal of temporary differences  |      | (4,525)        | (3,594)        |
|  | 16   | <b>(4,525)</b> | <b>(3,594)</b> |
| <b>Total income tax expense</b>  |      | <b>55,023</b>  | <b>54,199</b>  |
| <br>   |      |                |                |
| <b>Numerical reconciliation between income tax expense and profit before income tax</b>            |      |                |                |
| Net profit   |      | 180,114        | 155,152        |
| Income tax expense   |      | 55,023         | 54,199         |
| <b>Profit before income tax</b>  |      | <b>235,137</b> | <b>209,351</b> |
| Income tax expense using the Company's domestic tax rate of 30% (2010: 30%)                        |      | 70,541         | 62,805         |
| <b>Increase in income tax expense due to:</b>  |      |                |                |
| Non-deductible expenses  |      | 1,707          | 2,770          |
| <b>Decrease in income tax expense due to:</b>  |      |                |                |
| Research and development allowances  |      | (13,267)       | (7,688)        |
| Share based payment deductions   |      | (319)          | (305)          |
| Effect of tax rate in foreign jurisdictions  |      | 219            | (54)           |
|  |      | <b>58,881</b>  | <b>57,528</b>  |
| Adjustment for prior years   |      | (3,858)        | (3,329)        |
| <b>Income tax expense on profit before income tax</b>  |      | <b>55,023</b>  | <b>54,199</b>  |
| <br>   |      |                |                |
| Deferred tax recognised in other comprehensive income relating to derivative financial instruments |      | 3,475          | 11,585         |
| <b>Total deferred tax recognised in other comprehensive income</b>                                 | 16   | <b>3,475</b>   | <b>11,585</b>  |
| <br>   |      |                |                |
| Deferred tax recognised directly in equity relating to share based payments                        |      | 1,164          | (4,059)        |
| <b>Total deferred tax recognised directly in equity</b>  | 16   | <b>1,164</b>   | <b>(4,059)</b> |



|  | Cents per share | Total amount   | Franked/<br>unfranked | Date of payment   |
|--|-----------------|----------------|-----------------------|-------------------|
|  |                 | \$000          |                       |                   |
| <b>9. Dividends</b>  |                 |                |                       |                   |
| Dividends recognised in the current financial year by the Company are: |                 |                |                       |                   |
| <b>2011</b>  |                 |                |                       |                   |
| Interim 2011 ordinary  | 105.0           | 59,544         | 60% Franked           | 15 March 2011     |
| Final 2010 ordinary  | 105.0           | 59,404         | 60% Franked           | 23 September 2010 |
| <b>Total amount</b>  | <b>210.0</b>    | <b>118,948</b> |                       |                   |
| <b>2010</b>  |                 |                |                       |                   |
| Interim 2010 ordinary  | 95.0            | 53,705         | 100% Franked          | 16 March 2010     |
| Final 2009 ordinary  | 95.0            | 53,384         | 100% Franked          | 24 September 2009 |
| <b>Total amount</b>  | <b>190.0</b>    | <b>107,089</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 2011 ordinary  | 120.0        | 68,234        | 70% Franked | 22 September 2011 |
| <b>Total amount</b>  | <b>120.0</b> | <b>68,234</b> |             |                   |

The financial effect of the 2011 final dividend has not been brought to account in the financial statements for the year ended 30 June 2011 and will be recognised in the subsequent financial period.

There are no further tax consequences as a result of paying dividends other than a reduction in the franking account as shown below:

|   | Company |       |
|---|---------|-------|
|   | 2011    | 2010  |
|   | \$000   | \$000 |
| <b>Dividend franking account</b>  |         |       |
| 30% franking credits available to shareholders of Cochlear Limited for subsequent financial years | 18,941  | 5,509 |

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 Company may be prevented from distributing in subsequent financial years.

The ability to utilise the franking account credits is dependent upon the ability to declare dividends. The impact on the dividend franking account of dividends proposed after the balance sheet date but not recorded as a liability is to reduce it by \$20,428,208 (2010: \$15,266,718).

No additional current tax liability will arise to the extent that franking credits are available with which to pay fully franked dividends. Dividends in excess of the balance of the dividend franking account will either be unfranked or result in a franking deficit tax liability payable by the Company to the extent that franking credits are provided that do not exist. The Company's policy is not to pay dividends with franking credits that will result in a franking deficit tax liability.

## 10. Operating segments

Cochlear has three reportable segments, which are determined on a geographical basis and are the strategic business units of Cochlear. Segment results, assets and liabilities include items directly attributable to a segment. Unallocated items comprise corporate and other net expenses and corporate and manufacturing assets and liabilities.

Information about each reportable segment is included below. Performance is measured based on segment profit before income tax as included in the internal management reports that are reviewed by Cochlear's CEO/President, who is also the chief operating decision maker. Segment profit before income tax is used to measure performance as management believes that such information is the most relevant in evaluating the results of each operating segment.

### Information about reportable segments

|   | Americas      |                | Europe        |                | Asia Pacific  |                | Total         |                |
|---|---------------|----------------|---------------|----------------|---------------|----------------|---------------|----------------|
|   | 2011<br>\$000 | 2010*<br>\$000 | 2011<br>\$000 | 2010*<br>\$000 | 2011<br>\$000 | 2010*<br>\$000 | 2011<br>\$000 | 2010*<br>\$000 |
| External revenues excluding hedging         | 316,962       | 307,568        | 293,331       | 291,456        | 121,942       | 97,127         | 732,235       | 696,151        |
| Reportable segment profit before income tax | 150,889       | 155,570        | 134,227       | 135,973        | 37,424        | 29,811         | 322,540       | 321,354        |
| Reportable segment assets                   | 82,995        | 93,498         | 159,668       | 142,863        | 51,958        | 34,761         | 294,621       | 271,122        |
| Reportable segment liabilities              | 31,567        | 43,545         | 67,804        | 59,899         | 24,125        | 14,269         | 123,496       | 117,713        |
| <b>Other material items</b>                 |               |                |               |                |               |                |               |                |
| Depreciation and amortisation               | 683           | 733            | 1,574         | 1,600          | 599           | 650            | 2,856         | 2,983          |
| Write-(up)/down in value of inventories     | (74)          | 225            | (18)          | 207            | 510           | 194            | 418           | 626            |
| Segment acquisition of non-current assets   | 633           | 631            | 2,516         | 758            | 341           | 264            | 3,490         | 1,653          |

### Reconciliations of reportable segment revenues, profit or loss, assets and liabilities and other material items

|   | 2011<br>\$000  | 2010*<br>\$000 |
|---|----------------|----------------|
| <b>Revenues</b>                                     |                |                |
| Total segment revenue                               | 732,235        | 696,151        |
| Foreign exchange gains on hedged sales              | 77,411         | 38,652         |
| <b>Consolidated revenue</b>                         | <b>809,646</b> | <b>734,803</b> |
| <b>Profit or loss</b>                               |                |                |
| Total segment profit before income tax              | 322,540        | 321,354        |
| Corporate and other net expenses                    | (82,345)       | (102,002)      |
| Net finance expense                                 | (5,058)        | (10,001)       |
| <b>Consolidated profit before income tax</b>        | <b>235,137</b> | <b>209,351</b> |
| <b>Assets</b>                                       |                |                |
| Reportable segment assets                           | 294,621        | 271,122        |
| Unallocated corporate and manufacturing assets      | 446,426        | 480,597        |
| <b>Consolidated total assets</b>                    | <b>741,047</b> | <b>751,719</b> |
| <b>Liabilities</b>                                  |                |                |
| Reportable segment liabilities                      | 123,496        | 117,713        |
| Unallocated corporate and manufacturing liabilities | 114,268        | 195,698        |
| <b>Consolidated total liabilities</b>               | <b>237,764</b> | <b>313,411</b> |

\* 2010 has been restated to reflect the most current method of reporting to the chief operating decision maker.

|  | Reportable<br>segment<br>total<br>\$000 | Corporate and<br>manufacturing<br>total<br>\$000 | Consolidated<br>total<br>\$000 |
|--|---|--|--------------------------------|
| <b>2011</b>  |   |  |                                |
| <b>Other material items</b>  |   |  |                                |
| Depreciation and amortisation  | 2,856                                   | 24,539   | 27,395                         |
| Write-down in value of inventories   | 418                                     | 6,315  | 6,733                          |
| Acquisition of property, plant and equipment and enterprise resource planning system | 3,490                                   | 41,854   | 45,344                         |
| <b>2010</b>  |   |  |                                |
| <b>Other material items</b>  |   |  |                                |
| Depreciation and amortisation  | 2,983                                   | 20,114   | 23,097                         |
| Write-down in value of inventories   | 626                                     | 5,510  | 6,136                          |
| Acquisition of property, plant and equipment and enterprise resource planning system | 1,653                                   | 20,238   | 21,891                         |

**Revenue by product**

|                                   | 2011<br>\$000  | 2010<br>\$000  |
|-----------------------------------|----------------|----------------|
| Cochlear implants                 | 647,995        | 603,671        |
| Bone anchored hearing aids (Baha) | 84,240         | 92,480         |
| <b>Total</b>                      | <b>732,235</b> | <b>696,151</b> |

|   | 2011              | 2010              |
|---|-------------------|-------------------|
| <b>11. Earnings per share</b>   |                   |                   |
| <b>Basic earnings per share</b>   |                   |                   |
| The calculation of basic earnings per share for the year ended 30 June 2011 was based on net profit attributable to equity holders of the parent entity of \$180,114,000 (2010: \$155,152,000) and a weighted average number of ordinary shares on issue during the year ended 30 June 2011 of 56,596,077 (2010: 56,279,542) calculated as follows:   |                   |                   |
| Net profit attributable to equity holders of the parent entity  | \$180,114,000     | \$155,152,000     |
| Weighted average number of ordinary shares (basic):   |                   |                   |
| Issued ordinary shares at 1 July (number)   | 56,482,346        | 55,977,555        |
| Effect of options and performance shares exercised (number)   | 102,036           | 295,353           |
| Effect of shares issued under Employee Share Plan (number)  | 11,695            | 6,634             |
| <b>Weighted average number of ordinary shares (basic) at 30 June</b>  | <b>56,596,077</b> | <b>56,279,542</b> |
| <b>Basic earnings per share (cents)</b>   | <b>318.2</b>      | <b>275.7</b>      |
| <b>Diluted earnings per share</b>   |                   |                   |
| The calculation of diluted earnings per share for the year ended 30 June 2011 was based on net profit attributable to equity holders of the parent entity of \$180,114,000 (2010: \$155,152,000) and a weighted average number of ordinary shares on issue during the year ended 30 June 2011 of 56,989,026 (2010: 56,576,557) calculated as follows: |                   |                   |
| Net profit attributable to equity holders of the parent entity  | \$180,114,000     | \$155,152,000     |
| Weighted average number of ordinary shares (diluted):   |                   |                   |
| Weighted average number of shares (basic) (number)  | 56,596,077        | 56,279,542        |
| Effect of options and performance shares (number)   | 392,949           | 297,015           |
| <b>Weighted average number of ordinary shares (diluted) at 30 June</b>  | <b>56,989,026</b> | <b>56,576,557</b> |
| <b>Diluted earnings per share (cents)</b>   | <b>316.1</b>      | <b>274.2</b>      |

|   | 2011           | 2010           |
|---|----------------|----------------|
|   | \$000          | \$000          |
| <b>12. Trade and other receivables</b>                      |                |                |
| <b>Current</b>  |                |                |
| Trade receivables net of allowance for impairment losses    | 165,911        | 159,529        |
| Other receivables   | 9,714          | 6,330          |
| Forward exchange contracts                                  | 62,651         | 44,627         |
| Interest rate swap on loan for construction of Headquarters | -              | 204            |
| <b>Total current trade and other receivables</b>            | <b>238,276</b> | <b>210,690</b> |
| <b>Non-current</b>  |                |                |
| Other receivables   | 739            | 929            |
| Forward exchange contracts                                  | 16,445         | 24,214         |
| <b>Total non-current trade and other receivables</b>        | <b>17,184</b>  | <b>25,143</b>  |

