

Cochlear Annual Report 2006



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Financial Report

COCHLEAR LIMITED AND ITS CONTROLLED ENTITIES FINANCIAL REPORT FOR THE YEAR ENDED 30 JUNE 2006

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Directors' Report Cochlear Limited for the year ended 30 June 2006

The directors present their report, together with the Financial Report of Cochlear Limited (Company) and the Consolidated Financial Report of the Consolidated Entity (Cochlear), being the Company and its controlled entities, for the year ended 30 June 2006, and the Auditors' Report thereon.

Directors

The directors of the Company in office at any time during the financial year were Prof BDO Anderson, AO, Mr PR Bell, Mr TCE Bergman, Prof E Byrne, AO, Mr R Holliday-Smith, Mr PJ North, AM, Mr DP O'Dwyer, Dr JL Parker, Dr CG Roberts and Mr JH Veeneklaas. Information on the directors is presented on page 26 of the Annual Report.

Directors' meetings

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

	Board of directors		Audit Committee		Medical Science Committee		Nominations Committee		Remuneration Committee		Technology and Innovation Committee	
	Held ⁽ⁱ⁾	Attended ⁽ⁱⁱ⁾	Held ⁽ⁱ⁾	Attended ⁽ⁱⁱ⁾	Held ⁽ⁱ⁾	Attended ⁽ⁱⁱ⁾	Held ⁽ⁱ⁾	Attended ⁽ⁱⁱ⁾	Held ⁽ⁱ⁾	Attended ⁽ⁱⁱ⁾	Held ⁽ⁱ⁾	Attended ⁽ⁱⁱ⁾
Mr TCE Bergman	8	8	5	5	-	-	2	2	5	5	-	-
Prof BDO Anderson, AO ⁽ⁱⁱⁱ⁾	4	3	-	-	1	1	1	1	-	-	2	2
Mr PR Bell ^(iv)	7	6	-	-	-	-	1	1	4	4	3	2
Prof E Byrne, AO	8	8	-	-	2	2	2	2	-	-	4	4
Mr R Holliday-Smith	8	8	5	5	-	-	2	2	5	5	-	-
Mr PJ North, AM	8	8	5	5	-	-	2	2	-	-	4	4
Mr DP O'Dwyer ^(iv)	7	7	-	-	1	1	1	1	-	-	3	3
Dr JL Parker	8	8	-	-	-	-	-	-	-	-	4	4
Dr CG Roberts	8	8	-	-	2	2	-	-	-	-	4	4
Mr JH Veeneklaas	8	6	-	-	-	-	2	2	5	3	4	2

(i) Number of meetings held while in office.

(ii) Number of meetings attended.

(iii) Prof BDO Anderson, AO retired on 20 October 2005.

(iv) Mr PR Bell and Mr DP O'Dwyer were appointed on 1 August 2005.

Principal activities and review of operations and results

The principal activities and a review of the operations of the Consolidated Entity during the year ended 30 June 2006, and the results of these operations are set out in the CEO/President's Report and the Financial discussion and analysis.

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 2006 and the results of those operations are set out in the above-mentioned reports.

Consolidated results

The consolidated results for the financial year are:

	2006	2005
	\$000	\$000
Revenue	452,260	348,966
Profit before tax	108,835	82,307
Net profit attributable to equity holders of the parent	80,032	59,642
Basic earnings per share (cents)	146.8	110.1
Diluted earnings per share (cents)	145.2	109.7

Dividends

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

Type	Cents per share	Total amount \$000	Date of payment	Tax rate for franking credit
In respect of the previous financial year:				
Final – ordinary shares	45.0	24,430	22 September 2005	30%
In respect of the current financial year:				
Interim – ordinary shares	45.0	24,666	14 March 2006	30%

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

The final dividend in respect of the current financial year has not been provided for in the Financial Report as it was not declared until after 30 June 2006. Since the end of the financial year, the directors declared a final 55.0 cents per share dividend 100% franked at the tax rate of 30% amounting to a total of \$30,147,062.

Environmental regulations

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

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, and 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.

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is included in this Report. Refer to Note 5 of the financial statements for the detail and amount of both audit and non-audit services.

State of affairs

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

- on 21 September 2005, the Company issued 14,170 ordinary shares to eligible employees of the Consolidated Entity under the Employee Share Plan for nil consideration;
- on 21 September 2005, the Company issued 453,500 ordinary shares to eligible employees of the Consolidated Entity under the Executive Share Option Plan (ESOP) for \$38.12 per share consideration;
- on 16 December 2005, the Company issued 55,693 shares in trust to eligible employees of the Consolidated Entity under the Cochlear Executive Long Term Incentive Plan (CELTIP) for nil consideration;
- on 5 May 2006, a \$270 million order was placed by a major healthcare organisation based in Taipei to supply Nucleus cochlear implants in Taiwan and China over approximately the next six years;
- the Consolidated Entity incurred capital expenditure of \$15.0 million. This comprised of leasehold improvements of \$1.8 million, plant and equipment of \$12.5 million and the enterprise resource planning system of \$0.7 million; and
- from the financial year beginning 1 July 2005, the Consolidated Entity has complied with Australian equivalents to International Financial Reporting Standards (AIFRS) as issued by the Australian Accounting Standards Board.

Likely developments

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

Remuneration Report

Remuneration Committee

The Remuneration Committee operates under delegated authority of the Board. The Remuneration Committee approves the Remuneration Policy and structure for executives and executive directors (senior executives) and makes recommendations to the Board on the total remuneration packages of each senior executive.

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

Remuneration policies – audited

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 50% 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); and
- a significant proportion (up to 40% of total fixed remuneration) of total senior executive remuneration linked to the creation of long-term value for shareholders under the CELTIP.

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

Senior executives – audited

Remuneration of the senior executives is comprised of 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.

Service contracts – audited

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 and the President, European Region has a notice period of six months. The President, European Region will receive a maximum of CHF 30,000 for repatriation costs in the case of termination or resignation.

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

Base salary and benefits – audited

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

In addition to base salary, selected overseas based executives receive additional benefits including health insurance, a car allowance and a relocation allowance. In Australia, retirement benefits are paid in line with the statutory Superannuation Guarantee legislation levels. In July 2005, members of the legacy defined benefit plan (Plan) were given the opportunity to transfer to the accumulation fund with ongoing contributions based on the estimated required Company contributions under the Plan actuarial assessments to ensure that employees are not adversely prejudiced by the move. The transfer of all 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 – unaudited

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 – audited

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 objectives and the financial performance of Cochlear. Financial measures include revenue and earnings before interest and taxes targets. Short-term incentives are paid on both the half and full year results.

The percentage of total remuneration that is allocated to short-term incentives varies according to the senior executive's position and the range is 30% – 50% 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 – audited

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

The number of options and performance shares offered to a senior executive depends on their fixed remuneration and 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, having regard to the senior executive's role.

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

Directors' Report Cochlear Limited for the year ended 30 June 2006

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 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 growth as follows:

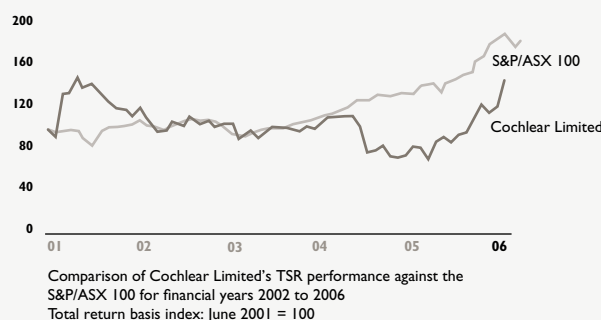
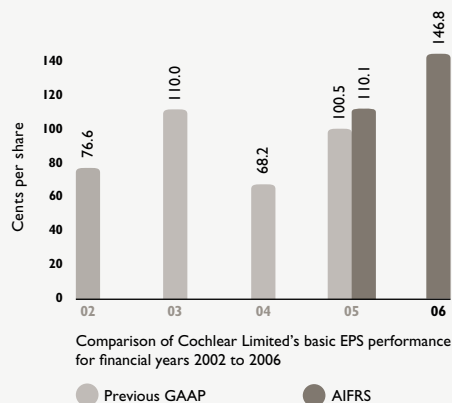
Compound annual growth rate of EPS over a three year period		Ranking of TSR growth rate against S&P/ASX 100 comparator group over a three year period	
Performance	% of options and performance shares vesting	Performance	% of options and performance shares vesting
<10%	0%	<50th percentile	0%
10% to 20%	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 the performance hurdles and time qualifications are met.

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

Performance of Cochlear in current CELTIP cycle – unaudited

Depicted in the charts below is a comparison of basic EPS for financial years 2002 to 2006 and the TSR performance of Cochlear relative to the S&P/ASX 100 from financial years 2002 to 2006:



For the year ended 30 June 2006, the growth in basic EPS was 33% and the total return to Cochlear Limited shareholders (as measured from the change in share price plus dividends paid) was 42%.

In considering Cochlear's performance and growth in shareholder value, the remuneration policies have regard to the following amounts in respect of the current financial year and the previous four financial years:

Amounts \$	2006	2005	2004	2003	2002
Net profit attributable to equity holders of the parent (million)	80.0	59.6	36.8	58.2	40.1
Dividends paid (million)	49.1	42.8	42.3	33.3	26.8
Share price	54.63	39.20	22.72	32.30	34.05

Net profit amounts for years 2002 to 2004 were calculated in accordance with previous Australian Generally Accepted Accounting Principles (previous GAAP). Net profit for 2005 and 2006 has been calculated in accordance with AIFRS. Net profit reported for 2005 under previous GAAP was \$54.5 million. For the impact on net profit of transition to AIFRS, see Note 31 to the financial statements.

Executive Share Option Plan – audited

The ESOP was replaced by the CELTIP in 2003. The final ESOP allocation vested in September 2005. The ESOP covers all options granted to senior executives prior to the 2004 financial year. Under the ESOP, each option is convertible to one ordinary share. The exercise price of options is based on the opening price of Cochlear Limited's shares sold in the ordinary course of trading on the ASX on the date the offer of the options was made. Options have a three year vesting period, and must be exercised within a month of vesting (expiry date).

All options under the ESOP lapse on the earlier of the expiry date or termination of the employee's employment. Options do not vest until three years after granting and thereafter the number of options exercisable depends on the compound annual growth rate of EPS achieved by Cochlear over a three year period. Three levels of growth have been set which determine the number of options, which are exercisable in any particular year. If the minimum compound annual growth rate of 10% in EPS is not achieved, no options can be exercised. To achieve a 100% allocation, a compound annual growth rate of 18% in EPS over the three year period must be achieved.

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

Executive directors – audited

At the date of this Remuneration Report, there are two executive directors in office.

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

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

Dr CG Roberts

Dr CG Roberts has been appointed for a fixed term of three years from the commencement date of 1 February 2004. If Cochlear terminates Dr CG Roberts' employment without cause before the end of the term, he will be entitled to receive an amount equivalent to the total fixed remuneration he would have received during the balance of the term.

Dr CG Roberts participates in the CMSTIP at a value equal to 50% of total fixed remuneration.

Dr CG Roberts participates to a value equal to 40% of total fixed remuneration under the CELTIP. This is in the form of 75% options and 25% performance shares.

Dr JL Parker

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

Dr JL Parker participates in the CMSTIP at a value equal to 30% of total fixed remuneration.

Dr JL Parker participates to a value equal to 30% of total fixed remuneration under the CELTIP. This is in the form of 75% options and 25% performance shares.

Non-executive directors – audited

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 has been 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 for non-executive directors were increased by 5% during the financial year with effect from 1 July 2005. Fees are within the aggregate amount approved by shareholders at the AGM in October 2004 of \$1,000,000 a year.

The Chairman of Cochlear is Mr TCE Bergman. His director's fees are set at three times the base fee for non-executive directors. He does not receive any additional fees for serving on committees of the Board.

From 2003, no new non-executive director has been entitled to join the Cochlear Limited directors' retirement scheme. Non-executive directors appointed prior to this are members of the scheme, which provides directors with more than five years service retirement benefits in line with the conditions detailed in the Corporations Act 2001 and set out in Note 28 of the financial statements.

Non-executive directors do not receive any performance related remuneration, options or performance shares.

There are no commitments to non-executive directors arising from non-cancellable contracts with the Company.

Directors' Report Cochlear Limited for the year ended 30 June 2006

Directors' and senior executives' remuneration details – audited

The following table provides the details of all directors and the executives of Cochlear with the greatest authority (key management personnel), and each of the five named officers of the Company and Consolidated Entity receiving the highest remuneration. Comparatives are disclosed in the 2005 Remuneration Report.