Cochlear's exposure to credit and currency risks and impairment losses related to trade and other receivables is disclosed in Note 26.

|                          |                |                |
|--------------------------|----------------|----------------|
| <b>13. Inventories</b>   |                |                |
| Raw materials and stores | 40,075         | 41,806         |
| Work in progress         | 13,641         | 12,650         |
| Finished goods           | 52,410         | 49,951         |
| <b>Total inventories</b> | <b>106,126</b> | <b>104,407</b> |

|   | 2011          | 2010          |
|---|---------------|---------------|
|   | \$000         | \$000         |
| <b>14. Property, plant and equipment</b>                      |               |               |
| <b>Leasehold improvements</b>                                 |               |               |
| At cost   | 22,398        | 32,722        |
| Accumulated amortisation                                      | (15,671)      | (24,576)      |
|   | <b>6,727</b>  | <b>8,146</b>  |
| <b>Plant and equipment</b>                                    |               |               |
| At cost   | 134,645       | 105,078       |
| Accumulated depreciation                                      | (72,015)      | (63,627)      |
|   | <b>62,630</b> | <b>41,451</b> |
| <b>Total property, plant and equipment, at net book value</b> | <b>69,357</b> | <b>49,597</b> |

#### Reconciliations

Reconciliations of the carrying amounts of each class of property, plant and equipment are set out below:

|   |               |               |
|---|---------------|---------------|
| <b>Leasehold improvements</b>                   |               |               |
| Carrying amount at beginning of financial year  | 8,146         | 7,871         |
| Additions                                       | 2,648         | 4,016         |
| Disposals                                       | (373)         | (13)          |
| Amortisation                                    | (3,472)       | (3,273)       |
| Effect of movements in foreign exchange         | (222)         | (455)         |
| <b>Carrying amount at end of financial year</b> | <b>6,727</b>  | <b>8,146</b>  |
| <b>Plant and equipment</b>                      |               |               |
| Carrying amount at beginning of financial year  | 41,451        | 38,923        |
| Additions                                       | 37,270        | 16,842        |
| Disposals                                       | (484)         | (457)         |
| Depreciation                                    | (15,063)      | (12,598)      |
| Effect of movements in foreign exchange         | (544)         | (1,259)       |
| <b>Carrying amount at end of financial year</b> | <b>62,630</b> | <b>41,451</b> |

|   | 2011           | 2010           |
|---|----------------|----------------|
|   | \$000          | \$000          |
| <b>15. Intangible assets</b>                                |                |                |
| <b>Intangible assets with indefinite useful lives</b>       |                |                |
| Goodwill, at cost   | 159,137        | 159,877        |
| Technology relationship, at cost                            | 1,800          | 1,800          |
| <b>Total intangible assets with indefinite useful lives</b> | <b>160,937</b> | <b>161,677</b> |
| <b>Intangible assets with definite useful lives</b>         |                |                |
| Acquired technology, patents and licences                   |                |                |
| At cost   | 39,705         | 39,242         |
| Accumulated amortisation                                    | (8,897)        | (5,673)        |
|   | <b>30,808</b>  | <b>33,569</b>  |
| Enterprise resource planning system                         |                |                |
| At cost   | 41,601         | 36,773         |
| Accumulated amortisation                                    | (27,305)       | (22,615)       |
|   | <b>14,296</b>  | <b>14,158</b>  |
| Customer relationships                                      |                |                |
| At cost   | 4,013          | 4,472          |
| Accumulated amortisation                                    | (4,013)        | (4,472)        |
|   | -              | -              |
| Capitalised development expenditure                         |                |                |
| At cost   | 7,759          | 7,759          |
| Accumulated amortisation                                    | (7,759)        | (7,759)        |
|   | -              | -              |
| Other intangible assets                                     |                |                |
| At cost   | 4,059          | 3,652          |
| Accumulated amortisation                                    | (1,550)        | (1,217)        |
|   | <b>2,509</b>   | <b>2,435</b>   |
| <b>Total intangible assets with definite useful lives</b>   | <b>47,613</b>  | <b>50,162</b>  |
| <b>Total intangible assets</b>                              | <b>208,550</b> | <b>211,839</b> |

|   | 2011           | 2010           |
|---|----------------|----------------|
|   | \$000          | \$000          |
| <b>Reconciliations</b>  |                |                |
| Reconciliations of the carrying amounts of each class of intangible assets are set out below: |                |                |
| <b>Goodwill</b>   |                |                |
| Carrying amount at beginning of financial year  | 159,877        | 173,599        |
| Effect of movements in foreign exchange   | (740)          | (13,722)       |
| <b>Carrying amount at end of financial year</b>   | <b>159,137</b> | <b>159,877</b> |
| <b>Technology relationship</b>  |                |                |
| Carrying amount at beginning of financial year  | 1,800          | 1,800          |
| <b>Carrying amount at end of financial year</b>   | <b>1,800</b>   | <b>1,800</b>   |
| <b>Acquired technology, patents and licences</b>  |                |                |
| Carrying amount at beginning of financial year  | 33,569         | 15,907         |
| Acquisitions  | 436            | 20,563         |
| Amortisation  | (3,219)        | (2,721)        |
| Effect of movements in foreign exchange   | 22             | (180)          |
| <b>Carrying amount at end of financial year</b>   | <b>30,808</b>  | <b>33,569</b>  |
| <b>Enterprise resource planning system</b>  |                |                |
| Carrying amount at beginning of financial year  | 14,158         | 13,981         |
| Acquisitions  | 5,426          | 4,385          |
| Amortisation  | (5,263)        | (4,139)        |
| Effect of movements in foreign exchange   | (25)           | (69)           |
| <b>Carrying amount at end of financial year</b>   | <b>14,296</b>  | <b>14,158</b>  |
| <b>Customer relationships</b>   |                |                |
| Carrying amount at beginning of financial year  | -              | -              |
| Amortisation  | -              | -              |
| Effect of movements in foreign exchange   | -              | -              |
| <b>Carrying amount at end of financial year</b>   | <b>-</b>       | <b>-</b>       |
| <b>Capitalised development expenditure</b>  |                |                |
| Carrying amount at beginning of financial year  | -              | 16             |
| Amortisation  | -              | (16)           |
| <b>Carrying amount at end of financial year</b>   | <b>-</b>       | <b>-</b>       |
| <b>Other intangible assets</b>  |                |                |
| Carrying amount at beginning of financial year  | 2,435          | 2,972          |
| Acquisitions  | 521            | -              |
| Amortisation  | (378)          | (350)          |
| Effect of movements in foreign exchange   | (69)           | (187)          |
| <b>Carrying amount at end of financial year</b>   | <b>2,509</b>   | <b>2,435</b>   |



**Amortisation charge**

Amortisation is recognised in the administration expenses line in the income statement except for amortisation of capitalised development expenditure which is recognised in the research and development expenses line.

**Impairment tests for cash generating units**

Impairment testing is performed assessing carrying amounts of goodwill, other intangible assets and property, plant and equipment at Cochlear's operating divisions (cash generating units).

For the purpose of impairment testing, goodwill is allocated to Cochlear's operating divisions which represent the lowest level within Cochlear at which the goodwill is monitored for internal management purposes, which is not higher than Cochlear's operating segments as reported in Note 10.

The aggregate carrying amounts of goodwill allocated to each cash generating unit are as follows:

|              | 2011           | 2010           |
|--------------|----------------|----------------|
|              | \$000          | \$000          |
| Americas     | 80,155         | 80,750         |
| Europe       | 69,811         | 69,771         |
| Asia Pacific | 9,171          | 9,356          |
|              | <b>159,137</b> | <b>159,877</b> |

The recoverable amount of each cash generating unit is based on value-in-use calculations. Those calculations use cash flow projections based on actual operating results and the three year business plan. Cash flows for further periods are extrapolated using a conservative growth rate of 3.0% (2010: 3.0%) per annum which is consistent with long-term economic growth rates. A pre-tax discount rate of 13.4% (2010: 13.4%) per annum has been used in discounting the projected pre-tax cash flows.

The key assumptions and the approach to determining their value in the current period are:

| <b>Assumption</b>          | <b>How determined</b>   |
|----------------------------|---|
| Discount rate              | Based on weighted average cost of capital   |
| Sales volume growth rate   | Based on a three year forecast taking into account historical growth rates and product lifecycle  |
| Terminal value growth rate | Based on a three year forecast taking into account historical growth rates and product lifecycle. |

The recoverable amount of each cash generating unit including unallocated corporate assets is in excess of their carrying amount and therefore no impairment charge was required. The excess of recoverable amount over carrying amount is such that a reasonably possible change in assumptions is unlikely to reduce the recoverable amount below the carrying amount.

|   | Assets        |               | Liabilities     |                 | Net           |               |
|---|---------------|---------------|-----------------|-----------------|---------------|---------------|
|   | 2011          | 2010          | 2011            | 2010            | 2011          | 2010          |
|   | \$000         | \$000         | \$000           | \$000           | \$000         | \$000         |
| <b>16. Deferred tax assets and liabilities</b>        |               |               |                 |                 |               |               |
| <b>Recognised deferred tax assets and liabilities</b> |               |               |                 |                 |               |               |
| Property, plant and equipment                         | 1,667         | 2,480         | (268)           | (192)           | 1,399         | 2,288         |
| Intangible assets                                     | 57            | 62            | -               | -               | 57            | 62            |
| Inventories   | 15,814        | 12,461        | -               | -               | 15,814        | 12,461        |
| Provisions  | 13,712        | 14,253        | -               | -               | 13,712        | 14,253        |
| Deferred revenue                                      | 1,468         | 2,091         | -               | -               | 1,468         | 2,091         |
| Forward exchange contracts                            | -             | -             | (24,151)        | (20,713)        | (24,151)      | (20,713)      |
| Other   | 13,592        | 11,932        | (5,819)         | (5,453)         | 7,773         | 6,479         |
| Tax loss carry-forwards                               | -             | 331           | -               | -               | -             | 331           |
| <b>Deferred tax assets/(liabilities)</b>              | <b>46,310</b> | <b>43,610</b> | <b>(30,238)</b> | <b>(26,358)</b> | <b>16,072</b> | <b>17,252</b> |
| Set off of tax  | (30,238)      | (26,358)      | 30,238          | 26,358          | -             | -             |
| <b>Net deferred tax assets</b>                        | <b>16,072</b> | <b>17,252</b> | <b>-</b>        | <b>-</b>        | <b>16,072</b> | <b>17,252</b> |

#### Unrecognised deferred tax liabilities

At 30 June 2011, a deferred tax liability of \$20.2 million (2010: \$20.1 million) relating to investments in subsidiaries has not been recognised because the Company controls whether the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future.

#### Current tax assets and liabilities

The current tax assets for the Consolidated Entity of \$3.9 million (2010: \$7.7 million) represent the amount of income taxes recoverable in respect of prior periods and arise from the payment of tax in excess of the amounts due to the relevant taxation authority. The current tax liabilities for the Consolidated Entity of \$17.3 million (2010: \$12.6 million) represent the amount of income taxes payable in respect of current and prior financial periods.

#### Movement in temporary differences during the year

|   | Note | 2011          | 2010          |
|---|------|---------------|---------------|
|   |      | \$000         | \$000         |
| Carrying amount at beginning of financial year  |      | 17,252        | 21,720        |
| Recognised in the income statement              | 8    | 4,525         | 3,594         |
| Recognised in other comprehensive income        | 8    | (3,475)       | (11,585)      |
| Recognised directly in equity                   | 8    | (1,164)       | 4,059         |
| Effects of movements in foreign exchange        |      | (1,066)       | (536)         |
| <b>Carrying amount at end of financial year</b> |      | <b>16,072</b> | <b>17,252</b> |

|   | 2011           | 2010           |
|---|----------------|----------------|
|   | \$000          | \$000          |
| <b>17. Loans and borrowings</b>   |                |                |
| <b>Current</b>  |                |                |
| Secured bank loan – operations  | 60,000         | -              |
| Secured bank loan – construction of Headquarters                            | -              | 73,811         |
| <b>Total current loans and borrowings</b>                                   | <b>60,000</b>  | <b>73,811</b>  |
| <b>Non-current</b>  |                |                |
| Secured bank loans – operations <sup>(i)</sup>                              | 3,040          | 82,934         |
| <b>Total non-current loans and borrowings</b>                               | <b>3,040</b>   | <b>82,934</b>  |
| <b>Financing arrangements</b>   |                |                |
| Cochlear had access to the following lines of credit at the reporting date: |                |                |
| Unsecured bank overdrafts   | 396            | 409            |
| Secured bank loans  | 3,539          | 3,843          |
| Secured bank loan – multi-option credit facility                            | 120,000        | 292,042        |
| Standby letters of credit   | 30,018         | 7,313          |
| Bank guarantees   | 4,882          | 5,329          |
| Secured bank loan – construction of Headquarters                            | -              | 110,000        |
| Bank guarantees – construction of Headquarters                              | -              | 1,000          |
|   | <b>158,835</b> | <b>419,936</b> |
| <b>Facilities utilised at the reporting date</b>                            |                |                |
| Unsecured bank overdrafts   | -              | -              |
| Secured bank loans  | 3,539          | 3,843          |
| Secured bank loan – multi-option credit facility                            | 60,000         | 80,000         |
| Standby letters of credit   | 10,545         | 7,313          |
| Bank guarantees   | 1,116          | 4,859          |
| Secured bank loan – construction of Headquarters                            | -              | 73,811         |
| Bank guarantees – construction of Headquarters                              | -              | 1,000          |
|   | <b>75,200</b>  | <b>170,826</b> |
| <b>Facilities not utilised at the reporting date</b>                        |                |                |
| Unsecured bank overdrafts   | 396            | 409            |
| Secured bank loans  | -              | -              |
| Secured bank loan – multi-option credit facility                            | 60,000         | 212,042        |
| Standby letters of credit   | 19,473         | -              |
| Bank guarantees   | 3,766          | 470            |
| Secured bank loan – construction of Headquarters                            | -              | 36,189         |
| Bank guarantees – construction of Headquarters                              | -              | -              |
|   | <b>83,635</b>  | <b>249,110</b> |

(i) Included within secured bank loans – operations is an amount of \$499,019 (2010: \$909,000) in relation to unamortised loan establishment fees.

#### Unsecured bank overdrafts

Certain unsecured bank overdrafts are payable on demand and are subject to annual review. Interest on unsecured bank facilities is variable and is charged at prevailing market rates.

#### Secured bank loans

Cochlear has a JPY300 million bank facility maturing September 2012, which is secured by a letter of guarantee. Interest is charged at prevailing market rates.

**Secured bank loans – multi-option credit facility**

Cochlear's corporate debt facility was amended and restated in April 2011. The facility now has two tranches: Tranche A is a \$75.0 million loan facility which may be extended for periods of 12 months, up until 20 April 2014; and Tranche B has a total limit of \$75.0 million maturing 20 April 2014. Tranche B provides Cochlear with the option to reallocate a sub-limit of up to \$30.0 million for the purpose of drawing either bank guarantees or letters of credit. The facility is secured by interlocking guarantees provided by certain controlled entities. Interest on the facility is variable and is charged at prevailing market rates.

**Secured bank loans – bank guarantee facility**

In December 2009, Cochlear secured a GBP1.0 million bank guarantee line which is supported by corporate indemnities and guarantee of up to GBP2.0 million.

|   | 2011           | 2010           |
|---|----------------|----------------|
|   | \$000          | \$000          |
| <b>18. 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   | 21,474         | 19,487         |
| Later than one year but not later than five years   | 66,650         | 71,912         |
| Later than five years   | 122,085        | 152,145        |
| <b>Total operating lease commitments</b>  | <b>210,209</b> | <b>243,544</b> |
| <b>Capital expenditure commitments</b>  |                |                |
| Contracted but not provided for and payable:  |                |                |
| Not later than one year   | 3,800          | 8,035          |
| <b>Total capital expenditure commitments</b>  | <b>3,800</b>   | <b>8,035</b>   |

Cochlear leases property under non-cancellable operating leases expiring from one to 15 years. Leases generally provide Cochlear 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 movements in the Consumer Price Index.

|  | Note | 2011<br>\$000 | 2010<br>\$000 |
|--|------|---------------|---------------|
| <b>19. Provisions</b>  |      |               |               |
| <b>Current</b>   |      |               |               |
| Employee benefits  | 25   | 26,795        | 22,474        |
| Warranties   |      | 9,336         | 8,542         |
| Legal and other  |      | 5,294         | 4,907         |
| Directors' retirement scheme   | 25   | -             | 888           |
| Make good lease costs  |      | 968           | 85            |
| <b>Total current provisions</b>  |      | <b>42,393</b> | <b>36,896</b> |
| <b>Non-current</b>   |      |               |               |
| Employee benefits  | 25   | 4,528         | 4,267         |
| Warranties   |      | 2,482         | 2,271         |
| Directors' retirement scheme   | 25   | 382           | 364           |
| Make good lease costs  |      | 3,872         | 4,703         |
| <b>Total non-current provisions</b>  |      | <b>11,264</b> | <b>11,605</b> |
| <b>Reconciliations</b>   |      |               |               |
| Reconciliations of the carrying amounts of each class of provision, except for the employee benefits provision, are set out below: |      |               |               |
| <b>Warranties</b>  |      |               |               |
| Carrying amount at beginning of financial year   |      | 10,813        | 10,137        |
| Provisions made  |      | 22,870        | 23,350        |
| Provisions used  |      | (21,865)      | (22,674)      |
| <b>Carrying amount at end of financial year</b>  |      | <b>11,818</b> | <b>10,813</b> |
| <b>Legal and other</b>   |      |               |               |
| Carrying amount at beginning of financial year   |      | 4,907         | 4,412         |
| Provisions made  |      | 2,307         | 2,359         |
| Provisions used  |      | (1,905)       | (1,855)       |
| Effects of movements in foreign exchange   |      | (15)          | (9)           |
| <b>Carrying amount at end of financial year</b>  |      | <b>5,294</b>  | <b>4,907</b>  |
| <b>Directors' retirement scheme</b>  |      |               |               |
| Carrying amount at beginning of financial year   |      | 1,252         | 1,200         |
| Provisions made  |      | 22            | 52            |
| Provisions used  |      | (892)         | -             |
| <b>Carrying amount at end of financial year</b>  |      | <b>382</b>    | <b>1,252</b>  |
| <b>Make good lease costs</b>   |      |               |               |
| Carrying amount at beginning of financial year   |      | 4,788         | 1,459         |
| Provisions made  |      | 1,247         | 3,346         |
| Provisions used  |      | (1,182)       | -             |
| Effects of movements in foreign exchange   |      | (13)          | (17)          |
| <b>Carrying amount at end of financial year</b>  |      | <b>4,840</b>  | <b>4,788</b>  |

### **Employee benefits**

Employee benefits include entitlements measured at the present value of future amounts expected to be paid, based on a 4% per annum projected weighted average increase in remuneration rates over an average period of eight years. The present value is calculated using a weighted average discount rate of 5% per annum based on national government securities with similar maturity terms.

### **Warranties**

See Note 3(g) for details of how the provision balance is determined.

### **Legal and other**

See Note 3(g) for details of how the provision balance is determined.

### **Directors' retirement scheme**

Non-executive directors appointed prior to 2003 were entitled to retirement benefits of up to three times their annual remuneration over the previous three years once they had more than five years' service. The ongoing accrual of benefits under the directors' retirement scheme ceased from 30 June 2007. The benefits accrued to that date are indexed by reference to the bank bill rate.

### **Make good lease costs**

See Note 3(g) for details of how the provision balance is determined.