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

	Year	Short-term			Post-employment			Other long-term	Equity compensation ^{(i), (iv)}			Total	Performance related remuneration as proportion of total %	Value of equity compensation as proportion of remuneration %	
		Salary and fees	Bonuses ⁽ⁱ⁾	Non-monetary benefits ⁽ⁱⁱ⁾	Total	Super-annuation benefits	Leaving benefits ⁽ⁱⁱⁱ⁾		Total	Long service leave	Value of options				Value of performance shares
Amounts \$															
Directors															
Non-executive															
Mr TCE Bergman Chairman	2006	252,000	-	-	252,000	12,139	257,365	269,504	-	-	-	-	521,504	-	-
	2005	240,000	-	-	240,000	11,585	202,037	213,622	-	-	-	-	453,622	-	-
Mr PR Bell (appointed 1 August 2005)	2006	115,073	-	-	115,073	10,356	-	10,356	-	-	-	-	125,429	-	-
Prof E Byrne, AO	2006	100,000	-	-	100,000	9,000	65,561	74,561	-	-	-	-	174,561	-	-
	2005	96,000	-	-	96,000	8,640	79,131	87,771	-	-	-	-	183,771	-	-
Mr R Holliday-Smith	2006	128,000	-	-	128,000	11,520	-	11,520	-	-	-	-	139,520	-	-
	2005	39,738	-	-	39,738	3,576	-	3,576	-	-	-	-	43,314	-	-
Mr PJ North, AM	2006	109,000	-	-	109,000	9,810	24,000	33,810	-	-	-	-	142,810	-	-
	2005	105,000	-	-	105,000	9,450	42,000	51,450	-	-	-	-	156,450	-	-
Mr DP O'Dwyer (appointed 1 August 2005)	2006	109,365	-	-	109,365	9,843	-	9,843	-	-	-	-	119,208	-	-
Mr JH Veeneklaas	2006	100,000	-	-	100,000	9,000	26,500	35,500	-	-	-	-	135,500	-	-
	2005	96,000	-	-	96,000	8,640	40,875	49,515	-	-	-	-	145,515	-	-
Prof BDO Anderson, AO (retired 20 October 2005)	2006	32,308	-	-	32,308	2,908	8,492	11,400	-	-	-	-	43,708	-	-
	2005	96,000	-	-	96,000	8,640	40,875	49,515	-	-	-	-	145,515	-	-
Executive															
Dr CG Roberts CEO/President	2006	750,750	403,155	-	1,153,905	12,139	-	12,139	8,842	186,988	62,699	249,687	1,424,573	45.8%	17.5%
	2005	719,313	648,359	-	1,367,672	11,585	-	11,585	5,290	129,212	37,343	166,555	1,551,102	52.5%	10.7%
Dr JL Parker Chief Technology Officer	2006	346,653	117,421	181,992	646,066	12,139	-	12,139	11,660	66,441	28,383	94,824	764,689	27.8%	12.4%
	2005	323,250	128,512	-	451,762	11,585	-	11,585	10,475	33,143	9,576	42,719	516,541	33.1%	8.3%
Total directors	2006	2,043,149	520,576	181,992	2,745,717	98,854	381,918	480,772	20,502	253,429	91,082	344,511	3,591,502		
	2005	1,715,301	776,871	-	2,492,172	73,701	404,918	478,619	15,765	162,355	46,919	209,274	3,195,830		

	Year	Short-term				Post-employment			Other long-term	Equity compensation ^{(i),(iv)}			Total	Performance related remuneration as proportion of total %	Value of equity compensation as proportion of remuneration %
		Salary and fees	Bonuses ⁽ⁱ⁾	Non-monetary benefits ⁽ⁱⁱ⁾	Total	Super-annuation benefits	Leaving benefits ⁽ⁱⁱⁱ⁾	Total		Long service leave	Value of options	Value of performance shares			
Amounts \$															
Executives															
Consolidated Entity															
Mr R Brook ^{(v),(vi),(vii)} President, European Region	2006	328,512	128,896	66,482	523,890	17,370	-	17,370	-	85,124	36,267	121,391	662,651	37.8%	18.3%
	2005	314,245	174,961	64,956	554,162	37,379	-	37,379	-	43,041	12,438	55,479	647,020	35.6%	8.6%
Mr NJ Mitchell ^{(v),(vi),(viii)} Chief Financial Officer and Company Secretary	2006	301,433	115,364	-	416,797	67,280	-	67,280	11,887	63,010	26,767	89,777	585,741	35.0%	15.3%
	2005	266,491	118,565	-	385,056	45,871	-	45,871	10,775	30,577	8,836	39,413	481,115	32.8%	8.2%
Mr MD Salmon ^{(v),(vi),(viii)} President, Asia Pacific Region	2006	333,397	108,719	-	442,116	12,139	-	12,139	3,119	52,744	17,753	70,497	527,871	34.0%	13.4%
	2005	297,161	91,685	-	388,846	10,917	-	10,917	1,630	30,592	8,840	39,432	440,825	29.7%	8.9%
Mr CM Smith ^{(v),(vi),(viii)} President, Americas Region	2006	442,478	172,289	22,804	637,571	17,431	-	17,431	-	136,451	9,977	146,428	801,430	39.8%	18.3%
	2005	415,520	175,407	157,185	748,112	10,323	-	10,323	-	130,398	-	130,398	888,833	34.4%	14.7%
Mr H Yoshikawa ^{(v),(viii)} General Manager and Representative Director, Japan	2006	290,292	90,559	21,941	402,792	40,416	-	40,416	-	12,285	11,111	23,396	466,604	24.4%	5.0%
	2005	300,074	96,776	22,757	419,607	39,296	-	39,296	-	-	3,525	3,525	462,428	21.7%	0.8%
Company															
Mr MC Kavanagh ^(v) Senior Vice President, Global Marketing	2006	276,961	92,127	-	369,088	12,139	-	12,139	7,154	54,287	23,484	77,771	466,152	36.4%	16.7%
	2005	272,471	102,573	-	375,044	11,585	-	11,585	2,661	27,211	7,863	35,074	424,364	32.4%	8.3%
Mr DN Morris ^{(v),(ix)} President, Bone Anchored Solutions	2006	276,007	93,939	-	369,946	12,139	-	12,139	5,483	56,152	23,442	79,594	467,162	37.1%	17.0%
Mr JF Patrick ^(v) Senior Vice President, Chief Scientist	2006	246,840	89,467	-	336,307	38,549	-	38,549	-	53,457	23,057	76,514	451,370	36.8%	17.0%
	2005	228,224	101,696	-	329,920	39,621	-	39,621	-	26,411	7,624	34,035	403,576	33.6%	8.4%
Mr DW Howitt ^(v) Senior Vice President, Manufacturing and Logistics	2005	244,007	93,580	-	337,587	11,585	-	11,585	8,260	24,258	7,010	31,268	388,700	32.1%	8.0%
Total executives	2006	2,495,920	891,360	111,227	3,498,507	217,463	-	217,463	27,643	513,510	171,858	685,368	4,428,981		
	2005	2,338,193	955,243	244,898	3,538,334	206,577	-	206,577	23,326	312,488	56,136	368,624	4,136,861		

- (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 2006. 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 during the financial year to the directors' retirement scheme. Refer to Note 28 to the financial statements for further information.
- (iv) The value disclosed above is the proportion of the fair value of the options and performance shares allocated to the reporting period. 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 applying a 25% volatility, as reflected in the historical volatility. Further details of options granted during the financial year are set out below.
- (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 overseas based executive.
- (viii) Denotes Consolidated Entity and Company executives.
- (ix) Not included in Company top five executives in 2005.
- (x) Not included in Company top five executives in 2006.

Exercise of options granted as remuneration – audited

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

	Number of shares	Amount paid \$/share
Executive director		
Dr JL Parker	25,000	38.12
Executives		
Mr NJ Mitchell	25,000	38.12
Mr JF Patrick	25,000	38.12
Mr H Yoshikawa	5,000	38.12

During the previous financial year, nil options were exercised as the relevant EPS and TSR hurdles were not achieved. There are no amounts unpaid on the shares issued as a result of the exercise of the options in 2005 or 2006.

Analysis of bonuses included in remuneration – unaudited

Details of the vesting profile of the short-term incentive 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 \$	Short-term incentive bonus		
	Included in remuneration	% vested in the financial year ⁽ⁱ⁾	% forfeited during the financial year ⁽ⁱⁱ⁾
Executive directors			
Dr CG Roberts	403,155	105.7%	-
Dr JL Parker	117,421	107.5%	-
Executives			
Consolidated Entity			
Mr R Brook	128,896	98.1%	1.9%
Mr NJ Mitchell	115,364	107.5%	-
Mr MD Salmon	108,719	104.0%	-
Mr CM Smith	172,289	130.3%	-
Mr H Yoshikawa	90,559	104.0%	-
Company			
Mr MC Kavanagh	92,127	106.0%	-
Mr DN Morris	93,939	107.1%	-
Mr JF Patrick	89,467	107.5%	-

(i) Amounts included in vested short-term incentives for the financial year represent the amounts that vested in the financial year based on achievement of personal goals and specified financial goals. Amounts exceeding 100% indicate performance above target. No amounts vest in future financial years in respect of the CMSTIP for the financial year.

(ii) The amounts forfeited in short-term incentives are due to personal and financial goals not being met in the financial year.

Analysis of share based payments granted as remuneration – unaudited

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 below:

	Date of grant	Financial years in which grant vests	Options				Performance shares					
			Number granted	% vested in financial year	% forfeited in financial year ⁽ⁱ⁾	Value yet to vest		Number granted	% vested in financial year	% forfeited in financial year ⁽ⁱ⁾	Value yet to vest	
						Min ⁽ⁱⁱ⁾ \$	Max ⁽ⁱⁱⁱ⁾ \$				Min ⁽ⁱⁱ⁾ \$	Max ⁽ⁱⁱⁱ⁾ \$
Executive directors												
Dr CG Roberts	23 August 2004	30 June 2008	164,321	-	-	nil	723,874	10,595	-	-	nil	209,206
	22 August 2005	30 June 2009	79,468	-	-	nil	374,238	5,923	-	-	nil	128,722
Dr JL Parker	1 September 2002	30 June 2006	50,000	50%	50%	nil	nil	-	-	-	-	-
	1 December 2003	30 June 2007	20,584	-	-	nil	40,841	2,648	-	-	nil	37,688
	23 August 2004	30 June 2008	42,149	-	-	nil	185,677	2,717	-	-	nil	53,649
	22 August 2005	30 June 2009	28,447	-	-	nil	133,965	2,120	-	-	nil	46,073
Executives												
Consolidated Entity												
Mr R Brook	1 December 2003	30 June 2007	26,046	-	-	nil	51,679	3,350	-	-	nil	47,680
	23 August 2004	30 June 2008	54,736	-	-	nil	241,126	3,529	-	-	nil	69,683
	22 August 2005	30 June 2009	36,138	-	-	nil	170,210	2,694	-	-	nil	58,541
Mr NJ Mitchell	1 September 2002	30 June 2006	50,000	50%	50%	nil	nil	-	-	-	-	-
	1 December 2003	30 June 2007	18,961	-	-	nil	37,622	2,439	-	-	nil	34,714
	23 August 2004	30 June 2008	38,886	-	-	nil	171,303	2,507	-	-	nil	49,569
	22 August 2005	30 June 2009	27,949	-	-	nil	131,620	2,083	-	-	nil	45,269
Mr MD Salmon	23 August 2004	30 June 2008	38,904	-	-	nil	171,382	2,508	-	-	nil	49,522
	22 August 2005	30 June 2009	27,174	-	-	nil	127,990	2,025	-	-	nil	44,003
Mr CM Smith	23 August 2004	30 June 2008	165,830	-	-	nil	730,522	-	-	-	-	-
	22 August 2005	30 June 2009	28,646	-	-	nil	134,923	2,135	-	-	nil	46,394
Mr H Yoshikawa	1 September 2002	30 June 2006	10,000	50%	50%	nil	nil	-	-	-	-	-
	1 December 2003	30 June 2007	-	-	-	-	-	1,000	-	-	nil	14,233
	23 August 2004	30 June 2008	-	-	-	-	-	1,000	-	-	nil	19,746
	22 August 2005	30 June 2009	12,120	-	-	nil	57,085	903	-	-	nil	19,622
Company												
Mr MC Kavanagh	1 December 2003	30 June 2007	17,836	-	-	nil	35,389	2,294	-	-	nil	32,649
	23 August 2004	30 June 2008	34,605	-	-	nil	152,443	2,231	-	-	nil	44,053
	22 August 2005	30 June 2009	22,635	-	-	nil	106,595	1,687	-	-	nil	36,663
Mr DN Morris	1 December 2003	30 June 2007	15,600	-	-	nil	30,953	2,439	-	-	nil	34,714
	23 August 2004	30 June 2008	30,269	-	-	nil	133,328	2,507	-	-	nil	49,513
	22 August 2005	30 June 2009	22,843	-	-	nil	107,591	1,703	-	-	nil	37,006
Mr JF Patrick	1 September 2002	30 June 2006	50,000	50%	50%	nil	nil	-	-	-	-	-
	1 December 2003	30 June 2007	17,325	-	-	nil	34,376	2,228	-	-	nil	31,710
	23 August 2004	30 June 2008	33,588	-	-	nil	147,963	2,163	-	-	nil	42,710
	22 August 2005	30 June 2009	22,718	-	-	nil	106,986	1,693	-	-	nil	36,793

(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 the highest level performance criteria not being achieved.

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

(iii) The maximum value of options and 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 option and performance shares vest. The maximum values disclosed above are based on the valuations as per this report.

Analysis of movements in options – unaudited

The movement of values during the reporting period 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				
Amounts \$	Granted in year ⁽ⁱ⁾	Exercised in year ⁽ⁱⁱ⁾	Forfeited in year ⁽ⁱⁱ⁾	Total option value in year
Executive directors				
Dr CG Roberts	374,238	-	-	374,238
Dr JL Parker	133,965	68,000	68,000	269,965
Executives				
<i>Consolidated Entity</i>				
Mr R Brook	170,210	-	-	170,210
Mr NJ Mitchell	131,620	68,000	68,000	267,620
Mr MD Salmon	127,990	-	-	127,990
Mr CM Smith	134,923	-	-	134,923
Mr H Yoshikawa	57,085	13,600	13,600	84,285
<i>Company</i>				
Mr DN Morris	107,591	-	-	107,591
Mr MC Kavanagh	106,595	-	-	106,595
Mr JF Patrick	106,986	68,000	68,000	242,986

(i) The value of options granted in the year is the fair value of options calculated at grant date using a 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 2006 to 30 June 2009).

(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

As 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
192,761	CELTIP	\$34.19	August 2006 – September 2008
715,540	CELTIP	\$18.97	August 2007 – September 2009
725,903	CELTIP	\$39.93	August 2008 – September 2010

The closing share price at 30 June 2006 was \$54.63.

During the financial year, the Company granted 725,903 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 financial report for the year ending 30 June 2008. 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, 513,500 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 PR Bell	1,500	-
Mr TCE Bergman	12,000	-
Prof E Byrne, AO	1,000	-
Mr R Holliday-Smith	1,000	-
Mr PJ North, AM	13,000	-
Mr DP O'Dwyer	2,450	-
Dr JL Parker	25,000	91,180
Dr CG Roberts	237,000	243,789
Mr JH Veeneklaas	1,000	-

Indemnification of officers

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

Insurance for directors and officers

During the financial year, the Company paid a premium for a Directors' and Officers' Liability Insurance policy and a Supplementary Legal Expenses Insurance policy. The insurance provides cover for the directors named in this 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 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 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 the Consolidated Entity the results of those operations, or the state of affairs of the Consolidated Entity, in future financial years.

Dividends

For dividends declared after 30 June 2006, see Note 7 of the financial statements.

Rounding off

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

Dated at Sydney this 15th day of August 2006.

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 Corporation Act 2001

I declare that, to the best of my knowledge and belief, in relation to the audit for the year ended 30 June 2006 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

Sydney, 15 August 2006



John Wigglesworth, Partner

Income statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

	Note	Consolidated		Company	
		2006	2005	2006	2005
		\$000	\$000	\$000	\$000
Revenue	3(a)	452,260	348,966	285,653	235,194
Cost of sales	3(b)	(130,962)	(99,699)	(110,771)	(91,886)
Gross profit		321,298	249,267	174,882	143,308
Other income	3(c)	884	618	379	5,946
Distribution, marketing and field technical expenses		(124,808)	(100,968)	(25,706)	(15,211)
Administration expenses		(29,951)	(25,262)	(23,314)	(20,203)
Research and development expenses	3(b)	(58,926)	(41,465)	(42,798)	(33,719)
Operating profit before net financing income		108,497	82,190	83,443	80,121
Financial income	4	6,729	3,045	10,454	2,658
Financial expenses	4	(6,391)	(2,928)	(16)	(1,244)
Net financing income		338	117	10,438	1,414
Profit before tax		108,835	82,307	93,881	81,535
Income tax expense	6	(30,610)	(23,833)	(26,522)	(20,347)
Net profit (including minority interest)		78,225	58,474	67,359	61,188
Attributable to:					
Equity holders of the parent		80,032	59,642	67,359	61,188
Minority interest		(1,807)	(1,168)	-	-
Net profit (including minority interest)		78,225	58,474	67,359	61,188
Basic earnings per share (cents)					
Ordinary shares	9	146.8	110.1		
Diluted earnings per share (cents)					
Ordinary shares	9	145.2	109.7		

The income statements are to be read in conjunction with the notes to the financial statements set out on pages 53 to 103.