## **20. Contingent liabilities**

The details and estimated maximum amounts of contingent liabilities are set out below. The directors are of the opinion that provisions are either adequate or 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.

### **Patent infringement complaint**

During the year ended 30 June 2008, the Company was served with a complaint for patent infringement by the Alfred E. Mann Foundation for Scientific Research (Mann Foundation).

The complaint, filed in the US District Court of California, alleges that two patents have been infringed.

The Company believes the Mann Foundation's allegations are without merit and is vigorously defending the complaint.

At the date of this report, the litigation process is ongoing. No provision has been established against settlement because the probability of a significant outflow is considered unlikely.

### **Guarantees - Operations**

Cochlear amended and restated its multi-option credit facility in April 2011. The facility now has two tranches with a total facility limit of \$150.0 million and provides Cochlear with a loan sub-facility limit, which may not exceed \$30.0 million for the purpose of drawing either bank guarantees or letters of credit. The loan sub-facility limit forms part of Tranche B of the facility, which matures 20 April 2014.

In December 2009, Cochlear secured a GBP1.0 million bank guarantee line which is supported by corporate indemnities and guarantee of up to GBP2.0 million.

### **Guarantees – Otologics LLC**

Cochlear has arranged a letter of credit of USD10.0 million (expiring 1 June 2012) facilitating a loan by Wells Fargo Bank funding joint research operations with Otologics LLC.

The obligation of Otologics to pay Cochlear if a call is made on the letter of credit is secured by intellectual property owned by Otologics LLC.

## 21. Capital and reserves

### Share capital

|   | Number of issued shares<br>in market circulation |                   | Number of shares held in<br>Trust under CELTIP |               | Total number of issued<br>shares |                   |
|---|--|-------------------|--|---------------|----------------------------------|-------------------|
|   | 2011   | 2010              | 2011   | 2010          | 2011                             | 2010              |
| On issue 1 July – fully paid                                  | 56,482,346                                       | 55,977,555        | 61,055   | 74,188        | 56,543,401                       | 56,051,743        |
| Issued for nil consideration under the<br>Employee Share Plan | 15,694   | 18,207            | -  | -             | 15,694                           | 18,207            |
| Shares issued into Trust                                      | -  | -                 | -  | 12,956        | -                                | 12,956            |
| Shares purchased from the market                              | (19,736)   | -                 | 19,736   | -             | -                                | -                 |
| Issued from the exercise of options                           | 185,928  | 460,495           | -  | -             | 185,928                          | 460,495           |
| Performance shares vesting from Trust                         | 15,910   | 26,089            | (15,910)                                       | (26,089)      | -                                | -                 |
| <b>On issue 30 June – fully paid</b>                          | <b>56,680,142</b>                                | <b>56,482,346</b> | <b>64,881</b>                                  | <b>61,055</b> | <b>56,745,023</b>                | <b>56,543,401</b> |

Cochlear has also issued options (see Note 25(b)).

The Company does not have authorised capital or par value in respect of its issued shares.

The 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.

### Treasury reserve

The treasury reserve comprises the cost of shares acquired by the Trust at the date of purchase.

### Translation reserve

The translation reserve records the foreign currency differences arising from the translation of the financial statements of foreign operations as well as from the translation of liabilities that hedge the Company's net investment in a foreign subsidiary, where their functional currency is different to the presentation currency of the reporting entity. See Note 3(d) for further details.

### Hedging reserve

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

### Share based payment reserve

The share based payment reserve comprises the cost of shares distributed to eligible executives under the CELTIP, as detailed in Note 25(b).

**22. Notes to the statement of cash flows**
**Cash assets**

The operating account received an average interest rate of 1.68% (2010: 1.0%) per annum.

Cash held on deposit for periods not exceeding 90 days received an average interest rate of 3.09% (2010: 2.8%) per annum.

**(a) Reconciliation of cash and cash equivalents**

For the purpose of the statement of cash flows, cash includes cash on hand and at bank and short-term deposits, net of outstanding bank overdrafts. Cash and cash equivalents at the reporting date as shown in the statement of cash flows are reconciled to the related items in the balance sheet as follows:

|   | 2011           | 2010           |
|---|----------------|----------------|
|   | \$000          | \$000          |
| Cash on hand  | 40,658         | 28,504         |
| Cash on deposit   | 31,765         | 14,304         |
| <b>Cash and cash equivalents</b>  | <b>72,423</b>  | <b>42,808</b>  |
| <br>  |                |                |
| <b>(b) Reconciliation of net profit to net cash provided by operating activities</b>      |                |                |
| Net profit  | 180,114        | 155,152        |
| <b>Add/(less) items classified as investing activities</b>                                |                |                |
| Loss on disposal of property, plant and equipment   | 857            | 470            |
| Construction profit net of relocation expense   | (6,130)        | -              |
| <b>Add non-cash items</b>   |                |                |
| Amounts set aside to provisions   | 53,453         | 56,309         |
| Depreciation and amortisation   | 27,395         | 23,097         |
| Equity settled share based payment transactions   | 5,426          | 5,068          |
| <b>Net cash provided by operating activities before changes in assets and liabilities</b> | <b>261,115</b> | <b>240,096</b> |
| <b>Changes in assets and liabilities</b>  |                |                |
| Change in trade and other receivables   | (9,259)        | (3,752)        |
| Change in inventories   | (3,511)        | 1,537          |
| Change in prepayments   | (752)          | 243            |
| Change in deferred tax assets   | 1,180          | (7,103)        |
| Change in trade and other payables  | 7,171          | 11,550         |
| Change in current tax liabilities   | 8,417          | 3,471          |
| Change in provisions  | (50,965)       | (49,208)       |
| Change in deferred revenue  | (316)          | 4,370          |
| Effects of movements in foreign exchange  | (11,803)       | (21,658)       |
| <b>Net cash provided by operating activities</b>  | <b>201,277</b> | <b>179,546</b> |



**23. Controlled entities**

|  | Interest held |           | Country of incorporation/<br>formation |
|--|---------------|-----------|--|
|  | 2011<br>%     | 2010<br>% |  |
| <b>Particulars in relation to controlled entities</b>                  |               |           |  |
| <b>Company</b>   |               |           |  |
| Cochlear Limited   |               |           | Australia                              |
| <b>Controlled entities</b>   |               |           |  |
| Cochlear AG  | 100           | 100       | Switzerland                            |
| Cochlear Americas  | 100           | 100       | USA                                    |
| Cochlear Benelux NV  | 100           | 100       | Belgium                                |
| Cochlear Bone Anchored Solutions AB                                    | 100           | 100       | Sweden                                 |
| Cochlear Canada Inc  | 100           | 100       | Canada                                 |
| Cochlear Deutschland GmbH & Co KG                                      | 100           | 100       | Germany                                |
| Cochlear Employee Share Trust  | 100           | 100       | Australia                              |
| Cochlear Europe Finance GmbH   | 100           | 100       | Germany                                |
| Cochlear Europe Limited  | 100           | 100       | UK                                     |
| Cochlear Executive Long Term Incentive Plan (Performance Shares) Trust | 100           | 100       | Australia                              |
| Cochlear Finance Pty Limited   | 100           | 100       | Australia                              |
| Cochlear France SAS  | 100           | 100       | France                                 |
| Cochlear German Holdings Pty Limited                                   | 100           | 100       | Australia                              |
| Cochlear Holdings NV   | 100           | 100       | Belgium                                |
| Cochlear Incentive Plan Pty Limited                                    | 100           | 100       | Australia                              |
| Cochlear Investments Pty Ltd   | 100           | 100       | Australia                              |
| Cochlear Latino America Sociedad Anonima                               | 100           | -         | Panama                                 |
| Cochlear Italia SRL  | 100           | 100       | Italy                                  |
| Cochlear Korea Limited   | 100           | 100       | Korea                                  |
| Cochlear Malaysia Sdn. Bhd.  | 100           | 100       | Malaysia                               |
| Cochlear Manufacturing Corporation                                     | 100           | 100       | USA                                    |
| Cochlear Medical Device (Beijing) Co., Ltd                             | 100           | 100       | China                                  |
| Cochlear Medical Device Company India Private Limited                  | 100           | 100       | India                                  |
| Cochlear Nordic AB   | 100           | 100       | Sweden                                 |
| Cochlear Research and Development Limited                              | 100           | 100       | UK                                     |
| Cochlear Sweden Holdings AB  | 100           | 100       | Sweden                                 |
| Cochlear Technologies Pty Limited                                      | (i)           | 100       | Australia                              |
| Cochlear Tibbi Cihazlar ve Saglik Hizmetleri Limited Sirketi           |               | 100       | Turkey                                 |
| Cochlear Verwaltungs GmbH  |               | 100       | Germany                                |
| Cochlear (HK) Limited  | 99.99         | 99.99     | Hong Kong                              |
| Cochlear (UK) Limited  | (i)           | 100       | UK                                     |
| Lachlan Project Development Pty Ltd                                    |               | 100       | Australia                              |
| Lachlan Project Holdings Pty Ltd                                       |               | 100       | Australia                              |
| Lachlan Project Security Holdings Pty Ltd                              |               | 100       | Australia                              |
| Medical Insurance Pte Limited  |               | 100       | Singapore                              |
| Miaki NV   |               | 100       | Belgium                                |
| Neopraxis Pty Limited  | (i)           | 100       | Australia                              |
| Nihon Cochlear Co Limited  |               | 100       | Japan                                  |
| Percutis AB  |               | 100       | Sweden                                 |

(i) Dormant.

**24. Related parties**

**Key management personnel**

The following were key management personnel of Cochlear at any time during the financial year and unless otherwise indicated were key management personnel for the entire period:

**Non-executive directors**

Mr R Holliday-Smith (Chairman)

Mrs YA Allen

Mr PR Bell

Prof E Byrne, AO

Mr A Denver

Mr DP O'Dwyer

**Executive director**

Dr CG Roberts

**Executives**

Mr R Brook

Mr J Janssen

Mr NJ Mitchell

Mr MD Salmon

Mr CM Smith.

**Key management personnel disclosures**

The key management personnel compensation is included in employee benefits expense as follows:

|                                | 2011             | 2010             |
|--------------------------------|------------------|------------------|
|                                | \$               | \$               |
| Short-term employee benefits   | 6,513,066        | 5,905,985        |
| Post-employment benefits       | 301,336          | 287,104          |
| Other long-term benefits       | 60,788           | 66,982           |
| Directors' retirement benefits | 18,288           | 51,413           |
| Share based payments           | 1,268,988        | 1,176,764        |
|                                | <b>8,162,466</b> | <b>7,488,248</b> |

Information regarding individual directors' and executives' remuneration and some equity instruments disclosures as permitted by section 300A of the Corporations Act 2001 is provided in the Remuneration Report in the Directors' Report on pages 4 to 13.

The key management personnel have not received any loans from Cochlear and there have been no other related party transactions with any of Cochlear's key management personnel unless where noted throughout this Financial Report.

**Options and performance shares granted as compensation**

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

|                                   | Held at<br>1 July 2010 | Granted as<br>remuneration | Vested and<br>exercised | Forfeited | Held at<br>30 June 2011 | Vested and<br>exercisable<br>at<br>30 June 2011 |
|-----------------------------------|------------------------|----------------------------|-------------------------|-----------|-------------------------|---|
| <b>Option holdings</b>            |                        |                            |                         |           |                         |   |
| <b>Executive director</b>         |                        |                            |                         |           |                         |   |
| Dr CG Roberts                     | 283,817                | 86,272                     | (64,718)                | (7,829)   | 297,542                 | 51,259  |
| <b>Executives</b>                 |                        |                            |                         |           |                         |   |
| Mr R Brook                        | 88,726                 | 17,674                     | (36,469)                | (2,308)   | 67,623                  | -   |
| Mr J Janssen                      | 72,072                 | 17,559                     | (31,120)                | (1,775)   | 56,736                  | -   |
| Mr NJ Mitchell                    | 89,597                 | 21,302                     | (31,014)                | (2,073)   | 77,812                  | -   |
| Mr MD Salmon                      | 84,610                 | 22,363                     | (16,929)                | (1,973)   | 88,071                  | 12,918  |
| Mr CM Smith                       | 81,182                 | -                          | (21,512)                | (1,666)   | 58,004                  | 5,910   |
| <b>Performance share holdings</b> |                        |                            |                         |           |                         |   |
| <b>Executive director</b>         |                        |                            |                         |           |                         |   |
| Dr CG Roberts                     | -                      | -                          | -                       | -         | -                       | -   |
| <b>Executives</b>                 |                        |                            |                         |           |                         |   |
| Mr R Brook                        | -                      | -                          | -                       | -         | -                       | -   |
| Mr J Janssen                      | -                      | -                          | -                       | -         | -                       | -   |
| Mr NJ Mitchell                    | -                      | -                          | -                       | -         | -                       | -   |
| Mr MD Salmon                      | -                      | -                          | -                       | -         | -                       | -   |
| Mr CM Smith                       | 4,103                  | 5,781                      | (2,062)                 | (315)     | 7,507                   | -   |

|                                   | Held at<br>1 July 2009 | Granted as<br>remuneration | Vested and<br>exercised | Forfeited | Held at<br>30 June 2010 | Vested and<br>exercisable<br>at<br>30 June 2010 |
|-----------------------------------|------------------------|----------------------------|-------------------------|-----------|-------------------------|---|
| <b>Option holdings</b>            |                        |                            |                         |           |                         |   |
| <b>Executive director</b>         |                        |                            |                         |           |                         |   |
| Dr CG Roberts                     | 309,913                | 58,599                     | (78,991)                | (5,704)   | 283,817                 | 64,718  |
| <b>Executives</b>                 |                        |                            |                         |           |                         |   |
| Mr R Brook                        | 70,946                 | 19,663                     | -                       | (1,883)   | 88,726                  | 21,356  |
| Mr J Janssen                      | 76,145                 | 14,358                     | (16,713)                | (1,718)   | 72,072                  | 19,499  |
| Mr NJ Mitchell                    | 70,448                 | 20,686                     | -                       | (1,537)   | 89,597                  | 17,443  |
| Mr MD Salmon                      | 93,770                 | 19,344                     | (27,011)                | (1,493)   | 84,610                  | 16,929  |
| Mr CM Smith                       | 84,614                 | 22,379                     | (23,474)                | (2,337)   | 81,182                  | 16,512  |
| <b>Performance share holdings</b> |                        |                            |                         |           |                         |   |
| <b>Executive director</b>         |                        |                            |                         |           |                         |   |
| Dr CG Roberts                     | -                      | -                          | -                       | -         | -                       | -   |
| <b>Executives</b>                 |                        |                            |                         |           |                         |   |
| Mr R Brook                        | 2,678                  | -                          | (2,678)                 | -         | -                       | -   |
| Mr J Janssen                      | 1,245                  | -                          | (1,245)                 | -         | -                       | -   |
| Mr NJ Mitchell                    | -                      | -                          | -                       | -         | -                       | -   |
| Mr MD Salmon                      | -                      | -                          | -                       | -         | -                       | -   |
| Mr CM Smith                       | 4,103                  | -                          | -                       | -         | 4,103                   | -   |

No options held by key management personnel were vested but not exercisable at 30 June 2010 or 2011.

All options and performance shares granted in the 2011 financial year were granted on 16 August 2010 and vest in August 2013. Options have an expiration date of 16 August 2015. 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 \$69.80 per share and a fair value of \$10.98 per share at grant date for options with performance based conditions and \$8.75 per share at grant date for options with market based conditions. The performance shares granted during the financial year had a fair value at grant date of \$46.78 per share for performance shares with performance based conditions and \$35.62 per share at grant date for performance shares with market based conditions.

**Movement in shares**

The movement during the financial year in the number of ordinary shares of Cochlear Limited held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

|                      | Held at<br>1 July 2010 | Purchases | Received on<br>exercise of<br>options and<br>performance<br>shares | Sales    | Held at<br>30 June 2011 |
|----------------------|------------------------|-----------|--|----------|-------------------------|
| <b>Directors</b>     |                        |           |  |          |                         |
| <b>Non-executive</b> |                        |           |  |          |                         |
| Mr R Holliday-Smith  | 2,500                  | 3,000     | -  | -        | 5,500                   |
| Mrs YA Allen*        | 1,000                  | 1,500     | -  | -        | 2,500                   |
| Mr PR Bell           | 2,500                  | -         | -  | -        | 2,500                   |
| Prof E Byrne, AO     | 2,000                  | -         | -  | -        | 2,000                   |
| Mr A Denver          | 2,500                  | -         | -  | -        | 2,500                   |
| Mr DP O'Dwyer        | 3,350                  | -         | -  | -        | 3,350                   |
| <b>Executive</b>     |                        |           |  |          |                         |
| Dr CG Roberts        | 660,592                | -         | 64,718   | -        | 725,310                 |
| <b>Executives</b>    |                        |           |  |          |                         |
| Mr R Brook           | 8,806                  | -         | 36,469   | (36,469) | 8,806                   |
| Mr J Janssen         | 1,801                  | -         | 31,120   | -        | 32,921                  |
| Mr NJ Mitchell       | 20,000                 | -         | 31,014   | (17,443) | 33,571                  |
| Mr MD Salmon         | 9,740                  | -         | 16,929   | (16,929) | 9,740                   |
| Mr CM Smith          | 3,964                  | -         | 23,574   | (17,538) | 10,000                  |

|                      | Held at<br>1 July 2009 | Purchases | Received on<br>exercise of<br>options and<br>performance<br>shares | Sales    | Held at<br>30 June 2010 |
|----------------------|------------------------|-----------|--|----------|-------------------------|
| <b>Directors</b>     |                        |           |  |          |                         |
| <b>Non-executive</b> |                        |           |  |          |                         |
| Mr R Holliday-Smith  | 2,500                  | -         | -  | -        | 2,500                   |
| Mr TCE Bergman       | 12,000                 | -         | -  | -        | 12,000                  |
| Mr PR Bell           | 2,500                  | -         | -  | -        | 2,500                   |
| Prof E Byrne, AO     | 2,000                  | -         | -  | -        | 2,000                   |
| Mr A Denver          | 2,500                  | -         | -  | -        | 2,500                   |
| Mr DP O'Dwyer        | 3,350                  | -         | -  | -        | 3,350                   |
| <b>Executive</b>     |                        |           |  |          |                         |
| Dr CG Roberts        | 602,821                | -         | 78,991   | (21,220) | 660,592                 |
| <b>Executives</b>    |                        |           |  |          |                         |
| Mr R Brook           | 11,128                 | -         | 2,678  | (5,000)  | 8,806                   |
| Mr J Janssen         | 556                    | -         | 17,958   | (16,713) | 1,801                   |
| Mr NJ Mitchell       | 59,852                 | -         | -  | (39,852) | 20,000                  |
| Mr MD Salmon         | 9,740                  | -         | 27,011   | (27,011) | 9,740                   |
| Mr CM Smith          | 2,122                  | -         | 23,474   | (21,632) | 3,964                   |

\* Shareholding at 1 July 2010 represents holding before appointment as director.

|  | Note | 2011<br>\$000 | 2010<br>\$000 |
|--|------|---------------|---------------|
| <b>25. Employee benefits</b>               |      |               |               |
| <b>Current</b>                             |      |               |               |
| Provision for long service leave           | 19   | 5,107         | 4,220         |
| Provision for annual leave                 | 19   | 13,188        | 11,286        |
| Provision for short-term incentives        | 19   | 8,500         | 6,968         |
| Provision for directors' retirement scheme | 19   | -             | 888           |
|  |      | 26,795        | 23,362        |
| Salary and wages accrued                   |      | 4,073         | 4,663         |
| <b>Total current employee benefits</b>     |      | <b>30,868</b> | <b>28,025</b> |
| <b>Non-current</b>                         |      |               |               |
| Provision for long service leave           | 19   | 4,528         | 4,267         |
| Provision for directors' retirement scheme | 19   | 382           | 364           |
| <b>Total non-current employee benefits</b> |      | <b>4,910</b>  | <b>4,631</b>  |
| <b>Total employee benefits</b>             |      | <b>35,778</b> | <b>32,656</b> |

Cochlear has benefit plans that provide pension benefits to employees upon retirement. These defined benefit plans cover, in aggregate, 65 employees. Cochlear contributed cash of \$0.8 million (2010: \$0.9 million) to defined benefit plans in the year ended 30 June 2011 and expects to contribute \$0.9 million in the year ending 30 June 2012. The net assets of the plans at 30 June 2011 were \$0.3 million (2010: \$0.3 million).

**(a) Defined contribution superannuation plans**

Cochlear makes contributions to defined contribution plans. The amount recognised as expense was \$12.9 million for the year ended 30 June 2011 (2010: \$11.7 million).

**(b) Share based payments**

Cochlear's Employee Share Plan (Plan) was approved by special resolution at the Annual General Meeting held on 19 October 1999. Under the Plan, the directors can at their discretion, 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 financial year 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.