Statements of recognised income and expense Cochlear Limited and its controlled entities for the year ended 30 June 2006

	Consolidated		Company		
	2006	2005	2006	2005	
	Note	\$000	\$000	\$000	
Foreign exchange translation differences		2,636	(2,708)	(391)	385
Movement in general reserve		2	(10)	-	-
Defined benefit plan revaluation		-	(98)	-	(98)
Cash flow hedges:					
Effective portion of changes in fair value		(1,021)	-	(1,021)	-
Losses taken to the income statement		(14,485)	-	(14,485)	-
Net income recognised directly in equity		(12,868)	(2,816)	(15,897)	287
Net profit (including minority interest)		78,225	58,474	67,359	61,188
Total recognised income and expense for the period		65,357	55,658	51,462	61,475
Attributable to:					
Equity holders of the parent		67,857	57,428	51,462	61,475
Minority interest		(2,500)	(1,770)	-	-
Total recognised income and expense for the period		65,357	55,658	51,462	61,475
Effect of change in accounting policy – financial instruments (with 2005 not restated)					
Hedging reserve		19,102	-	19,102	-
Attributable to:					
Equity holders of the parent		19,102	-	19,102	-
Minority interest		-	-	-	-
		19,102	-	19,102	-

Other movements in equity arising from transactions with equity participants as equity participants are set out in Note 24. The statements of recognised income and expense are to be read in conjunction with the notes to the financial statements set out on pages 53 to 103.

Balance sheets Cochlear Limited and its controlled entities as at 30 June 2006

	Note	Consolidated		Company	
		2006	2005	2006	2005
		\$'000	\$'000	\$'000	\$'000
Current assets					
Cash and cash equivalents	25(a)	87,073	106,077	27,458	72,191
Receivables	10	109,388	91,373	109,770	59,238
Inventories	11	76,822	49,518	47,209	25,726
Other	12	5,920	4,186	2,349	2,117
Total current assets		279,203	251,154	186,786	159,272
Non-current assets					
Receivables	10	-	9,938	-	9,938
Other financial assets	13	383	187	33,994	18,521
Plant and equipment	14	30,833	24,624	21,381	19,884
Intangible assets	15	205,238	194,329	4,126	8,263
Deferred tax assets	16	30,267	22,464	5,072	7,749
Total non-current assets		266,721	251,542	64,573	64,355
Total assets		545,924	502,696	251,359	223,627
Current liabilities					
Payables	17	57,345	46,539	28,337	18,914
Interest bearing liabilities	19	70,547	64,107	-	1,273
Current tax liabilities		24,981	12,455	14,407	8,380
Provisions	21	27,058	24,541	15,642	16,829
Other	18	23,525	45,396	857	18,322
Total current liabilities		203,456	193,038	59,243	63,718
Non-current liabilities					
Interest bearing liabilities	19	125,493	138,951	-	-
Provisions	21	6,433	6,108	5,655	4,703
Other	18	764	9,938	764	9,938
Total non-current liabilities		132,690	154,997	6,419	14,641
Total liabilities		336,146	348,035	65,662	78,359
Net assets		209,778	154,661	185,697	145,268
Equity					
Issued capital	23	66,663	49,375	66,663	49,375
Reserves	24	3,010	(3,917)	3,077	(128)
Retained earnings	24	137,864	104,462	115,957	96,021
Total equity attributable to equity holders of the parent		207,537	149,920	185,697	145,268
Minority interest	24	2,241	4,741	-	-
Total equity	24	209,778	154,661	185,697	145,268

The balance sheets are to be read in conjunction with the notes to the financial statements set out on pages 53 to 103.

Statements of cash flows Cochlear Limited and its controlled entities for the year ended 30 June 2006

	Note	Consolidated		Company	
		2006	2005	2006	2005
		\$'000	\$'000	\$'000	\$'000
Cash flows from operating activities					
Cash receipts in the course of operations		432,838	338,705	234,073	223,459
Cash payments in the course of operations		(352,164)	(216,649)	(209,038)	(142,865)
Dividends received		-	-	-	5,131
Grant and other income received		884	618	379	815
Interest received		3,816	2,634	5,896	2,592
Interest paid		(6,391)	(2,928)	(16)	(282)
Income taxes paid		(27,428)	(19,370)	(19,358)	(12,811)
Net cash provided by operating activities	25(b)	51,555	103,010	11,936	76,039
Cash flows from investing activities					
Payment for plant and equipment		(14,329)	(4,992)	(6,968)	(3,569)
Payment for enterprise resource planning system		(706)	(3,044)	-	(5)
Proceeds from sale of non-current assets		572	27	197	1,279
Investment in controlled entities		-	-	(15,380)	(12,045)
Payment for acquisition of cochlear implant distribution businesses		-	(3,405)	-	-
Payment for controlled entities (net of cash acquired)		-	(192,208)	-	-
Development expenditure		(179)	(4,375)	(179)	(4,375)
Net cash used in investing activities		(14,642)	(207,997)	(22,330)	(18,715)
Cash flows from financing activities					
Repayment of borrowings		(29,787)	(2,100)	(1,273)	(2,100)
Proceeds from borrowings		3,678	178,812	-	-
Proceeds from issue of shares		17,288	-	17,288	-
Dividends paid by the parent		(49,096)	(42,832)	(49,096)	(42,832)
Net cash (used in)/provided by financing activities		(57,917)	133,880	(33,081)	(44,932)
Net (decrease)/increase in cash and cash equivalents		(21,004)	28,893	(43,475)	12,392
Cash and cash equivalents at 1 July		103,627	74,091	70,918	58,526
Effects of exchange fluctuation on the balances of cash held in foreign currencies		2,703	643	15	-
Cash and cash equivalents at 30 June	25(a)	85,326	103,627	27,458	70,918

The statements of cash flows are to be read in conjunction with the notes to the financial statements set out on pages 53 to 103.

I. Statement of significant accounting policies

This Financial Report was authorised for issue by the directors on 15 August 2006.

The significant policies which have been adopted in the preparation of this Financial Report are:

(a) Statement of compliance

The Financial Report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards adopted by the Australian Accounting Standards Board (AASB) and the Corporations Act 2001.

International Financial Reporting Standards (IFRS) form the basis of Australian Accounting Standards adopted by the AASB, and for the purpose of this report are called Australian equivalents to IFRS (AIFRS), to distinguish from previous Australian Generally Accepted Accounting Principles (previous GAAP). The financial report of the Consolidated Entity also complies with IFRS and interpretations adopted by the International Accounting Standards Board.

This is the Consolidated Entity's first AIFRS financial report prepared in accordance with Australian Accounting Standards, being AIFRS, and AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* (AASB 1) has been applied.

An explanation of how the transition to AIFRS has affected the reported financial position, financial performance and cash flows of the Consolidated Entity is provided in Note 31. This note includes reconciliations of equity and profit for comparative periods reported under previous GAAP to those reported for those periods under AIFRS.

(b) Basis of preparation

The Financial Report is presented in Australian dollars, rounded off to the nearest one thousand, unless otherwise stated.

The Financial Report is prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, and financial instruments classified as available for sale.

The entity has elected to early adopt the following revised accounting standards:

- AASB 119 *Employee Benefits* (December 2004);
- AASB 2004-3 *Amendments to Australian Accounting Standards* (December 2004) amending AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004), AASB 101 *Presentation of Financial Statements* and AASB 124 *Related Party Disclosures*;
- AASB 2005-3 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 119 *Employee Benefits* (either July or December 2004);
- AASB 2005-4 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004), AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*;
- AASB 2005-5 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004) and AASB 139 *Financial Instruments: Recognition and Measurement*;
- AASB 2005-6 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 3 *Business Combinations*;
- AASB 2005-7 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 134 *Interim Financial Reporting*;
- AASB 2005-8 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004); and
- AASB 2006-1 *Amendments to Australian Accounting Standards* (January 2006) amending AASB 121 *The Effects of Changes in Foreign Exchange Rates*.

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

- AASB 2005-1 *Amendments to Australian Accounting Standards* (May 2005) amending AASB 139 *Financial Instruments: Recognition and Measurement*;
- AASB 2005-9 *Amendments to Australian Accounting Standards* (September 2005) amending AASB 4 *Insurance Contracts*;
- AASB 2005-10 *Amendments to Australian Accounting Standards* (September 2005) amending AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 101 *Presentation of Financial Statements*, AASB 114 *Segment Reporting*, AASB 117 *Leases*, AASB 133 *Earnings per Share*, AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 1 *First-time adoption of Australian Equivalents to International Financial Reporting Standards*, AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*; and
- AASB 7 *Financial Instruments: Disclosures* (August 2005).

The impact of these standards is yet to be determined but they will be applied by the Consolidated Entity on the relevant application date.

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

The preparation of a financial report in conformity with the Australian Accounting Standards requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenue and expenses. These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The 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 if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of Australian Accounting Standards that have significant effect on the Financial Report and estimates with a significant risk of material adjustment in the next year are discussed in this Note 1.

(c) 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.

Investments in controlled entities are carried at their cost of acquisition in the Company's financial statements.

Associates

Associates are those entities in which the Consolidated Entity has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Consolidated Entity's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Consolidated Entity's share of losses exceeds its interest in an associate, the Consolidated Entity's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Consolidated Entity has incurred legal or constructive obligations or made payments on behalf of an associate.

In the Company's financial statements, investments in associates are carried at the cost of acquisition, less any impairment losses.

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.

Unrealised gains arising from transactions with associates are eliminated to the extent of the Consolidated Entity's interest in the entity with adjustments made to the investment in associates and share of associates net profit accounts.

(d) Revenue recognition

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

Sales revenue

Sales revenue comprises revenue earned (net of returns, discounts and allowances) from the provision of products or services. 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, the costs incurred or to be incurred cannot be measured reliably, 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 (h).

Other income

Other revenue, including government grants, is recognised on a systematic basis as income 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 which is when the entitlement is confirmed.

Sales of non-current assets

The gain or loss on disposal of non-current assets is recognised as other operating income at the date control of the asset passes to the buyer, usually when an unconditional contract of sale is signed.

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

(e) Goods and services tax

Revenue, 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.

(f) Foreign currency

Foreign currency transactions

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at reporting date are translated to Australian dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Australian dollars at foreign exchange rates ruling at the dates the fair values were determined.

Financial statements of foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, generally are translated to Australian dollars at foreign exchange rates ruling at that date. The revenues and expenses of foreign operations are translated to Australian dollars at rates approximating the foreign exchange rates ruling at the dates of transactions.

Net investment in foreign operations

Exchange differences arising from the translation of the net investment in foreign operations, and of related hedges are taken to the foreign currency translation reserve. They are released into the income statement upon disposal.

The AASB 1 election to reset the existing foreign currency translation reserve balance to nil on conversion has not been adopted.

(g) Derivative financial instruments

The Consolidated Entity uses derivative financial instruments to hedge its exposure to foreign exchange arising from operating, investing and financing activities. In accordance with its treasury policy, the Consolidated Entity 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.

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on re-measurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged (see accounting policy (h)).

(h) Hedges

Cash flow hedges

Current period policy

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity. 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 included in the initial cost or other 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 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. The ineffective part of any gain or loss is recognised immediately in the income statement.

When a hedging instrument expires or is sold, terminated or exercised, or the Company revokes designation of the hedge relationship but the hedged forecast transaction still is expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, then the cumulative unrealised gain or loss recognised in equity is recognised immediately in the income statement.

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

Comparative period policy

For the year ended 30 June 2005, the following accounting treatment was applied: transactions were designated as a hedge of the anticipated specific purchase or sale of goods or services, purchase of qualifying assets, or an anticipated interest transaction, only when they were expected to reduce exposure to the risks being hedged and were designated prospectively so that it was clear when an anticipated transaction had or had not occurred and it was probable the anticipated transaction would occur as designated. Gains or losses on the hedge arising up to the date of the anticipated transaction, together with any other costs or gains arising at the time of entering into the hedge, were deferred and included in the measurement of the anticipated transaction when the transaction had occurred as designated. Any gains or losses on the hedged transaction after that date were included in the income statement.

The net amounts receivable or payable under forward foreign exchange contracts and the associated deferred gains or losses were recorded on the balance sheet from the date of inception of the hedge transaction. When recognised, the net receivables or payables were revalued using the foreign currency exchange rate current at the reporting date.

When the anticipated transaction was no longer expected to occur as designated, the deferred gain or loss relating to the hedged transaction was recognised immediately in the income statement.

Where a hedge transaction was terminated early and the anticipated transaction was still expected to occur as designated, deferred gains and losses that arose on the foreign currency hedge prior to its termination continued to be deferred and were included in the measurement of the purchase or sale when it occurred. Where a hedge transaction was terminated early because the anticipated transaction was no longer expected to occur as designated, deferred gains and losses that arose on the foreign currency hedge prior to its termination were included in the income statement for the financial period.

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

Hedge of monetary assets and liabilities

When a derivative financial instrument is used to hedge economically the foreign exchange exposure of a recognised monetary asset or liability, hedge accounting is not applied and any gain or loss on the hedging instrument is recognised in the income statement.

Hedge of net investment in foreign operations

The portion of the gain or loss on an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised directly in equity. The ineffective portion is recognised immediately in the income statement.

(i) 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 the Consolidated Entity's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

(j) Provisions

A provision is recognised in the balance sheet when the Consolidated Entity has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

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. The provision is determined on a discounted cash flow basis. Warranty periods on hardware products extend for three to 10 years. The Consolidated Entity is expected to incur the majority of the liability over the next three to 10 years.

Dividends

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

Restructuring, employee termination benefits and surplus lease space

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

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

Self-insurance

The Company self-insures to manage certain risks associated with operating in its line of business. Outstanding claims are recognised when an incident occurs that may give rise to a claim and are measured at the cost that the entity 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

The Consolidated Entity has a number of operating leases over its offices that require the asset 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. The Consolidated Entity is expected to incur the liability within the next 12 years. An offsetting asset of the same value is also recognised and is classified in plant and equipment. This asset is amortised to the income statement over the life of the lease.