The CELTIP was approved and adopted at the Annual General Meeting on 20 October 2003 and replaced the Executive Share Option Plan. The CELTIP offers a mixture of options over unissued shares and performance shares. Both the options and the performance shares are subject to a three year vesting period. The number of options and performance shares exercisable by the executives will depend on the performance of Cochlear over the vesting period. Half of the offer will be assessed against the compound annual growth rate of the EPS achieved by Cochlear, and the other half against the TSR as measured against the S&P/ASX 100 comparator group. If the minimum compound annual growth rate in EPS of 10% is not achieved, 50% of shares will not be issued or released to the executives. If the TSR of Cochlear is below the 50<sup>th</sup> percentile against the S&P/ASX 100 comparator group over the three years, the remaining 50% of shares will not be issued or released.

To achieve a 100% allocation of options and shares, a compound annual growth rate in EPS of more than 20% over three years must be achieved and the TSR of Cochlear must be above the 75<sup>th</sup> percentile against the S&P/ASX 100.

At the date of this report, unissued ordinary shares of the Company under option and issued shares held in the Trust and the terms and conditions of the grants and issues are as follows:

| Grant date                  | Number of instruments | Conditions for minimum vesting   | Contractual life of options |
|-----------------------------|-----------------------|--|-----------------------------|
| Option grant in August 2007 | 84,378                | Three years of service, a minimum compound annual growth rate in EPS of 10%.                                     | 5 years                     |
|                             | 84,378                | The Consolidated Entity's TSR is above the 50 <sup>th</sup> percentile against the S&P/ASX 100 over three years. | 5 years                     |
| Option grant in August 2008 | 348,057               | Three years of service, a minimum compound annual growth rate in EPS of 10%.                                     | 5 years                     |
|                             | 348,056               | The Consolidated Entity's TSR is above the 50 <sup>th</sup> percentile against the S&P/ASX 100 over three years. | 5 years                     |
| Option grant in August 2009 | 209,453               | Three years of service, a minimum compound annual growth rate in EPS of 10%.                                     | 5 years                     |
|                             | 209,452               | The Consolidated Entity's TSR is above the 50 <sup>th</sup> percentile against the S&P/ASX 100 over three years. | 5 years                     |
| Option grant in August 2010 | 217,839               | Three years of service, a minimum compound annual growth rate in EPS of 10%.                                     | 5 years                     |
|                             | 217,838               | The Consolidated Entity's TSR is above the 50 <sup>th</sup> percentile against the S&P/ASX 100 over three years. | 5 years                     |
| <b>Total options</b>        | <b>1,719,451</b>      |  |                             |

| Issue date                               | Number of instruments | Conditions for minimum vesting   | Contractual life of shares in the Trust |
|--|-----------------------|--|---|
| Performance shares issued in August 2007 | 164                   | Three years of service, a minimum compound annual growth rate in EPS of 10%.                                     | 5 years                                 |
|  | 164                   | The Consolidated Entity's TSR is above the 50 <sup>th</sup> percentile against the S&P/ASX 100 over three years. | 5 years                                 |
| Performance shares issued in August 2008 | 10,430                | Three years of service, a minimum compound annual growth rate in EPS of 10%.                                     | 5 years                                 |
|  | 10,430                | The Consolidated Entity's TSR is above the 50 <sup>th</sup> percentile against the S&P/ASX 100 over three years. | 5 years                                 |
| Performance shares issued in August 2009 | 8,782                 | Three years of service, a minimum compound annual growth rate in EPS of 10%.                                     | 5 years                                 |
|  | 8,782                 | The Consolidated Entity's TSR is above the 50 <sup>th</sup> percentile against the S&P/ASX 100 over three years. | 5 years                                 |
| Performance shares issued in August 2010 | 11,282                | Three years of service, a minimum compound annual growth rate in EPS of 10%.                                     | 5 years                                 |
|  | 11,282                | The Consolidated Entity's TSR is above the 50 <sup>th</sup> percentile against the S&P/ASX 100 over three years. | 5 years                                 |
| <b>Total performance shares</b>          | <b>61,316</b>         |  |   |

The number and weighted average exercise prices of options are as follows:

|                               | Weighted<br>average<br>exercise price<br>\$ | Number of<br>options | Weighted<br>average<br>exercise price<br>\$ | Number of<br>options |
|-------------------------------|---|----------------------|---|----------------------|
|                               | 2011  | 2011                 | 2010  | 2010                 |
| Outstanding at 1 July         | 55.00                                       | 1,818,601            | 50.71                                       | 1,895,423            |
| Forfeited                     | 63.35                                       | (70,728)             | 51.53                                       | (51,930)             |
| Exercised                     | 54.09                                       | (471,920)            | 42.52                                       | (460,498)            |
| Granted                       | 69.80                                       | 443,498              | 60.04                                       | 435,606              |
| <b>Outstanding at 30 June</b> | <b>58.72</b>                                | <b>1,719,451</b>     | <b>55.00</b>                                | <b>1,818,601</b>     |
| Exercisable at 30 June        | 63.18                                       | 168,756              | 49.43                                       | 312,058              |

The weighted average share price at date of exercise was \$74.28 (2010: \$61.83).

The estimated value of options for the current financial year is calculated at the date of grant using the Black-Scholes model, applying a 34.6% volatility, as reflected in the historical volatility.

For options outstanding at 30 June 2011, 168,756 options have an exercise price of \$63.18, 696,113 options have an exercise price of \$49.91, 418,905 options have an exercise price of \$60.04 and 435,677 options have an exercise price of \$69.80 (2010: 312,058 options at \$49.43, 378,811 options at \$63.18, 696,113 options at \$49.91 and 431,619 options at \$60.04). The weighted average remaining contractual life of options outstanding at the end of the year is three years (2010: three years).

#### **Inputs for measurement of grant date fair values**

The grant date fair value of options and performance shares was measured based on the Black-Scholes model. Expected volatility is estimated by considering historic average share price volatility. The inputs used in the measurement of the fair values at grant date are the following:

|   | 2011        | 2010        |
|---|-------------|-------------|
| Fair value of options at grant date                 | \$9.86      | \$9.04      |
| Fair value of performance shares at grant date      | \$41.26     | \$36.52     |
| Share price at grant date                           | \$69.31     | \$61.15     |
| Exercise price                                      | \$69.80     | \$60.04     |
| Expected volatility (weighted average volatility)   | 34.6%       | 33.2%       |
| Option life   | 3 - 5 years | 3 - 5 years |
| Expected dividends                                  | 2.60%       | 2.62%       |
| Risk free interest rate (based on government bonds) | 4.49%       | 4.92%       |

## 26. Financial instruments

### Credit risk

#### *Exposure to credit risk*

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

|   | 2011           | 2010           |
|---|----------------|----------------|
|   | \$000          | \$000          |
| Cash and cash equivalents                                   | 72,423         | 42,808         |
| Trade receivables and other receivables                     | 176,364        | 166,788        |
| Forward exchange contracts                                  | 79,096         | 68,841         |
| Interest rate swap on loan for construction of Headquarters | -              | 204            |
|   | <b>327,883</b> | <b>278,641</b> |

The maximum exposure to credit risk for trade receivables at the reporting date by geographic region was:

|              | 2011           | 2010           |
|--------------|----------------|----------------|
|              | \$000          | \$000          |
| Americas     | 48,814         | 56,578         |
| Europe       | 82,968         | 77,735         |
| Asia Pacific | 34,129         | 25,216         |
|              | <b>165,911</b> | <b>159,529</b> |

#### *Impairment losses*

The ageing of Cochlear's trade receivables at the reporting date was:

|   | 2011           | 2010           |
|---|----------------|----------------|
|   | \$000          | \$000          |
| <b>Gross receivables</b>  |                |                |
| Not past due  | 117,604        | 125,729        |
| Past due 0 – 30 days  | 19,365         | 16,573         |
| Past due 31 – 120 days  | 20,643         | 9,319          |
| Past due 121 – 270 days   | 8,717          | 10,008         |
| Past due 271 days and over                                      | 4,481          | 3,724          |
|   | <b>170,810</b> | <b>165,353</b> |
| Impairment losses   | (4,899)        | (5,824)        |
| <b>Trade receivables net of allowance for impairment losses</b> | <b>165,911</b> | <b>159,529</b> |

There are certain jurisdictions in which Cochlear operates where it is customary practice for customers to make payment beyond 270 days. As such, Cochlear discloses the balance as overdue; however, it is not indicative of a higher than normal credit risk as payments are typically received by Cochlear within the extended timeframes.

The movement in the allowance for impairment losses in respect of trade receivables during the year was as follows:

|   | 2011           | 2010           |
|---|----------------|----------------|
|   | \$000          | \$000          |
| Balance at 1 July                       | (5,824)        | (4,240)        |
| Impairment losses utilised/(recognised) | 6              | (1,980)        |
| Effect of movements in foreign exchange | 919            | 396            |
| <b>Balance at 30 June</b>               | <b>(4,899)</b> | <b>(5,824)</b> |

Impairment losses recognised in the year relate to significant individual customers or portfolios of customers which have been assessed as impaired under Cochlear's accounting policy as detailed in Note 3(i).



Based upon past experience, Cochlear believes that no impairment allowance is necessary in respect of trade receivables not past due.

The allowance accounts used in respect of trade receivables are used to record impairment losses unless Cochlear is satisfied that no recovery of the amount owing is possible; at that point, the amount considered non-recoverable is written off against the financial asset directly.

### Liquidity risk

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements:

|                              | Effective interest rate<br>Per annum | Carrying amount<br>\$000 | Contractual cash flows<br>\$000 | 6 months or less<br>\$000 | 6 - 12 months<br>\$000 | 1 - 2 years<br>\$000 | 2 - 5 years<br>\$000 | More than 5 years<br>\$000 |
|------------------------------|--------------------------------------|--------------------------|---------------------------------|---------------------------|------------------------|----------------------|----------------------|----------------------------|
| <b>Financial liabilities</b> |                                      |                          |                                 |                           |                        |                      |                      |                            |
| <b>30 June 2011</b>          |                                      |                          |                                 |                           |                        |                      |                      |                            |
| AUD floating rate loan       | 7.23%                                | 59,501                   | 64,353                          | 2,188                     | 62,165                 | -                    | -                    | -                          |
| JPY floating rate loan       | 1.41%                                | 3,539                    | 3,599                           | 25                        | 25                     | 3,549                | -                    | -                          |
| Trade and other payables     | -                                    | 85,047                   | 85,047                          | 85,047                    | -                      | -                    | -                    | -                          |
| <b>Total</b>                 |                                      | <b>148,087</b>           | <b>152,999</b>                  | <b>87,260</b>             | <b>62,190</b>          | <b>3,549</b>         | -                    | -                          |

|   | Effective interest rate<br>Per annum | Carrying amount<br>\$000 | Contractual cash flows<br>\$000 | 6 months or less<br>\$000 | 6 - 12 months<br>\$000 | 1 - 2 years<br>\$000 | 2 - 5 years<br>\$000 | More than 5 years<br>\$000 |
|---|--------------------------------------|--------------------------|---------------------------------|---------------------------|------------------------|----------------------|----------------------|----------------------------|
| <b>Financial liabilities</b>                            |                                      |                          |                                 |                           |                        |                      |                      |                            |
| <b>30 June 2010</b>                                     |                                      |                          |                                 |                           |                        |                      |                      |                            |
| AUD floating rate loan                                  | 6.97%                                | 79,091                   | 90,774                          | 2,812                     | 2,766                  | 85,196               | -                    | -                          |
| AUD floating rate loan for construction of Headquarters | 6.17%                                | 73,811                   | 75,342                          | 75,342                    | -                      | -                    | -                    | -                          |
| JPY floating rate loan                                  | 1.85%                                | 3,843                    | 3,999                           | 36                        | 35                     | 71                   | 3,857                | -                          |
| Trade and other payables                                | -                                    | 70,763                   | 70,763                          | 70,763                    | -                      | -                    | -                    | -                          |
| <b>Total</b>  |                                      | <b>227,508</b>           | <b>240,878</b>                  | <b>148,953</b>            | <b>2,801</b>           | <b>85,267</b>        | <b>3,857</b>         | -                          |

It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

### Cash flow hedges

In the year ended 30 June 2011, Cochlear designated some sales and purchases of various currencies as cash flow hedges to hedge the amount converted into AUD for forecast future transactions. These are hedges of forecast future transactions to manage the currency risk arising from exchange rate fluctuations. The hedged items were highly probable foreign currency transactions.

The effectiveness of the hedging relationship is calculated prospectively using regression analysis on market values. An effectiveness test is carried out retrospectively using the cumulative dollar offset method. For this, the changes in the fair values of the hedged item and the hedging instrument attributable to spot rate changes are calculated and a ratio is created. If this ratio is between 80% and 125%, the hedge is effective.

All material hedges were effective at the reporting date.

The following table indicates the periods in which the cash flows associated with Cochlear's derivatives that are cash flow hedges are expected to occur:

#### 30 June 2011

|                            | Carrying amount | Expected cash flows | 6 months or less | 6 - 12 months | 1 - 2 years | 2 - 5 years |
|----------------------------|-----------------|---------------------|------------------|---------------|-------------|-------------|
|                            | \$000           | \$000               | \$000            | \$000         | \$000       | \$000       |
| Forward exchange contracts | 79,096          | 79,320              | 33,424           | 29,325        | 16,534      | 37          |

#### 30 June 2010

|                            | Carrying amount | Expected cash flows | 6 months or less | 6 - 12 months | 1 - 2 years | 2 - 5 years |
|----------------------------|-----------------|---------------------|------------------|---------------|-------------|-------------|
|                            | \$000           | \$000               | \$000            | \$000         | \$000       | \$000       |
| Forward exchange contracts | 68,841          | 69,334              | 21,570           | 23,154        | 23,374      | 1,236       |

The expected impact on the income statement is not considered to be significantly different to the cash flow impact noted above.

### Currency risk

#### Exposure to currency risk

Cochlear's exposure to foreign currency risk was as follows, based upon notional amounts:

| Amounts local currency thousands    | USD           | EUR           | GBP            | SEK             | JPY           |
|-------------------------------------|---------------|---------------|----------------|-----------------|---------------|
| <b>30 June 2011</b>                 |               |               |                |                 |               |
| Trade receivables                   | 70,674        | 41,143        | 3,580          | 9,229           | 439,519       |
| Secured bank loans                  | -             | -             | -              | -               | (300,000)     |
| Trade payables                      | (12,506)      | (4,740)       | (5,887)        | (36,106)        | (102,405)     |
| <b>Gross balance sheet exposure</b> | <b>58,168</b> | <b>36,403</b> | <b>(2,307)</b> | <b>(26,877)</b> | <b>37,114</b> |

| Amounts local currency thousands    | USD           | EUR           | GBP            | SEK             | JPY           |
|-------------------------------------|---------------|---------------|----------------|-----------------|---------------|
| <b>30 June 2010</b>                 |               |               |                |                 |               |
| Trade receivables                   | 60,792        | 36,770        | 3,488          | 11,000          | 428,804       |
| Secured bank loans                  | -             | -             | -              | -               | (300,000)     |
| Trade payables                      | (11,734)      | (4,793)       | (5,845)        | (37,873)        | (52,615)      |
| <b>Gross balance sheet exposure</b> | <b>49,058</b> | <b>31,977</b> | <b>(2,357)</b> | <b>(26,873)</b> | <b>76,189</b> |

Cochlear enters into forward exchange contracts to hedge anticipated sales and purchases in USD, EUR, SEK and JPY.

The amounts of forward cover taken are in accordance with approved policy and internal forecasts.

The following table sets out the gross value to be received (sell) or paid (buy) under forward exchange contracts and the weighted average contracted exchange rates of outstanding contracts:

|   | Foreign exchange rates |       | Gross value |         |
|---|------------------------|-------|-------------|---------|
|   | 2011                   | 2010  | 2011        | 2010    |
|   |                        |       | \$000       | \$000   |
| <b>Sell USD</b>                                     |                        |       |             |         |
| Not later than one year                             |                        |       | 165,732     | 217,940 |
| Later than one year but not later than two years    |                        |       | 75,802      | 155,102 |
| Later than two years but not later than three years |                        |       | 5,154       | 51,599  |
| Weighted average exchange rates contracted          | 0.82                   | 0.78  |             |         |
| <b>Sell EUR</b>                                     |                        |       |             |         |
| Not later than one year                             |                        |       | 146,798     | 187,329 |
| Later than one year but not later than two years    |                        |       | 69,938      | 94,591  |
| Later than two years but not later than three years |                        |       | -           | 40,457  |
| Weighted average exchange rates contracted          | 0.64                   | 0.57  |             |         |
| <b>Sell JPY</b>                                     |                        |       |             |         |
| Not later than one year                             |                        |       | 6,792       | 8,327   |
| Later than one year but not later than two years    |                        |       | 2,500       | 5,016   |
| Later than two years but not later than three years |                        |       | 130         | 608     |
| Weighted average exchange rates contracted          | 75.35                  | 76.66 |             |         |

The following significant exchange rates applied to Cochlear during the year:

|         | Average rate |        | Reporting date spot rate |        |
|---------|--------------|--------|--------------------------|--------|
|         | 2011         | 2010   | 2011                     | 2010   |
| AUD 1 = |              |        |                          |        |
| USD     | 0.984        | 0.877  | 1.048                    | 0.874  |
| EUR     | 0.725        | 0.634  | 0.732                    | 0.708  |
| GBP     | 0.622        | 0.554  | 0.656                    | 0.580  |
| SEK     | 6.629        | 6.421  | 6.738                    | 6.764  |
| JPY     | 82.010       | 80.497 | 84.764                   | 78.064 |
| CHF     | 0.940        | 0.932  | 0.874                    | 0.950  |

## Interest rate risk

### Profile

At the reporting date, the interest rate profile of Cochlear's interest-bearing financial instruments was as follows:

|                                  | 2011   | 2010    |
|----------------------------------|--------|---------|
|                                  | \$000  | \$000   |
| <b>Carrying amount</b>           |        |         |
| <b>Variable rate instruments</b> |        |         |
| Financial assets                 | 72,423 | 42,808  |
| Financial liabilities            | 63,040 | 156,745 |

**Sensitivity analysis**

In managing interest rate and currency risks, Cochlear aims to reduce the impact of short-term fluctuations on Cochlear's earnings. However, over the longer term, permanent changes in foreign exchange and interest rates will have an impact on profit.

For the year ended 30 June 2011, it is estimated that a general increase of one percent in interest rates would have decreased Cochlear's profit after income tax and equity by approximately \$0.2 million (2010: \$0.2 million). A one percent decrease in interest rates would have had the equal but opposite effect on Cochlear's profit and equity.

It is estimated that a general increase of ten percent in the value of the AUD against other foreign currencies would have decreased Cochlear's profit for the year ended 30 June 2011, including hedging results and after income tax, by approximately \$10.8 million (2010: \$4.1 million) and decreased Cochlear's equity by \$13.2 million (2010: \$4.4 million). A ten percent decrease in the value of the AUD against other foreign currencies would have increased Cochlear's profit by \$7.5 million (2010: \$4.5 million) and increased equity by \$8.8 million (2010: \$4.9 million).

**Fair values**

The fair values of financial assets and liabilities, together with carrying amounts shown in the balance sheet, are as follows:

|  | Note | 2011                     |                     | 2010                     |                     |
|--|------|--------------------------|---------------------|--------------------------|---------------------|
|  |      | Carrying amount<br>\$000 | Fair value<br>\$000 | Carrying amount<br>\$000 | Fair value<br>\$000 |
| Cash and cash equivalents                        |      | 72,423                   | 72,423              | 42,808                   | 42,808              |
| Trade and other receivables – current            | 12   | 238,276                  | 238,276             | 210,690                  | 210,690             |
| Trade and other receivables – non-current        | 12   | 17,184                   | 17,184              | 25,143                   | 25,143              |
| Trade and other payables – current               |      | (85,047)                 | (85,047)            | (70,763)                 | (70,763)            |
| Trade and other payables – non-current           |      | -                        | -                   | (5,724)                  | (5,724)             |
| Secured bank loans – operations                  | 17   | (63,040)                 | (63,539)            | (82,934)                 | (83,843)            |
| Secured bank loan – construction of Headquarters | 17   | -                        | -                   | (73,811)                 | (73,811)            |
| <b>Total</b>                                     |      | <b>179,796</b>           | <b>179,297</b>      | <b>45,409</b>            | <b>44,500</b>       |

**Basis for determining fair values**

The following summarises the significant methods and assumptions used in estimating the fair values of financial instruments reflected in the table above.

**Derivatives**

The fair value of forward exchange contracts is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk interest free rate based on government bonds. These fair values are provided by independent third parties.

**Non-derivative financial assets and liabilities**

The fair value of cash, receivables, payables and short-term borrowings is considered to approximate their carrying amount because of their short maturity.

The directors consider the carrying amount of long-term borrowings recorded in the financial statements approximates their fair value.