(k) 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 no longer amortised but is tested annually for impairment (see accounting policy (l)).

Negative goodwill arising on an acquisition is recognised directly in the income statement.

Enterprise resource planning system

The external expenditure incurred on hardware and software and the external costs necessary for the implementation of the system are recognised as an intangible asset, to the extent that the Company controls future economic benefits as a result of the costs incurred, and is stated at cost less accumulated amortisation. All internal development, licence and support costs attributable to feasibility, alternative approach assessment and implementation are expensed as incurred.

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.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the Consolidated Entity has sufficient resources to complete development.

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 (l)).

Other intangible assets

Other intangible assets, principally comprising of technology acquired, 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 (l)).

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

Acquired technology	4 years
Enterprise resource planning system	2.5 – 4 years
Customer relationships	4 years
Intellectual property	3 years
Capitalised development expenditure	1 – 3 years.

(l) Impairment

The carrying amounts of the Consolidated Entity's assets, other than inventories (see accounting policy (n)), employee benefit assets (see accounting policy (o)), and deferred tax assets (see accounting policy (q)), 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, assets that have an indefinite useful life and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date.

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.

Goodwill and indefinite-lived intangible assets were tested for impairment at 1 July 2004, the date of transition to AIFRS, even though no indication of impairment existed.

Calculation of recoverable amount

Receivables

The recoverable amount of the Consolidated Entity's investments in held-to-maturity receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (that is, the effective interest rate computed at initial recognition of these financial assets). Receivables with a short duration are not discounted.

Impairment of receivables is not recognised until objective evidence is available that a loss event has occurred. Significant receivables are individually assessed for impairment. Impairment testing of significant receivables that are not assessed as impaired individually is performed by placing them into portfolios of significant receivables with similar risk profiles and undertaking a collective assessment of impairment. Non-significant receivables are not individually assessed. Instead, impairment testing is performed by placing non-significant receivables in portfolios of similar risk profiles, based on objective evidence from historical experience adjusted for any effects of conditions existing at each balance date.

The allowance for impairment is calculated with reference to the profile of debtors in the Consolidated Entity's sales and marketing regions.

Other assets

The recoverable amount of other assets is the greater of their fair value less costs to sell, and value in use. 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 and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs.

Reversals of impairment

An impairment loss in respect of a receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of goodwill is not reversed.

In respect of other assets, an impairment loss is reversed when there is an indication that the impairment loss may no longer exist and 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.

(m) Plant and equipment

Owned assets

Items of plant and equipment are stated at cost or deemed cost less accumulated depreciation (see below) and impairment losses (see accounting policy (l)). An asset's cost is determined as 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 proportion of fixed and variable overheads, and capitalised interest.

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

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 step-ups.

Depreciation

Items of 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.

Depreciation rates and methods and residual values are reviewed annually for appropriateness. 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	5 – 9 years
Plant and equipment	3 – 8 years.

(n) Inventories

Inventories are carried 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.

(o) Employee benefits

Defined contribution plans

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

Defined benefit plans

The Consolidated Entity has early adopted the revised AASB 119 Employee Benefits (December 2004) (AASB 119).

A liability or asset in respect of defined benefit superannuation plans is recognised in the balance sheet, and is measured as the present value of the defined benefit obligation as at the reporting date plus 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 annually by independent actuaries using the projected unit credit method.

When the calculation results in plan assets exceeding liabilities to the Consolidated Entity, 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 subsequent to transition date will be recognised directly in retained earnings.

Wages, salaries and annual leave

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

Long service leave

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

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

Share based payment transactions

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

The fair value of options and 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 and non-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.

The exemption under AASB 1 has been applied, resulting in no adjustment being made for options granted prior to 7 November 2002 which had vested before 1 July 2004. Options granted after 7 November 2002 and remaining unvested at 1 January 2004 have been recognised through the opening balance sheet.

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 AIFRS, the Trust qualifies as an equity compensation plan special purpose entity and its results are included in those for the Consolidated Entity.

At transition date, the Trust held shares of the Company. The shares are accounted for as treasury shares and treated as a reduction in the share capital of the Company and the Consolidated Entity.

(p) Receivables

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

(q) Taxation

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

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of goodwill and other assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(r) Payables

Trade and other payables are stated at amortised cost.

(s) Interest bearing liabilities

Effective 1 July 2005, interest bearing liabilities are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest bearing liabilities are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis.

Until 30 June 2005, bank loans were carried in the balance sheet at their principal amount. Interest expense was accrued at the contracted rate and included in payables.

(t) Net financing income

Financial costs include interest, finance charges in respect of finance leases. Debt establishment costs are capitalised and recognised as a reduction in interest bearing liabilities. They are calculated based on the effective interest rate method and are amortised over the period of the loan.

Interest income is recognised as it accrues. Dividend income from subsidiaries is recognised by the parent when the dividends are declared by the subsidiary. Foreign exchange differences net of the effect of hedges on borrowings are recognised in net financing income.

(u) Earnings per share

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

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

(v) Segment reporting

A segment is a distinguishable component of the Consolidated Entity that is engaged either in providing products or services within a particular economic environment (geographical segment), or in providing products or services (business segment), which is subject to risks and rewards that are different from those of other segments.

(w) Accounting estimates and judgements

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

Key sources of estimation uncertainty

US Department of Justice Inquiry

The Company was informed by the US Department of Justice that Cochlear America's, a wholly-owned subsidiary, is subject to an inquiry. For further details, refer to Note 22.

2. Changes in accounting policies

In the current financial year, the Company adopted AASB 132 *Financial Instruments: Disclosure and Presentation* (AASB 132) and AASB 139 *Financial Instruments: Recognition and Measurement* (AASB 139). This change in accounting policy has been adopted in accordance with the transition rules contained in AASB 1, which does not require the restatement of comparative information for financial instruments within the scope of AASB 132 and AASB 139.

The adoption of AASB 139 has resulted in the Company recognising all derivative financial instruments as assets or liabilities at fair value. This change has been accounted for by adjusting the opening balance of the hedging reserve at 1 July 2005.

The impact on the balance sheet in the comparative period is set out below as an adjustment to the opening balance sheet at 1 July 2005. The impact on the income statement of the comparative period is nil.

Reconciliation of opening balances affected by AASB 132 and AASB 139 at 1 July 2005:

	Note	Consolidated			Company		
		Previous GAAP	Effect of transition to AIFRS	AIFRS	Previous GAAP	Effect of transition to AIFRS	AIFRS
Amounts \$'000							
Deferred tax liabilities		-	8,186	8,186	-	8,186	8,186
Deferred gain on hedges	(a)	27,288	(27,288)	-	27,288	(27,288)	-
Hedging reserve	(a)	-	19,102	19,102	-	19,102	19,102

(a) Under previous GAAP, the Consolidated Entity did not recognise any derivatives at fair value on the balance sheet. Instead, it had translated the forward exchange contracts in accordance with previous GAAP giving rise to an accumulated deferred gain of \$27,288,000. In accordance with AIFRS, all derivatives would be recognised at fair value. At 1 July 2005, the fair value of the forward exchange contracts was \$27,288,000. The effect in the Consolidated Entity and the Company is to increase the hedging reserve by \$27,288,000 less deferred tax of \$8,186,000, and to decrease the deferred gain on hedges previously recorded as a liability by \$27,288,000 at 1 July 2005.

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

	Consolidated		Company		
	2006	2005	2006	2005	
	Note	\$'000	\$'000	\$'000	
3. Revenue and expenses					
(a) Revenue					
Sale of goods revenue before hedging		428,516	320,444	264,802	208,285
Foreign exchange gains on hedged sales		20,693	26,791	20,693	26,791
Revenue from the sale of goods		449,209	347,235	285,495	235,076
Rendering of services revenue		3,051	1,731	158	118
Total revenue		452,260	348,966	285,653	235,194
(b) Expenses					
Cost of sales:					
Carrying amount of inventories recognised as an expense		128,028	96,409	110,665	89,883
Other		2,681	1,056	106	78
Write-down in value of inventories		253	2,234	-	1,925
Total cost of sales		130,962	99,699	110,771	91,886
Research and development expenses:					
Research and development expenditure		56,703	44,579	40,575	36,833
Development expenditure capitalised		(179)	(4,375)	(179)	(4,375)
Capitalised development expenditure – amortisation expense		2,402	1,261	2,402	1,261
Total research and development expenses		58,926	41,465	42,798	33,719
(c) Other income					
Dividends from controlled entities		-	-	-	5,131
Grant received or due and receivable		233	221	233	221
Other income		651	397	146	594
Total other income		884	618	379	5,946
(d) Other expenses					
Costs resulting from integration of acquired entity		1,524	2,778	-	-
Total other expenses		1,524	2,778	-	-
(e) Profit before tax has been arrived at after charging/(crediting) the following items:					
Impairment loss/(gain) on trade receivables		127	(632)	-	(19)
Increase in provisions		10,550	6,651	7,335	2,025
Employee benefits expense		117,312	95,098	58,853	53,271
Operating lease rental expense		6,647	6,597	2,687	2,838
Loss/(gain) on disposal of plant and equipment		20	7	(177)	-

	Consolidated		Company		
	2006	2005	2006	2005	
	Note	\$000	\$000	\$000	\$000
4. Net financing income					
Interest income		3,683	2,700	5,762	2,658
Net foreign exchange gain		3,046	345	4,692	-
Financial income		6,729	3,045	10,454	2,658
Interest expense		6,391	2,928	16	282
Net foreign exchange loss		-	-	-	962
Financial expenses		6,391	2,928	16	1,244
Net financing income		338	117	10,438	1,414

	Consolidated		Company		
	2006	2005	2006	2005	
	Note	\$	\$	\$	\$
5. Auditors' remuneration					
Audit services					
Auditors of the Company:					
KPMG Australia:					
- audit and review of financial reports		350,000	274,600	335,500	274,600
- other regulatory audit services		6,400	5,500	6,400	5,500
Overseas KPMG firms:					
- audit and review of financial reports		443,796	359,772	25,876	24,644
- other regulatory audit services		-	10,891	-	-
Other auditor		-	37,994	-	-
		800,196	688,757	367,776	304,744
Other services					
Auditors of the Company:					
KPMG Australia:					
- international taxation services		423,792	257,529	387,720	257,529
- other assurance services		17,250	47,495	17,250	47,495
- other taxation services		185,698	235,789	150,962	235,786
Overseas KPMG firms:					
- taxation services		218,217	112,050	16,350	40,292
- international taxation services		118,717	85,552	7,580	47,642
- other assurance services		9,700	-	-	-
		973,374	738,415	579,862	628,744

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

	Note	Consolidated		Company	
		2006	2005	2006	2005
		\$000	\$000	\$000	\$000
6. Income tax expense					
Recognised in the income statement					
Current tax expense					
Current year		21,549	22,958	28,064	18,968
Overprovided in prior years		(283)	(638)	(406)	(286)
		21,266	22,320	27,658	18,682
Deferred tax expense					
Origination and reversal of temporary differences		5,777	(887)	(1,136)	1,665
Benefits of tax losses		3,567	2,400	-	-
	16	9,344	1,513	(1,136)	1,665
Total income tax expense in the income statement		30,610	23,833	26,522	20,347
Numerical reconciliation between income tax expense and profit before tax					
Profit before tax		108,835	82,307	93,881	81,535
Income tax expense using the domestic corporate rate of 30% (2005: 30%)		32,651	24,692	28,164	24,461
Increase in income tax expense due to:					
Non-deductible expenses		764	1,647	617	153
Effect of tax rate in foreign jurisdictions		-	440	151	-
Decrease in income tax expense due to:					
Research and development allowance		(2,004)	(2,308)	(2,004)	(2,308)
Non-assessable dividends from controlled entities		-	-	-	(1,539)
Effect of tax rate in foreign jurisdictions		(518)	-	-	(134)
		30,893	24,471	26,928	20,633
Overprovided in prior years		(283)	(638)	(406)	(286)
Income tax expense on profit before tax		30,610	23,833	26,522	20,347
Deferred tax recognised directly in equity					
Relating to derivative financial instruments	16	(6,645)	-	(6,645)	-

	Cents per share	Total amount \$000	Franked/unfranked	Date of payment
7. Dividends				
Dividends recognised in the current financial year by the Company are:				
2006				
Interim 2006 ordinary	45.0	24,666	Franked	14 Mar 2006
Final 2005 ordinary	45.0	24,430	Franked	22 Sep 2005
Total amount		49,096		
2005				
Interim 2005 ordinary	35.0	19,001	Franked	15 Mar 2005
Final 2004 ordinary	44.0	23,831	Franked	23 Sep 2004
Total amount		42,832		

Franked dividends declared or paid during the financial year were franked at the tax rate of 30%.

Subsequent events				
Since the end of the financial year, the directors declared the following dividends:				
Final 2006 ordinary	55.0	30,147	Franked	21 Sep 2006
Total amount		30,147		

The financial effect of the 2006 final dividend has not been brought to account in the financial statements for the year ended 30 June 2006 and will be recognised in the subsequent financial period.

	Company	
	2006	2005
	\$000	\$000
Dividend franking account		
30% franking credits available to shareholders of Cochlear Limited for subsequent financial periods	13,352	9,069

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 credits is dependent upon there being sufficient available profits to declare dividends. The impact on the dividend franking account of dividends proposed after balance sheet date but not recorded as a liability is to reduce it by \$12,920,169 (2005: \$10,470,113).

No additional current tax liability will arise to the extent that franking credits are available in which to pay appropriately franked dividends. Dividends in excess of the balance of the dividend franking account will either be unfranked or result in 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.

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

8. Segment reporting

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

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

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

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

	Americas		Europe		Asia Pacific		Eliminations		Consolidated	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000
Revenue										
Revenue outside the Consolidated Entity	198,188	131,163	173,722	133,021	59,657	57,991	-	-	431,567	322,175
Inter-segment sales revenue	-	-	-	-	229,657	175,333	(229,657)	(175,333)	-	-
Foreign exchange gains on hedged sales									20,693	26,791
Total revenue									452,260	348,966
Segment result	52,065	24,850	45,721	37,783	12,048	11,728	-	-	109,834	74,361
Unallocated (loss)/profit									(1,337)	7,829
Net financing income									338	117
Profit before tax									108,835	82,307
Income tax expense									(30,610)	(23,833)
Net profit (including minority interest)									78,225	58,474
Segment depreciation and amortisation	4,953	463	2,954	1,213	892	246	-	-	8,799	1,922
Unallocated depreciation and amortisation									7,276	9,749
Total depreciation and amortisation									16,075	11,671
Segment non-cash expenses other than depreciation and amortisation	1,775	(1,989)	479	769	278	294	-	-	2,532	(926)
Unallocated non-cash expenses other than depreciation and amortisation									(812)	4,070
Total non-cash expenses other than depreciation and amortisation									1,720	3,144
Inventory write-down	203	923	15	942	35	369	-	-	253	2,234
Segment assets	164,697	132,871	231,758	198,335	40,560	33,336	(57,840)	(70,039)	379,175	294,503
Unallocated assets									166,749	208,193
Total assets									545,924	502,696
Segment liabilities	85,570	65,129	66,116	64,299	9,699	11,563	(89,226)	(52,915)	72,159	88,076
Unallocated liabilities									263,987	259,959
Total liabilities									336,146	348,035
Segment acquisition of non-current assets	2,129	3,440	5,444	1,850	360	54	-	-	7,933	5,344
Unallocated acquisition of non-current assets									7,102	2,692
Total acquisition of non-current assets									15,035	8,036

Secondary reporting

The Consolidated Entity operates in a single business segment, being the implantable hearing device industry.

	Consolidated	
	2006	2005
9. Earnings per share		
Basic earnings per share		
The calculation of basic earnings per share for the year ended 30 June 2006 was based on net profit attributable to equity holders of the parent of \$80,032,000 (2005: \$59,642,000) and a weighted average number of ordinary shares outstanding during the year ended 30 June 2006 of 54,530,299 (2005: 54,152,156) calculated as follows:		
Net profit attributable to equity holders of the parent	\$80,032,000	\$59,642,000
Weighted average number of ordinary shares:		
Issued ordinary shares at 1 July	54,169,325	54,096,455
Effect of shares issued on 24 September 2004	-	55,701
Effect of shares issued on 21 September 2005	350,376	-
Effect of shares issued on 30 September 2005	10,598	-
Weighted average number of ordinary shares	54,530,299	54,152,156
Diluted earnings per share		
The calculation of diluted earnings per share for the year ended 30 June 2006 was based on net profit attributable to equity holders of the parent of \$80,032,000 (2005: \$59,642,000) and a weighted average number of ordinary shares outstanding during the year ended 30 June 2006 of 55,122,283 (2005: 54,382,919) calculated as follows:		
Net profit attributable to equity holders of the parent	\$80,032,000	\$59,642,000
Weighted average number of ordinary shares (diluted):		
Weighted average number of shares (basic)	54,530,299	54,152,156
Effect of options and performance shares	591,984	230,763
Weighted average number of ordinary shares (diluted)	55,122,283	54,382,919

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

	Note	Consolidated		Company	
		2006	2005	2006	2005
		\$'000	\$'000	\$'000	\$'000
10. Receivables					
Current					
Trade receivables net of allowance for impairment loss		96,060	65,611	10,987	8,605
Other receivables		7,427	8,412	4,100	2,741
Amount receivable from controlled entities	29	-	-	88,782	30,542
Forward exchange contracts		5,901	17,350	5,901	17,350
Total current receivables		109,388	91,373	109,770	59,238
Non-current					
Forward exchange contracts		-	9,938	-	9,938
Total non-current receivables		-	9,938	-	9,938
11. Inventories					
Raw materials and stores		28,975	20,526	26,900	18,973
Work in progress		7,835	6,172	6,578	5,836
Finished goods		40,012	22,820	13,731	917
Total inventories		76,822	49,518	47,209	25,726
12. Other current assets					
Prepayments		5,920	4,186	2,349	2,117
13. Other financial assets					
Shares in controlled entities, unlisted, at cost	26	-	-	33,868	18,489
Other amounts receivable		383	187	126	32
Total financial assets		383	187	33,994	18,521

	Consolidated		Company		
	2006	2005	2006	2005	
	Note	\$000	\$000	\$000	
14. Plant and equipment					
Leasehold improvements					
At cost		21,973	20,550	19,572	18,960
Accumulated amortisation		(10,309)	(7,601)	(9,757)	(7,163)
		11,664	12,949	9,815	11,797
Plant and equipment					
At cost		50,716	38,302	33,087	27,130
Accumulated depreciation		(31,547)	(26,627)	(21,521)	(19,043)
		19,169	11,675	11,566	8,087
Total plant and equipment, at net book value		30,833	24,624	21,381	19,884
Reconciliations					
Reconciliations of the carrying amounts of each class of plant and equipment are set out below:					
Leasehold improvements					
Carrying amount at beginning of financial year		12,949	15,222	11,797	14,706
Additions		1,796	593	684	624
Disposals		(323)	(27)	-	(743)
Amortisation		(2,782)	(2,855)	(2,670)	(2,790)
Effect of movements in foreign exchange		24	16	4	-
Carrying amount at end of financial year		11,664	12,949	9,815	11,797
Plant and equipment					
Carrying amount at beginning of financial year		11,675	10,812	8,087	8,703
Additions		12,533	4,399	6,284	2,945
Disposals		(269)	(7)	(20)	(536)
Depreciation		(5,245)	(4,160)	(2,938)	(3,025)
Acquisitions through business combinations		-	1,042	-	-
Effect of movements in foreign exchange		475	(411)	153	-
Carrying amount at end of financial year		19,169	11,675	11,566	8,087

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

	Consolidated		Company	
	2006	2005	2006	2005
	Note	\$000	\$000	\$000
15. Intangible assets				
Goodwill at cost		185,352	168,002	-
Acquired technology				
At cost		3,702	3,334	-
Accumulated amortisation		(1,234)	(278)	-
		2,468	3,056	-
Enterprise resource planning system				
At cost		13,091	12,217	9,179
Accumulated amortisation		(10,545)	(7,178)	(9,093)
		2,546	5,039	86
Customer relationships				
At cost		5,433	5,002	-
Accumulated amortisation		(1,826)	(417)	-
		3,607	4,585	-
Intellectual property capitalised, at cost⁽ⁱ⁾		6,788	6,825	-
Capitalised development expenditure				
At cost		7,385	7,524	7,524
Accumulated amortisation		(3,345)	(1,261)	(3,345)
		4,040	6,263	4,179
Other intangible assets				
At cost		583	590	-
Accumulated amortisation		(146)	(31)	-
		437	559	-
Total intangible assets		205,238	194,329	4,126

(i) Intellectual property is not amortised on the basis that it has not yet reached the condition necessary for it to be capable of operating in the manner intended by the Consolidated Entity.

	Consolidated		Company	
	2006	2005	2006	2005
	Note	\$000	\$000	\$000
Reconciliations				
Reconciliations of the carrying amounts of each class of intangible assets are set out below:				
Goodwill				
Carrying amount at beginning of financial year		168,002	-	-
Acquisitions through business combinations		-	181,922	-
Effect of movements in foreign exchange		17,350	(13,920)	-
Carrying amount at end of financial year		185,352	168,002	-
Acquired technology				
Carrying amount at beginning of financial year		3,056	-	-
Acquisitions through business combinations		-	3,334	-
Amortisation		(926)	(278)	-
Effects of movements in foreign exchange		338	-	-
Carrying amount at end of financial year		2,468	3,056	-
Enterprise resource planning system				
Carrying amount at beginning of financial year		5,039	4,664	2,000
Other acquisitions		706	3,044	-
Amortisation		(3,366)	(2,669)	(1,914)
Effect of movements in foreign exchange		167	-	-
Carrying amount at end of financial year		2,546	5,039	86
Customer relationships				
Carrying amount at beginning of financial year		4,585	-	-
Acquisitions through business combinations		-	5,002	-
Amortisation		(1,238)	(417)	-
Effect of movements in foreign exchange		260	-	-
Carrying amount at end of financial year		3,607	4,585	-
Intellectual property capitalised, at cost				
Carrying amount at beginning of financial year		6,825	6,825	-
Acquisitions through business combinations		-	-	-
Amortisation		-	-	-
Effect of movements in foreign exchange		(37)	-	-
Carrying amount at end of financial year		6,788	6,825	-
Capitalised development expenditure				
Carrying amount at beginning of financial year		6,263	3,149	6,263
Development phase expenditure		179	4,375	179
Amortisation		(2,402)	(1,261)	(2,402)
Effect of movements in foreign exchange		-	-	-
Carrying amount at end of financial year		4,040	6,263	4,040

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

	Consolidated		Company	
	2006	2005	2006	2005
Note	\$000	\$000	\$000	\$000
Other intangible assets				
Carrying amount at beginning of financial year	559	-	-	-
Acquisitions through business combinations	-	590	-	-
Amortisation	(116)	(31)	-	-
Effect of movements in foreign exchange	(6)	-	-	-
Carrying amount at end of financial year	437	559	-	-

Amortisation charge

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

Impairment tests for cash generating units containing goodwill

The following units have significant carrying amounts of goodwill:

	Consolidated		Company	
	2006	2005	2006	2005
Note	\$000	\$000	\$000	\$000
Americas	69,721	63,104	-	-
Europe	109,518	99,344	-	-
Asia Pacific	6,113	5,554	-	-
	185,352	168,002	-	-

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 a further two year period are extrapolated using a 3.5% per annum growth rate and are appropriate because the related acquisitions are long-term businesses. This growth rate is consistent with the long-term average growth rate for the industry. A post-tax discount rate of 9.5% per annum has been used in discounting the projected cash flows.

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

Assumption	How determined
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 amounts and therefore no impairment charge was required. Any adverse change in assumptions could reduce the recoverable amount below the carrying amount.

	Assets		Liabilities		Net	
	2006	2005	2006	2005	2006	2005
	\$000	\$000	\$000	\$000	\$000	\$000
16. Deferred tax assets and liabilities						
Recognised deferred tax assets and liabilities						
<i>Consolidated</i>						
Plant and equipment	1,793	683	-	(302)	1,793	381
Intangible assets	-	-	(3,072)	(4,339)	(3,072)	(4,339)
Inventories	9,682	6,936	-	(1,686)	9,682	5,250
Prepayments	-	-	(101)	(75)	(101)	(75)
Employee benefits	754	780	-	(3)	754	777
Provisions	8,535	13,138	-	-	8,535	13,138
Deferred revenue	7,396	5,404	-	-	7,396	5,404
Forward exchange contracts	-	-	(1,541)	(374)	(1,541)	(374)
Other	977	-	(123)	(98)	854	(98)
Tax value of loss carry-forwards recognised	5,967	2,400	-	-	5,967	2,400
Net deferred tax assets/(liabilities)	35,104	29,341	(4,837)	(6,877)	30,267	22,464
<i>Company</i>						
Plant and equipment	1,103	485	-	-	1,103	485
Intangible assets	-	-	(1,212)	(1,879)	(1,212)	(1,879)
Inventories	854	1,289	-	-	854	1,289
Provisions	5,983	8,055	-	-	5,983	8,055
Forward exchange contracts	-	-	(1,541)	(104)	(1,541)	(104)
Other	-	-	(115)	(97)	(115)	(97)
Net deferred tax assets/(liabilities)	7,940	9,829	(2,868)	(2,080)	5,072	7,749

At 30 June 2006, a deferred tax liability of \$14,282,667 (2005: \$5,151,203) relating to an investment in a subsidiary 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.

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

Movement in temporary differences during the year

Amounts \$'000	Consolidated				Company			
	Balance at 1 July	Recognised in income	Recognised in equity	Balance at 30 June	Balance at 1 July	Recognised in income	Recognised in equity	Balance at 30 June
2005								
Plant and equipment	342	39	-	381	652	(167)	-	485
Intangible assets	(945)	(3,394)	-	(4,339)	(945)	(934)	-	(1,879)
Inventories	3,645	1,605	-	5,250	866	423	-	1,289
Prepayments	(72)	(3)	-	(75)	-	-	-	-
Employee benefits	722	55	-	777	-	-	-	-
Provisions	12,519	619	-	13,138	5,892	2,163	-	8,055
Deferred revenue	5,373	31	-	5,404	275	(275)	-	-
Foreign exchange movement	(355)	(19)	-	(374)	(378)	274	-	(104)
Other	(278)	180	-	(98)	(278)	181	-	(97)
Tax value of loss carry-forwards recognised	-	2,400	-	2,400	-	-	-	-
	20,951	1,513	-	22,464	6,084	1,665	-	7,749
2006								
Plant and equipment	381	1,412	-	1,793	485	618	-	1,103
Intangible assets	(4,339)	1,267	-	(3,072)	(1,879)	667	-	(1,212)
Inventories	5,250	4,432	-	9,682	1,289	(435)	-	854
Prepayments	(75)	(26)	-	(101)	-	-	-	-
Employee benefits	777	(23)	-	754	-	-	-	-
Provisions	13,138	(4,603)	-	8,535	8,055	(2,072)	-	5,983
Deferred revenue	5,404	1,992	-	7,396	-	-	-	-
Foreign exchange movement ⁽ⁱ⁾	(8,560)	374	6,645	(1,541)	(8,290)	104	6,645	(1,541)
Other	(98)	952	-	854	(97)	(18)	-	(115)
Tax value of loss carry-forwards recognised	2,400	3,567	-	5,967	-	-	-	-
	14,278	9,344	6,645	30,267	(437)	(1,136)	6,645	5,072

(i) Foreign exchange movement includes \$8,186,000 of opening balance adjustment for the deferred tax liabilities on deferred gain on hedges as set out in Note 2.

	Consolidated		Company		
	2006	2005	2006	2005	
	Note	\$'000	\$'000	\$'000	
17. Payables					
Trade creditors and other creditors		57,345	46,539	28,337	18,914
18. Other liabilities					
Current					
Deferred foreign exchange hedge gain		-	17,350	-	17,350
Deferred revenue		23,525	28,046	857	972
Total current other liabilities		23,525	45,396	857	18,322
Non-current					
Deferred foreign exchange hedge gain		-	9,938	-	9,938
Forward exchange contracts		764	-	764	-
Total non-current other liabilities		764	9,938	764	9,938
19. Interest bearing liabilities					
Current					
Bank overdrafts		1,747	2,450	-	1,273
Bank loans, secured		68,800	61,657	-	-
Total current interest bearing liabilities		70,547	64,107	-	1,273
Non-current					
Bank loans, secured		125,493	138,951	-	-
Financing arrangements					
The Consolidated Entity has access to the following lines of credit at reporting date:					
Bank overdrafts		3,747	3,177	2,000	2,000
Bank loans		200,309	237,056	5,000	5,000
Standby letters of credit		3,004	227	227	227
Bank guarantee facility		292	280	280	280
		207,352	240,740	7,507	7,507
Facilities utilised at reporting date					
Bank overdrafts		1,747	2,450	-	1,273
Bank loans		194,293	200,608	-	-
Standby letters of credit		191	191	191	191
Bank guarantee facility		279	279	279	279
		196,510	203,528	470	1,743
Facilities not utilised at reporting date					
Bank overdrafts		2,000	727	2,000	727
Bank loans		6,016	36,448	5,000	5,000
Standby letters of credit		2,813	36	36	36
Bank guarantee facility		13	1	1	1
		10,842	37,212	7,037	5,764

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

Bank overdrafts

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

Bank loans

The bank loans are secured by a letter of guarantee provided by the Company and are payable within one to five years. Refer to Note 30 for details.