**Fair value hierarchy**

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie. as prices) or indirectly (ie. derived from prices); and
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

|   | Level 2<br>\$000 | Total<br>\$000 |
|---|------------------|----------------|
| <b>30 June 2011</b>   |                  |                |
| <b>Derivative financial assets</b>                          |                  |                |
| Forward exchange contracts                                  | 79,096           | 79,096         |
| <b>30 June 2010</b>   |                  |                |
| <b>Derivative financial assets</b>                          |                  |                |
| Forward exchange contracts                                  | 68,841           | 68,841         |
| Interest rate swap on loan for construction of Headquarters | 204              | 204            |

There have been no transfers between levels during the year.

**27. Events subsequent to the reporting date**

Other than the matter noted below, there has not arisen in the interval between the 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 significantly affect the operations of Cochlear, the results of those operations, or the state of affairs of Cochlear in future financial years:

**Dividends**

For dividends declared after 30 June 2011, see Note 9.

## 28. Construction of Headquarters

Cochlear completed construction work on its new Headquarters at Macquarie University (MU) site during the year ended 30 June 2011. Upon practical completion, MU paid Cochlear a development fee of \$130.3 million and ownership of the building was transferred to MU. No progress payments were made during the course of development which commenced in 2009.

The Headquarters was constructed on land owned by MU by a special purpose entity, Lachlan Project Development Pty Ltd. Adjacent land has been reserved by MU for possible future expansion by Cochlear over the next 25 years.

Construction activities are not part of the ordinary course of Cochlear's business and Cochlear was exposed to the usual risks associated with construction.

Construction contract expense was determined as the sum of costs incurred plus interest capitalised during the year. Revenue was recognised on a percentage of completion basis throughout the project.

Cochlear now leases the premises for a minimum of 15 years from a MU entity.

Cochlear also incurred certain relocation related expenses pertaining to its Headquarters relocation. These expenses have been included in net construction profit and mainly relate to running two sites whilst obtaining regulatory approval for manufacturing at the new Headquarters.

The total project construction revenue and expenses have been brought to account over the years ended 30 June 2009 and 2010 and the current year. The total project construction profit has been recognised in the year ended 30 June 2011.

|  | Note | Total project<br>\$000 | 2011<br>\$000 | 2010<br>\$000 |
|--|------|------------------------|---------------|---------------|
| Construction contract revenue                        |      | 130,302                | 66,606        | 63,696        |
| Construction contract expense                        |      | (118,712)              | (55,016)      | (63,696)      |
| Relocation related expenditure                       |      | (5,460)                | (5,460)       | -             |
| <b>Construction profit net of relocation expense</b> | 5(c) | <b>6,130</b>           | <b>6,130</b>  | -             |

The balance sheet as at 30 June 2010 included \$74.3 million as current capitalised building costs and \$73.8 million as current loans related to the construction of the Headquarters.

## 29. Parent entity disclosures

At and throughout the financial year ended, 30 June 2011, the parent company of Cochlear was Cochlear Limited.

|  | Company        |                |
|--|----------------|----------------|
|  | 2011           | 2010           |
|  | \$000          | \$000          |
| <b>Result of the parent entity</b>                         |                |                |
| Net profit   | 138,705        | 129,846        |
| Other comprehensive income                                 | 7,281          | 25,699         |
| <b>Total comprehensive income</b>                          | <b>145,986</b> | <b>155,545</b> |
| <b>Financial position of the parent entity at year end</b> |                |                |
| Current assets   | 244,909        | 208,174        |
| Total assets   | 642,810        | 587,794        |
| Current liabilities  | 155,348        | 113,286        |
| Total liabilities  | 230,452        | 211,228        |
| <b>Total equity of the parent entity comprising of:</b>    |                |                |
| Issued capital   | 123,226        | 119,842        |
| Treasury reserve   | (3,489)        | (2,826)        |
| Hedging reserve  | 56,288         | 45,516         |
| Share based payment reserve                                | 28,652         | 26,350         |
| Retained earnings  | 207,681        | 187,684        |
| <b>Total equity</b>  | <b>412,358</b> | <b>376,566</b> |

### Parent entity contingencies

The details of all contingent liabilities in respect to Cochlear Limited are disclosed in Note 20.

### Parent entity capital commitments for acquisition of plant and equipment

|   | Company      |              |
|---|--------------|--------------|
|   | 2011         | 2010         |
|   | \$000        | \$000        |
| <b>Plant and equipment</b>  |              |              |
| Contracted but not yet provided for and payable:                                      |              |              |
| Within one year   | 3,495        | 7,628        |
| <b>Total parent entity capital commitments for acquisition of plant and equipment</b> | <b>3,495</b> | <b>7,628</b> |

1 In the opinion of the directors of Cochlear Limited (the Company):

- (a) the consolidated financial statements and notes and the Remuneration Report in the Directors' Report set out on pages 4 to 69, are in accordance with the Corporations Act 2001, including:
  - (i) giving a true and fair view of the Consolidated Entity's financial position as at 30 June 2011 and of its performance for the financial year ended on that date; and
  - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001;
- (b) the Financial Report also complies with International Financial Reporting Standards as disclosed in Note 2(a); and
- (c) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

2 The directors have been given the declarations required by section 295A of the Corporations Act 2001 from the Chief Executive Officer and Chief Financial Officer for the financial year ended 30 June 2011.

Dated at Sydney this 9<sup>th</sup> day of August 2011.

Signed in accordance with a resolution of the directors:



Director



Director



**Report on the financial report**

We have audited the accompanying financial report of the Consolidated Entity comprising Cochlear Limited (the Company) and the entities it controlled at the year's end or from time to time during the financial year, which comprises the consolidated balance sheet as at 30 June 2011, and consolidated income statement and consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year ended on that date, a description of significant accounting policies and other explanatory notes 1 to 29 and the directors' declaration.

**Directors' responsibility for the financial report**

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In note 2(a), the directors also state, in accordance with Australian Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial report, comprising the financial statements and notes, comply with International Financial Reporting Standards.

**Auditor's responsibility**

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001* and Australian Accounting Standards, a true and fair view which is consistent with our understanding of the Consolidated Entity's financial position and of its performance.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Independence**

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

**Auditor's opinion**

In our opinion:

- (a) the financial report of Cochlear Limited is in accordance with the *Corporations Act 2001*, including:
  - (i) giving a true and fair view of the Consolidated Entity's financial position as at 30 June 2011 and of its performance for the year ended on that date; and
  - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in note 2(a).

**Report on the remuneration report**

We have audited the Remuneration Report included in the directors' report for the year ended 30 June 2011. The directors of the Company are responsible for the preparation and presentation of the remuneration report in accordance with Section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the remuneration report, based on our audit conducted in accordance with auditing standards.

**Auditor's opinion**

In our opinion, the remuneration report of Cochlear Limited for the year ended 30 June 2011, complies with Section 300A of the *Corporations Act 2001*.

KPMG

Sydney, 9 August 2011

Kevin Leighton, Partner

## ADDITIONAL INFORMATION

Additional information required by Australian Securities Exchange Listing Rules and not disclosed elsewhere in this report – the information presented is as at 2 August 2011:

### Shareholdings

#### Substantial shareholders

| Shareholder                             | Number of ordinary shares held | %            |
|---|--------------------------------|--------------|
| Capital (Institutional Group)           | 3,989,551                      | 7.03         |
| Wilson HTM Group Ltd                    | 3,319,654                      | 5.85         |
| The Bank of New York Mellon Corporation | 2,847,424                      | 5.02         |
| <b>Total</b>                            | <b>10,156,629</b>              | <b>17.90</b> |

#### Distribution of shareholders

| Number of shares held | Number of ordinary shareholders |
|-----------------------|---------------------------------|
| 1 - 1,000             | 24,525                          |
| 1,001 - 5,000         | 2,954                           |
| 5,001 - 10,000        | 197                             |
| 10,001 - 100,000      | 94                              |
| 100,001 and over      | 20                              |
| <b>Total</b>          | <b>27,790</b>                   |

Non-marketable parcels – 162 shareholders held less than a marketable parcel of ordinary shares

#### Twenty largest shareholders

| Shareholder   | Number of ordinary shares held | %            |
|---|--------------------------------|--------------|
| HSBC Custody Nominees (Australia) Limited                         | 13,374,086                     | 23.57        |
| National Nominees Limited   | 10,490,178                     | 18.49        |
| JP Morgan Nominees Australia Limited                              | 9,697,998                      | 17.09        |
| Citicorp Nominees Pty Limited                                     | 1,587,950                      | 2.80         |
| Cogent Nominees Pty Limited                                       | 992,976                        | 1.75         |
| Dr Christopher Graham Roberts                                     | 713,310                        | 1.26         |
| Citicorp Nominees Pty Limited (CFS WSLE Geared Share Fund a/c)    | 466,532                        | 0.82         |
| Australian Reward Investment Alliance                             | 460,661                        | 0.81         |
| JP Morgan Nominees Australia Limited (Cash income a/c)            | 380,949                        | 0.67         |
| UBS Wealth Management Australia Nominees Pty Ltd                  | 251,957                        | 0.44         |
| Citicorp Nominees Pty Limited (Cwllth Bank Off Super a/c)         | 232,893                        | 0.41         |
| AMP Life Limited  | 219,889                        | 0.39         |
| Queensland Investment Corporation                                 | 210,836                        | 0.37         |
| Warbont Nominees Pty Ltd (Settlement Entrepot a/c)                | 138,036                        | 0.24         |
| Perpetual Trustee Company Limited                                 | 136,201                        | 0.24         |
| Agro Investments Limited  | 128,000                        | 0.23         |
| Cogent Nominees Pty Limited (SL Non Cash Collateral a/c)          | 125,000                        | 0.22         |
| Professor James Finlay Patrick                                    | 107,427                        | 0.19         |
| RBC Dexia Investor Services Australia Nominees Pty Ltd (GSAM a/c) | 91,792                         | 0.16         |
| The Australian National University                                | 90,000                         | 0.16         |
|   |                                | <b>70.31</b> |

The 20 largest shareholders held 70.31% of the ordinary shares of the Company.

#### On market buy-back

There is no current on market buy-back.

## Compliance Statement

1. This statement has been prepared under accounting policies which comply with accounting standards as defined in the Corporations Act 2001 or other standards acceptable to ASX.

Identify other standards used

Nil

2. This report, and the accounts upon which the report is based (if separate), use the same accounting policies.
3. This report does give a true and fair view of the matters disclosed.
4. This report is based on financial statements to which one of the following applies:

The accounts have been audited.

The accounts have been subject to a review.

The accounts are in the process of being audited or subject to review.

The accounts have not yet been audited or reviewed.

5. The entity has a formally constituted audit committee.

Sign here:



Date: 9 August 2011

Print name

NJ Mitchell