	Consolidated		Company	
	2006	2005	2006	2005
Note	\$000	\$000	\$000	\$000
20. Commitments				
Operating lease commitments				
Future non-cancellable operating lease rentals not provided for in the financial statements are payable as follows:				
Not later than one year	5,886	5,165	2,323	1,995
Later than one year but not later than five years	12,881	15,979	5,076	6,221
Later than five years	2,647	3,161	-	-
Total commitments	21,414	24,305	7,399	8,216
Capital expenditure commitments				
Contracted but not provided for and payable:				
Not later than one year	1,294	584	1,294	584

The Consolidated Entity leases property under non-cancellable operating leases expiring from one to seven years. Leases generally provide the Consolidated Entity with a right of renewal at which time all terms are renegotiated. Lease payments comprise a base amount plus an incremental contingent rental. Contingent rentals are based on movements in the Consumer Price Index.

	Note	Consolidated		Company	
		2006	2005	2006	2005
		\$'000	\$'000	\$'000	\$'000
21. Provisions					
Current					
Employee benefits	28	14,633	10,949	8,020	7,253
Warranty		7,010	6,206	6,122	5,580
Other and legal		5,415	7,386	1,500	3,996
Total current provisions		27,058	24,541	15,642	16,829
Non-current					
Employee benefits		2,007	2,377	1,292	1,158
Warranty		1,673	1,076	1,673	985
Directors' retirement scheme		1,457	1,327	1,457	1,327
Make good lease costs		1,296	1,328	1,233	1,233
Total non-current provisions		6,433	6,108	5,655	4,703
Reconciliations					
Reconciliations of the carrying amounts of each class of provision, except for the employee benefits provision, are set out below:					
Warranty					
Carrying amount at beginning of financial year		7,282	6,616	6,565	6,565
Provisions made during financial year		7,635	6,214	7,352	871
Acquisitions through business combinations		-	658	-	-
Provisions used during financial year		(6,312)	(6,206)	(6,122)	(871)
Effects of movements in foreign exchange		78	-	-	-
Carrying amount at end of financial year		8,683	7,282	7,795	6,565
Other and legal					
Carrying amount at beginning of financial year		7,386	9,731	3,996	3,000
Provisions made during financial year		1,505	437	-	1,154
Acquisitions through business combinations		-	375	-	-
Provisions used during financial year		(3,612)	(3,157)	(2,496)	(158)
Effects of movements in foreign exchange		136	-	-	-
Carrying amount at end of financial year		5,415	7,386	1,500	3,996
Directors' retirement scheme					
Carrying amount at beginning of financial year		1,327	1,173	1,327	1,173
Provisions made during financial year		216	411	216	411
Provisions used during financial year		(251)	(257)	(251)	(257)
Unwind of discount		165	-	165	-
Carrying amount at end of financial year		1,457	1,327	1,457	1,327
Make good lease costs					
Carrying amount at beginning of financial year		1,328	1,328	1,233	1,233
Provisions made during financial year		63	-	-	-
Provisions used during financial year		(95)	-	-	-
Carrying amount at end of financial year		1,296	1,328	1,233	1,233

Employee benefits

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

Warranties

Refer to Note 1(j) for details of how the provision balance is determined.

Other and legal

For details of legal costs relating to the US Department of Justice Inquiry, refer Note 22. For details on the self-insurance provision, refer to Note 1(j).

Directors' retirement scheme

Refer to Note 28.

Make good lease costs

Refer to Note 1(j) for details of how the provision balance is determined.

22. Contingent liabilities

The detail 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.

US Department of Justice Inquiry

In March 2004, the Company was informed by the US Department of Justice (DOJ) that Cochlear Americas, a wholly-owned subsidiary, is subject to an inquiry under federal healthcare laws in the US that deal with the Medicare and Medicaid programs, including some with potential criminal and civil sanctions. Discussions with the DOJ are ongoing, but at the date of this report, no specific claims have been made. The Company is cooperating fully with the inquiry and has engaged a nationally recognised law firm with specialised expertise in US healthcare law.

In prior years, the Company has recorded a provision in respect of estimated cost of responding to the investigation.

Based on the information available at the date of this report, the financial impact of the investigation has been adequately provided for.

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

Guarantees

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

The Cochlear Sweden Holdings facility is a multi currency facility with a limit of euro 94.4 million, or equivalent thereof. The outstanding balance of the loan at reporting date was SEK 866.5 million (euro 94.4 million).

The Cochlear Americas facility is for USD 12.0 million. The outstanding balance of the loan at reporting date was USD 12.0 million.

The Cochlear Europe Limited facility is for GBP 7.5 million. The outstanding balance of the loan at reporting date was GBP 7.1 million.

	Consolidated		Company		
	2006	2005	2006	2005	
	Note	\$000	\$000	\$000	
23. Issued capital					
Share capital					
54,636,995 (2005: 54,169,325) ordinary shares fully paid ⁽ⁱ⁾		66,663	49,375	66,663	49,375
Issued share capital					
54,812,840 (2005: 54,289,477) ordinary shares fully paid ⁽ⁱ⁾					
Movements in issued share capital					
Balance at beginning of financial year		50,746	50,746	50,746	50,746
14,170 (2005: 72,870) shares issued for nil consideration under the Employee Share Plan ⁽ⁱⁱ⁾		-	-	-	-
453,500 (2005: nil) shares issued from the exercise of options ⁽ⁱⁱⁱ⁾		17,288	-	17,288	-
55,693 (2005: 54,917) shares issued for nil consideration under the CELTIP ^(iv)		-	-	-	-
Balance at end of financial year		68,034	50,746	68,034	50,746
Treasury reserve					
175,845 (2005: 120,152) ordinary shares fully paid ⁽ⁱ⁾					
Movements in treasury reserve					
Balance at beginning of financial year		(1,371)	(1,371)	(1,371)	(1,371)
55,693 (2005: 54,917) shares issued for nil consideration under the CELTIP ^(iv)		-	-	-	-
Balance at end of financial year		(1,371)	(1,371)	(1,371)	(1,371)
Net share capital		66,663	49,375	66,663	49,375

(i) Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings. Ordinary shares have no par value.

(ii) On 21 September 2005, the Company issued 14,170 shares to eligible employees of the Consolidated Entity under the Employee Share Plan for nil consideration.

(iii) On 21 September 2005, the Company issued 453,500 ordinary shares issued from the exercise of options granted under the ESOP.

(iv) On 16 December 2005, the Company issued 55,693 shares to eligible employees of the Consolidated Entity under the CELTIP for nil consideration.

24. Reconciliation of movement in capital and reserves attributable to equity holders of the parent

Consolidated									
Amounts \$'000	Issued capital	Treasury reserve	Translation reserve	General reserve	Hedging reserve	Retained earnings	Total	Minority interest	Total equity
2005									
Balance as at 1 July 2004	50,746	(1,371)	(1,885)	84	-	86,154	133,728	6,511	140,239
Total recognised income and expense	-	-	(2,106)	(10)	-	59,544	57,428	(1,770)	55,658
Crystallisation of foreign currency translation reserve	-	-	-	-	-	(996)	(996)	-	(996)
Equity settled transactions	-	-	-	-	-	2,592	2,592	-	2,592
Dividends to shareholders	-	-	-	-	-	(42,832)	(42,832)	-	(42,832)
Balance at 30 June 2005	50,746	(1,371)	(3,991)	74	-	104,462	149,920	4,741	154,661
2006									
Balance as at 1 July 2005	50,746	(1,371)	(3,991)	74	-	104,462	149,920	4,741	154,661
Effect of change in accounting policy	-	-	-	-	19,102	-	19,102	-	19,102
Opening balance at 1 July 2005 – restated	50,746	(1,371)	(3,991)	74	19,102	104,462	169,022	4,741	173,763
Total recognised income and expense	-	-	3,329	2	(15,506)	80,032	67,857	(2,500)	65,357
Shares issued	17,288	-	-	-	-	-	17,288	-	17,288
Equity settled transactions	-	-	-	-	-	2,466	2,466	-	2,466
Dividends to shareholders	-	-	-	-	-	(49,096)	(49,096)	-	(49,096)
Balance at 30 June 2006	68,034	(1,371)	(662)	76	3,596	137,864	207,537	2,241	209,778

Company									
Amounts \$'000	Issued capital	Treasury reserve	Translation reserve	General reserve	Hedging reserve	Retained earnings	Total	Minority interest	Total equity
2005									
Balance as at 1 July 2004	50,746	(1,371)	(513)	-	-	75,952	124,814	-	124,814
Total recognised income and expense	-	-	385	-	-	61,090	61,475	-	61,475
Shares issued	-	-	-	-	-	-	-	-	-
Equity settled transactions	-	-	-	-	-	1,811	1,811	-	1,811
Dividends to shareholders	-	-	-	-	-	(42,832)	(42,832)	-	(42,832)
Balance at 30 June 2005	50,746	(1,371)	(128)	-	-	96,021	145,268	-	145,268
2006									
Balance as at 1 July 2005	50,746	(1,371)	(128)	-	-	96,021	145,268	-	145,268
Effect of change in accounting policy	-	-	-	-	19,102	-	19,102	-	19,102
Opening balance at 1 July 2005 – restated	50,746	(1,371)	(128)	-	19,102	96,021	164,370	-	164,370
Total recognised income and expense	-	-	(391)	-	(15,506)	67,359	51,462	-	51,462
Shares issued	17,288	-	-	-	-	-	17,288	-	17,288
Equity settled transactions	-	-	-	-	-	1,673	1,673	-	1,673
Dividends to shareholders	-	-	-	-	-	(49,096)	(49,096)	-	(49,096)
Balance at 30 June 2006	68,034	(1,371)	(519)	-	3,596	115,957	185,697	-	185,697

Treasury reserve

The treasury reserve comprises the on market value of shares acquired by the Trust.

Foreign currency translation reserve

The foreign currency translation reserve records the foreign currency differences arising from the translation of the financial statements of foreign operations where their functional currency is different to the presentation currency of the reporting entity. Refer to Note 1(f) 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 hedged transactions that have not yet occurred.

25. Notes to the statements of cash flows

Cash assets

The operating account received an average interest rate of:

- Company 4.8% (2005: 4.8%) per annum; and
- Consolidated 2.4% (2005: 1.3%) per annum.

Cash held on deposit for periods not exceeding 90 days received an average interest rate of:

- Company 5.6% (2005: 5.4%) per annum; and
- Consolidated 5.6% (2005: 5.4%) per annum.

(a) Reconciliation of cash and cash equivalents

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

	Note	Consolidated		Company	
		2006	2005	2006	2005
		\$000	\$000	\$000	\$000
Cash on hand		62,778	33,299	3,163	64
Cash on deposit		24,295	72,778	24,295	72,127
		87,073	106,077	27,458	72,191
Bank overdrafts	19	(1,747)	(2,450)	-	(1,273)
		85,326	103,627	27,458	70,918
(b) Reconciliation of net profit to net cash provided by operating activities					
Net profit (including minority interest)		78,225	58,474	67,359	61,188
Add items classified as investing activities					
Loss/(gain) on disposal of non-current assets		20	7	(177)	-
Add non-cash items					
Amounts set aside to provisions		18,681	10,243	11,179	7,493
Depreciation and amortisation		16,075	11,671	9,924	9,745
Share based payments		2,466	2,592	1,673	1,811
Net cash provided by operating activities before changes in assets and liabilities		115,467	82,987	89,958	80,237
Changes in assets and liabilities					
Increase in receivables		(29,464)	(1,488)	(61,981)	(18,034)
(Increase)/decrease in inventories		(27,304)	2,342	(21,483)	7,703
(Increase)/decrease in prepayments		(1,930)	4,402	(326)	(591)
(Increase)/decrease in deferred tax assets		(7,803)	(4,673)	2,677	(749)
Increase/(decrease) in payables		10,806	(1,252)	9,423	1,758
Increase in current tax liabilities		12,526	8,879	6,027	9,020
Decrease in provisions		(15,840)	(3,567)	(11,414)	(4,149)
(Decrease)/increase in deferred revenue		(4,521)	19,071	(115)	972
Effects of movements in foreign exchange		(382)	(3,691)	(830)	(128)
Net cash provided by operating activities		51,555	103,010	11,936	76,039

	Note	Interest held		Country of incorporation/ formation
		2006 %	2005 %	
26. Controlled entities				
(a) Particulars in relation to controlled entities				
Company				
Cochlear Limited				Australia
Controlled entities				
Cochlear Executive Long Term Incentive Plan (Performance Shares) Trust		100	100	Australia
Cochlear Incentive Plan Pty Limited		100	100	Australia
Cochlear Europe Limited	(i)	100	100	UK
Cochlear Acoustics Limited	(i)	75	75	UK
Cochlear AG	(i)	100	100	Switzerland
Cochlear (UK) Limited	(i), (ii)	100	100	UK
Cochlear GmbH	(i)	100	100	Germany
Cochlear Americas	(i)	100	100	USA
Cochlear (HK) Limited	(i)	100	100	Hong Kong
Nihon Cochlear Co Limited	(i)	100	100	Japan
Neopraxis Pty Limited	(ii)	100	100	Australia
Cochlear Technologies Pty Limited		100	100	Australia
Medical Insurance Pte Limited	(i)	100	100	Singapore
Cochlear Holdings NV	(i)	100	100	Belgium
Miaki NV	(i)	100	100	Belgium
Cochlear Benelux NV	(i)	100	100	Belgium
Cochlear France SAS	(i)	100	100	France
Cochlear Holdings France SAS	(i)	100	100	France
Cochlear Italia SRL	(i)	100	100	Italy
Cochlear Sweden Holdings	(i)	100	100	Sweden
Entific Medical Systems AB	(i)	100	100	Sweden
Entific Medical Systems Inc	(i)	100	100	USA
Cochlear Canada Inc	(i), (iii)	100	100	Canada
Cochlear Bone Anchored Solutions France SAS	(i), (iv)	100	100	France
Entific Medical Systems Deutschland GmbH	(i)	100	100	Germany
Entific Australia Pty Ltd	(ii)	100	100	Australia
Cochlear Nordic AB	(i), (v)	100	100	Sweden

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

(ii) Dormant.

(iii) Name changed from Entific Canada Inc on 29 August 2005.

(iv) Name changed from Entific Medical Systems SAS on 21 March 2006.

(v) Name changed from Entific Harbour AB on 22 November 2005.

(b) Acquisition of controlled entities

During the previous financial year, the following acquisitions were made in the Consolidated Entity:

- (i) three distribution businesses were acquired, being:
- on 1 July 2004, Nihon Cochlear Co Limited, a wholly-owned subsidiary of the Company, acquired the cochlear implant distribution business from its distributor for cash;
 - on 1 July 2004, the Consolidated Entity purchased 100% of the voting shares of Miaki NV, a distributor of Cochlear Limited products, incorporated in Belgium. At the time of acquisition, Miaki NV owned 100% of the voting shares of Newmedic NV, which was subsequently renamed to Cochlear Benelux NV;
 - on 1 November 2004, the Consolidated Entity purchased 100% of the voting shares of Newmedic International SAS, a distributor of Cochlear Limited products, incorporated in France. Newmedic International SAS was subsequently renamed to Cochlear France SAS; and
- (ii) on 8 March 2005, the Consolidated Entity purchased 100% of the shares of Entific Medical Systems AB, a company incorporated in Sweden. The company designs, manufactures and distributes bone anchored hearing implants.

Details of each acquisition are as follows:

Amounts \$'000	Distributor businesses			Entific Medical Systems AB		
	Carrying amounts	Fair value adjustments	Recognised values	Carrying amounts	Fair value adjustments	Recognised values
Cash and cash equivalents	2,702	-	2,702	19,039	-	19,039
Receivables	7,096	-	7,096	8,438	-	8,438
Inventories	3,267	-	3,267	3,755	398	4,153
Plant and equipment	190	-	190	852	-	852
Intangible assets	590	-	590	-	9,050	9,050
Payables	(5,688)	-	(5,688)	(10,446)	-	(10,446)
Interest bearing liabilities	(318)	-	(318)	-	-	-
Provisions	-	-	-	(1,033)	-	(1,033)
Net identifiable assets	7,839	-	7,839	20,605	9,448	30,053
Goodwill on acquisition			14,178			165,284
Consideration paid			22,017			195,337
Cash acquired			(2,702)			(19,039)
Net cash outflow			19,315			176,298

If all of the acquisitions above had occurred on 1 July 2004, the Consolidated Entity revenue would have been \$379,219,919 and net profit attributable to equity holders would have been \$54,069,073 for the year ended 30 June 2005 assuming the result during the period prior to acquisitions was the same (on a pro-rata basis) as the period following the acquisitions.

27. Key management personnel disclosures

The following were key management personnel of the Consolidated Entity at any time during the reporting period and unless otherwise indicated were key management personnel for the entire period:

Non-executive directors

Mr TCE Bergman (Chairman)

Prof BDO Anderson, AO (resigned 20 October 2005)

Mr PR Bell (appointed 1 August 2005)

Prof E Byrne, AO

Mr R Holliday-Smith

Mr PJ North, AM

Mr DP O'Dwyer (appointed 1 August 2005)

Mr J H Veeneklaas

Executive directors

Dr CG Roberts

Dr JL Parker

Executives

Mr R Brook

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:

	Consolidated		Company	
	2006	2005	2006	2005
Note	\$000	\$000	\$000	\$000
Short-term employee benefits	4,766	4,568	3,604	3,266
Post-employment benefits	595	583	560	535
Other long-term benefits	36	28	36	28
Equity compensation benefits	773	474	505	288
	6,170	5,653	4,705	4,117

Information regarding individual directors and executives remuneration is provided in the Remuneration Report in the Directors' Report on pages 38 to 46.

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

Options and performance shares granted as compensation

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

	Held at 1 July 2005	Granted as remuneration	Vested and exercised	Forfeited	Held at 30 June 2006	Vested and exercisable at 30 June 2006
Option holdings						
Executive directors						
Dr CG Roberts	164,321	79,468	-	-	243,789	-
Dr JL Parker	112,733	28,447	(25,000)	(25,000)	91,180	-
Executives						
Mr R Brook	80,782	36,138	-	-	116,920	-
Mr NJ Mitchell	107,847	27,949	(25,000)	(25,000)	85,796	-
Mr MD Salmon	38,904	27,174	-	-	66,078	-
Mr CM Smith	165,830	28,646	-	-	194,476	-
Performance share holdings						
Executive directors						
Dr CG Roberts	10,595	5,923	-	-	16,518	-
Dr JL Parker	5,365	2,120	-	-	7,485	-
Executives						
Mr R Brook	6,879	2,694	-	-	9,573	-
Mr NJ Mitchell	4,946	2,083	-	-	7,029	-
Mr MD Salmon	2,508	2,025	-	-	4,533	-
Mr CM Smith	-	2,135	-	-	2,135	-

No options held by key management personnel are vested but not exercisable.

All options and performance shares granted in the 2006 financial year were granted on 22 August 2005 and vest in August 2008. Options have an expiration date of 30 September 2010. 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 \$39.93 per share and a fair value of \$4.63 per share at grant date for options with performance based conditions and \$3.48 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 \$21.36 per share for performance shares with performance based conditions and \$16.02 per share at grant date for performance shares with market based conditions.

	Held at 1 July 2004	Granted as remuneration	Vested and exercised	Forfeited	Held at 30 June 2005	Vested and exercisable at 30 June 2005
Option holdings						
<i>Executive directors</i>						
Dr CG Roberts	-	164,321	-	-	164,321	-
Dr JL Parker	70,584	42,149	-	-	112,733	-
<i>Executives</i>						
Mr R Brook	26,046	54,736	-	-	80,782	-
Mr NJ Mitchell	68,961	38,886	-	-	107,847	-
Mr MD Salmon	-	38,904	-	-	38,904	-
Mr CM Smith	-	165,830	-	-	165,830	-
Performance share holdings						
<i>Executive directors</i>						
Dr CG Roberts	-	10,595	-	-	10,595	-
Dr JL Parker	2,648	2,717	-	-	5,365	-
<i>Executives</i>						
Mr R Brook	3,350	3,529	-	-	6,879	-
Mr NJ Mitchell	2,439	2,507	-	-	4,946	-
Mr MD Salmon	-	2,508	-	-	2,508	-
Mr CM Smith	-	-	-	-	-	-

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

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 personally related entities, is as follows:

	Held at 1 July 2005	Purchases	Received on exercise of options	Sales	Held at 30 June 2006
Directors					
Non-executive					
Mr TCE Bergman	12,000	-	-	-	12,000
Mr PR Bell	-	1,500	-	-	1,500
Prof E Byrne, AO	1,000	-	-	-	1,000
Mr R Holliday-Smith	1,000	-	-	-	1,000
Mr PJ North, AM	13,000	-	-	-	13,000
Mr DP O'Dwyer	-	2,450	-	-	2,450
Mr JH Veeneklaas	1,000	-	-	-	1,000
Executive					
Dr CG Roberts	237,000	-	-	-	237,000
Dr JL Parker	25,000	-	25,000	(25,000)	25,000
Executives					
Mr R Brook	-	-	-	-	-
Mr NJ Mitchell	35,000	-	25,000	(25,000)	35,000
Mr MD Salmon	1,457	1,000	-	-	2,457
Mr CM Smith	-	-	-	-	-
Directors					
Non-executive					
Mr TCE Bergman	12,000	-	-	-	12,000
Mr PR Bell ⁽ⁱ⁾	n/a	n/a	n/a	n/a	n/a
Prof E Byrne, AO	1,000	-	-	-	1,000
Mr R Holliday-Smith	-	1,000	-	-	1,000
Mr PJ North, AM	13,000	-	-	-	13,000
Mr DP O'Dwyer ⁽ⁱ⁾	n/a	n/a	n/a	n/a	n/a
Mr JH Veeneklaas	1,000	-	-	-	1,000
Non-executive					
Dr CG Roberts	162,000	75,000	-	-	237,000
Dr JL Parker	25,000	-	-	-	25,000
Executives					
Mr R Brook	-	-	-	-	-
Mr NJ Mitchell	15,000	20,000	-	-	35,000
Mr MD Salmon	-	1,457	-	-	1,457
Mr CM Smith	-	-	-	-	-

(i) Appointed director on 1 August 2005.

	Note	Consolidated		Company	
		2006	2005	2006	2005
		\$000	\$000	\$000	\$000
28. Employee benefits					
Current					
Liability for long service leave		2,586	1,381	1,731	1,381
Liability for annual leave		6,565	5,138	4,346	3,643
Liability for short-term incentives		5,482	4,440	1,943	2,229
	21	14,633	10,959	8,020	7,253
Salary and wages accrued		2,664	1,500	1,122	710
Total current employee benefits		17,297	12,459	9,142	7,963
Non-current					
Present value of funded defined benefit obligation		3,293	4,089	3,293	4,089
Fair value of plan assets – funded		(3,647)	(4,891)	(3,647)	(4,891)
Present value of net obligations		(354)	(802)	(354)	(802)
Adjustment for asset ceiling		30	478	30	478
Recognised liability for defined benefit obligation⁽ⁱ⁾		(324)	(324)	(324)	(324)
Liability for long service leave	21	2,007	2,377	1,292	1,158
Directors' retirement scheme ⁽ⁱⁱ⁾	21	1,457	1,327	1,457	1,327
Total employee benefits		3,140	3,380	2,425	2,161

(i) Recognised in other assets.

(ii) The Cochlear Limited directors' retirement scheme provides retiring non-executive directors with more than five years service the benefit of up to three times their average annual remuneration over the previous three years. The directors' retirement scheme was closed to new directors effective from 2003.

(a) Liability for defined benefit obligation

The Consolidated Entity and the Company make contributions to defined benefit plans that provide pension benefits for employees upon retirement.

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

	Consolidated		Company		
	2006	2005	2006	2005	
	Note	\$'000	\$'000	\$'000	\$'000
Movement in the net asset for defined benefit obligation recognised directly in retained earnings					
Net asset for defined benefit obligation at 1 July		324	603	324	603
Contributions by employer		167	197	167	197
Expense recognised in the income statement		(167)	(336)	(167)	(336)
Actuarial losses recognised in the statement of recognised income and expense		-	(140)	-	(140)
Net asset for defined benefit obligation at 30 June		324	324	324	324
Defined benefit pension plans					
Amounts in the balance sheet:					
Assets		324	324	324	324
Liabilities		-	-	-	-
Net asset		324	324	324	324
Amounts for the current and previous four years are as follows:					
Defined benefit obligation		(3,293)	(4,089)	(3,293)	(4,089)
Plan assets		3,647	4,891	3,647	4,891
Surplus		354	802	354	802
Experience adjustments on plan liabilities		(647)	64	(647)	64
Experience adjustments on plan assets		266	4	266	4
The Consolidated Entity and Company have used the exemption in AASB 1 and disclosed amounts above for each annual reporting period prospectively from the transition date to AIFRS.					
Changes in the present value of defined benefit obligation are as follows:					
Opening defined benefit obligation		4,089	3,600	4,089	3,600
Service cost		275	264	275	264
Interest cost		234	170	234	170
Actuarial losses		647	262	647	262
Contributions by plan participants		50	92	50	92
Benefits paid		(2,002)	(299)	(2,002)	(299)
Closing defined benefit obligation		3,293	4,089	3,293	4,089
Changes in fair values of plan assets are as follows:					
Opening fair value of plan assets		4,891	4,551	4,891	4,551
Expected return		275	346	275	346
Actuarial gains		266	4	266	4
Contributions by employer		167	197	167	197
Contributions by plan participants		50	92	50	92
Benefits paid		(2,002)	(299)	(2,002)	(299)
Closing fair value of plan assets		3,647	4,891	3,647	4,891

The major categories of plan assets as a percentage of total plan assets are as follows:

	Consolidated		Company	
	2006	2005	2006	2005
Australian equities	23.5%	24.5%	23.5%	24.5%
Australian fixed interest	25.7%	15.0%	25.7%	15.0%
International fixed interest	9.2%	10.0%	9.2%	10.0%
Property	4.3%	2.8%	4.3%	2.8%
Cash	16.5%	26.0%	16.5%	26.0%

The Consolidated Entity's investment policies and strategies for the pension benefits do not use target allocations for the individual asset categories. The Consolidated Entity's investment goals are to maximise returns subject to specific risk management policies. The Consolidated Entity addresses diversification by the use of mutual fund investments whose underlying investments are in a balanced portfolio of growth and defensive assets. These mutual fund investments are readily marketable and can be sold to fund benefit payment obligations as they become payable.

	Consolidated		Company	
	2006	2005	2006	2005
Expense recognised in the income statement				
Service cost	275	264	275	264
Interest cost	234	170	234	170
Expected return	(275)	(346)	(275)	(346)
Adjustment for asset ceiling	(67)	248	(67)	248
	167	336	167	336

Expenses are recognised in the administration expenses line of the income statement.

The actual return on plan assets for the year ended 30 June 2006 was \$416,000 (2005: \$350,000).

The Consolidated Entity expects to contribute \$370,014 to its defined benefit plans in the 2007 financial year.

Principal actuarial assumptions

Principal actuarial assumptions at the reporting date (expressed as weighted averages per annum):

	Consolidated		Company	
	2006	2005	2006	2005
Discount rate at 30 June	5.7%	5.2%	5.7%	5.2%
Expected return on plan assets at 30 June	7.7%	7.3%	7.7%	7.3%
Future salary increases	4.0%	4.0%	4.0%	4.0%

The overall expected long-term rate of return on assets is 7.7% per annum. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

(b) Surplus for each defined benefit plan on a funding basis

Amounts \$'000	Consolidated							
	2006 ⁽ⁱ⁾				2005 ⁽ⁱⁱ⁾			
	Plan assets	Accrued benefit ⁽ⁱⁱⁱ⁾	Plan surplus/ (deficit)	Contribution recommendations (per year) ^(iv)	Plan assets	Accrued benefits ⁽ⁱⁱⁱ⁾	Plan surplus/ (deficit)	Contribution recommendations (per year) ^(iv)
Cochlear superannuation plans	27,667	27,313	354	4,131	19,714	18,566	1,148	3,934

- (i) Plan assets at net market value, and accrued benefits have been calculated at 30 June 2006, being the date of the most recent financial statements of the plans.
- (ii) Plan assets at net market value and accrued benefits were calculated at 30 June 2005, being the date of the most recent financial statements of the plans.
- (iii) Accrued benefits are benefits which the plans are presently obliged to pay at some future date, as a result of membership of the plans and calculated in accordance with AAS 25 *Financial Reporting by Superannuation Plans*. Accordingly, the surplus does not always equal the defined benefit obligation. The Consolidated Entity has a legal liability to make up a deficit in the funds but no legal right to benefit from any surplus in the funds other than by way of contribution holiday.
- (iv) Contribution recommendations are based on a funding methodology that will result in adequate funding for payments expected to be made over the next five years. The levels of the contributions to the plans are reassessed annually.

The principal economic assumptions used in making these recommendations include (on a per annum basis):

	Consolidate	
	2006	2005
Expected return on plan assets	7.7%	7.3%
Future salary increases	4.0%	4.0%

(c) Defined contribution superannuation plan

The Consolidated Entity makes contributions to defined contribution superannuation plans. The amount recognised as expense was \$5,607,060 for the year ended 30 June 2006 (2005: \$4,442,242).

(d) Share based payments

The Company's Employee Share Plan was approved by special resolution at the Annual General Meeting held on 19 October 1999. Under this plan, the directors 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 reporting period is the market price of the Company's shares on the ASX as at the start of trading on the issue date. Shares under the plan vest with the employee immediately but are non-transferable for a period of up to three years.

The CELTIP was approved and adopted at the Annual General Meeting on 20 October 2003 and replaced the ESOP. 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 shares exercisable by the executives will depend on the performance of the Consolidated Entity over the vesting period. Half of the offer will be assessed against the compound annual growth rate of the earnings per share achieved by the Consolidated Entity, and the other half against the total shareholder return (TSR) as measured against the S&P/ASX 100. If the minimum compound annual growth rate in earnings per share of 10% is not achieved, 50% of shares will not be issued or released to the executives. If the Consolidated Entity is below the 50th percentile against the S&P/ASX 100 over the three years, the remaining 50% of shares will not be issued or released.

To achieve a 100% allocation of options and shares, compound annual growth rate in earnings per share of 20% must be achieved and the TSR of the Consolidated Entity must be in at least the 75th 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 are:

Grant date	Number of instruments	Conditions for minimum vesting	Contractual life of options
Option grant in December 2003	96,380	Three years of service, a minimum compound annual growth rate in earnings per share of 10%.	5 years
	96,381	The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Option grant in August 2004	357,770	Three years of service, a minimum compound annual growth rate in earnings per share of 10%.	5 years
	357,770	The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Option grant in August 2005	362,952	Three years of service, a minimum compound annual growth rate in earnings per share of 10%.	5 years
	362,951	The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Total options	1,634,204		Contractual life of shares in the Trust
Performance shares issued in December 2003	27,122	Three years of service, a minimum compound annual growth rate in earnings per share of 10%.	5 years
	27,122	The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Performance shares issued in August 2004	29,214	Three years of service, a minimum compound annual growth rate in earnings per share of 10%.	5 years
	29,215	The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Performance shares issued in August 2005	31,086	Three years of service, a minimum compound annual growth rate in earnings per share of 10%.	5 years
	31,086	The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Total performance shares	174,845		

	Weighted average exercise price \$	Number of options	Weighted average exercise price \$	Number of options
	2006	2006	2005	2005
Outstanding at beginning of financial year	30.27	1,898,251	37.55	2,148,761
Forfeited during financial year	18.97	(22,950)	37.66	(989,000)
Exercised/forfeited during financial year ⁽ⁱ⁾	38.12	(967,000)	-	-
Granted during financial year	39.93	725,903	18.97	738,490
Outstanding at end of financial year	30.10	1,634,204	30.27	1,898,251
Exercisable at end of financial year	34.19	192,761	38.12	967,000

(i) Weighted average share price at date of exercise was \$40.84.

The estimated value of options for the current financial year is calculated at the date of grant using the Black-Scholes model, applying a 25% volatility, as reflected in the historical volatility.

For options outstanding at the end of the year, 715,540 options have an exercise price of \$18.97 with the remaining balance falling within the range of \$34.19 – \$39.93 (2005: 738,490 options at \$18.97 and the remainder falling within the range of \$34.19 – \$38.12). The weighted average remaining contractual life of options outstanding at the end of the year is three years (2005: two years).

29. Related parties

Non-director related parties

The Company engages in purchases and sales of goods with its controlled entities and pays a licence fee for the use of intellectual property. These transactions are in the ordinary course of business on a transfer pricing basis and 45 day terms apply.

The aggregate amounts included in the profit before tax for the Company that resulted from transactions with non-director related parties are:

	Company	
	2006	2005
	\$000	\$000
Revenue from the sale of goods	229,657	175,333
Distribution, marketing and field technical expenses	7,600	-
Interest income	3,126	175
Dividends from controlled entities	-	5,131
Interest expense	365	270
The aggregate amounts receivable from wholly-owned controlled entities by the Company at reporting date are:		
Current receivables	88,782	30,542

30. Financial instruments

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

Credit risk

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

Foreign exchange risk

The Consolidated Entity and the Company are exposed to changes in foreign exchange rates from their activities. It is the Consolidated Entity's and the Company's policy to use forward exchange contracts to hedge these risks. The Consolidated Entity and the Company do not enter, hold or issue derivative financial instruments for trading purposes.

The Company enters into forward exchange contracts to hedge anticipated sales and purchases in US dollars, euro, Japanese yen, Hong Kong dollars and Swedish kroner.

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 under forward exchange contracts and the weighted average contracted exchange rates of outstanding contracts:

	Foreign exchange rates		Consolidated		
		2006	2005	2006	2005
Note			\$000	\$000	
Sell United States dollar					
			95,937	67,346	
			45,802	37,842	
			5,956	4,052	
		0.72	0.67		
Sell euro					
			104,656	62,031	
			56,251	37,496	
			6,070	3,479	
		0.57	0.56		
Sell Japanese yen					
			8,962	9,204	
			3,893	4,536	
			503	-	
		68.43	50.03		
Sell Hong Kong dollar					
			-	10,160	
			-	5,107	
			-	-	
		-	4.87		
Buy Sweden kroner					
			24,986	-	
			36,056	-	
			-	-	
		5.29	-		

Forecast transactions

The Consolidated Entity classifies its forward exchange contracts hedging forecast transactions as cash flow hedges and states them at fair value. The fair value of forward exchange contracts at 1 July 2005 was adjusted against the opening balance of the hedging reserve at that date.

The net fair value of forward exchange contracts used as hedges of forecast transactions at 30 June 2006 was \$5.1 million (2005: \$27.3 million).

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

Interest rate risk

Effective interest rates, repayment and repricing analysis

In respect of interest bearing financial liabilities, the following table indicates their effective interest rates at the reporting date. As the liabilities are subject to variable interest rates, they reprice within six months. The repayment schedule is as follows:

Consolidated		2006					2005					
Amounts \$000	Effective interest rate per annum	12 months or less	1 – 2 years	2 – 5 years	More than 5 years	Total	Effective interest rate per annum	12 months or less	1 – 2 years	2 – 5 years	More than 5 years	Total
Secured bank loans:												
GBP floating rate loan	5.1%	17,511	-	-	-	17,511	3.9%	15,060	-	-	-	15,060
SEK floating rate loan	3.2%	34,902	34,902	90,591	-	160,395	2.6%	32,361	31,439	107,512	-	171,312
USD floating rate loan	5.7%	16,387	-	-	-	16,387	3.5%	14,236	-	-	-	14,236
JPY bank overdraft	1.7%	1,747	-	-	-	1,747	1.7%	1,177	-	-	-	1,177
AUD bank overdraft	-	-	-	-	-	-	8.8%	1,273	-	-	-	1,273
		70,547	34,902	90,591	-	196,040		64,107	31,439	107,512	-	203,058

Company		2006					2005					
Amounts \$000	Effective interest rate per annum	12 months or less	1 – 2 years	2 – 5 years	More than 5 years	Total	Effective interest rate per annum	12 months or less	1 – 2 years	2 – 5 years	More than 5 years	Total
AUD bank overdraft	-	-	-	-	-	-	8.8%	1,273	-	-	-	1,273

Trade receivables and trade payables are not interest bearing and the related cash flows are not subject to interest rate risk.

31. Impact of adopting Australian equivalents to International Financial Reporting Standards

Impact of transition to AIFRS

As stated in Note 1(a), these are the Consolidated Entity's and the Company's first consolidated financial statements prepared in accordance with AIFRS.

The policies set out in Note 1(a) have been applied in preparing the financial statements for the year ended 30 June 2006 and the comparative information presented in these financial statements for the year ended 30 June 2005 and in the preparation of an opening AIFRS balance sheet at 1 July 2004 (the Consolidated Entity's date of transition).

In preparing their opening AIFRS balance sheet, the Consolidated Entity and the Company have adjusted amounts reported previously in financial statements prepared in accordance with previous GAAP. An explanation of how the transition from previous GAAP to AIFRS has affected the Consolidated Entity's and the Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

(a) Reclassifications

Under AIFRS, financial income consisting of interest income and foreign exchange gains has been transferred from the revenue line to the net financing income line in the income statement for the year ended 30 June 2005, resulting in a reduction in revenue of \$2,700,000 for the Consolidated Entity (Company: \$2,658,000).

In addition, other income has been reclassified from revenue to form part of operating profit before net financing income. This resulted in a reduction to revenue of \$963,000 for the year ended 30 June 2005 for the Consolidated Entity (Company: \$5,946,000).

Under previous GAAP, enterprise resource planning system development costs were classified as plant and equipment in the financial statements. Under AIFRS, these costs have been reclassified as intangible assets. For the Consolidated Entity and the Company, this resulted in \$3,899,000 being reclassified from plant and equipment to intangible assets at 1 July 2004 and \$5,039,000 for the Consolidated Entity (Company: \$2,000,000) at 30 June 2005.

Other debtor balances have been reclassified from other assets to receivables. This resulted in an increase in receivables in the Consolidated Entity of \$9,164,000 (Company: \$3,275,000) at 1 July 2004 and \$8,686,000 for the Consolidated Entity (Company: \$2,916,000) at 30 June 2005.

Other non-current receivables have been reclassified from non-current receivables to non-current other financial assets. This resulted in an increase in non-current other financial assets in the Consolidated Entity of \$175,000 (Company: nil) at 1 July 2004 and \$187,000 for the Consolidated Entity (Company: \$32,000) at 30 June 2005.

(b) Business combinations

As permitted by the election available under AASB 1, the classification and accounting treatment of business combinations that occurred prior to transition date have not been restated in preparing the transition date AIFRS balance sheet. The assets and liabilities are subject to the other requirements of AASB 1, as discussed below.

Under AIFRS, inventories acquired as part of a business combination are recognised at fair value rather than historical cost. The impact of this change at the transition date is nil. For the year ended 30 June 2005, the value of inventories increased by \$398,000 with a corresponding decrease to goodwill for the Consolidated Entity.

This fair value adjustment was recognised as an expense during the year ended 30 June 2006 following the sale of inventories in the normal course of business.

Business combinations that occurred on or after 1 July 2004 must be accounted for by applying the purchase method. There were no adjustments for either the Consolidated Entity or the Company as a result of transition to AIFRS as there were no contingent liabilities or restructuring provisions at the respective acquisition dates.

(c) Intangible assets

Goodwill

Goodwill represents the difference between the cost of a business combination over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash generating units and tested annually for impairment (refer to (d) for further details on impairment testing).

Research and development expenditure

Under AIFRS, expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the Consolidated Entity has sufficient resources to complete the development. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses. Under previous GAAP, the Consolidated Entity expensed all development expenditure as incurred.

Development expenditure incurred which meet the criteria for deferral was capitalised and an adjustment of \$3,149,000 was made as an increase to retained earnings for both the Consolidated Entity and the Company at 1 July 2004. For the year ended 30 June 2005, a further \$4,377,000 of expenditure was deferred. The research and development expenses of the Consolidated Entity and the Company decreased by \$4,377,000 for the year ended 30 June 2005 as a result of this capitalisation.

Capitalised development expenditure was tested for impairment. No impairment losses were required.

Other intangible assets

Other intangible assets acquired are stated at cost less accumulated amortisation and impairment losses. On transition and at each subsequent reporting date, other intangible assets are reviewed to ensure they can be recognised under AASB 138 Intangible Assets and tested for impairment. No reclassifications or impairment losses were required.

Amortisation

Amortisation is recognised on a straight-line basis over the estimated useful lives of the intangible assets. Amortisation commences from the date the intangible asset is available for use. Changes in useful life on transition to AIFRS were accounted for prospectively. Goodwill is not subject to amortisation but tested for impairment annually. The estimated useful lives are as follows:

	AIFRS	Previous GAAP
Goodwill	Indefinite	20 years
Acquired technology	4 years	4 years
Enterprise resource planning system	2.5 – 4 years	2.5 – 4 years
Customer relationships	4 years	4 years
Intellectual property	3 years	3 years
Capitalised development expenditure	1 – 3 years	Expensed

The impact on the value of intangible assets and retained earnings of the Consolidated Entity at transition date is nil and at 30 June 2005 was an increase of \$1,858,000. The impact on the results of the Consolidated Entity for the year ended 30 June 2005 is a decrease in distribution, marketing and field technical expenses of \$577,000 (Company: nil) and in administration expenses of \$2,544,000 (Company: nil) from the reversal of the goodwill amortisation offset by an increase to research and development expenses due to the amortisation of \$1,263,000 (Company: \$1,263,000) of capitalised development expenditure.

(d) Impairment

Under previous GAAP, the carrying amounts of non-current assets valued on a cost basis were reviewed at reporting date to determine whether they were in excess of their recoverable amount. If the carrying amount of a non-current asset was in excess of its recoverable amount, the asset was written down to the lower amount and the write-down was recognised in the income statement in the period in which it occurred. In assessing recoverable amounts, the relevant cash flows were not discounted to their present value.

Under AIFRS, the carrying amount of non-current assets, excluding goodwill and deferred tax assets, is reviewed at each reporting date to determine whether there is any indication of impairment. Goodwill is tested annually for impairment regardless of whether there are indicators of impairment.

If there is any indication that an asset is impaired, the recoverable amount is estimated for the individual asset, or if not possible, for the smallest identifiable cash generating unit to which the asset belongs. An impairment loss, represented by the excess of carrying amount over recoverable amount, is recognised in the income statement as an impairment loss.

No impairment write-downs were recorded either at transition date or at 30 June 2005.

(e) Employee benefits

Defined benefit plans

Under previous GAAP, defined benefit plans were accounted for on a funding basis. For the year ended 30 June 2004, an actuarial assessment of the Company's defined benefit plan revealed that plan assets were less than vested benefits by \$325,778 and this amount was accrued in the financial statements.

Under AIFRS, a liability or asset in respect of defined benefit superannuation plans is recognised in the balance sheet, and is measured as the present value of the defined benefit obligation as at the reporting date plus 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 plans to the reporting date, calculated annually by independent actuaries using the projected unit credit method.

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. The full amount of actuarial gains and losses that arise subsequent to transition date are recognised directly in retained earnings in accordance with AASB 119 which was early adopted.

The AASB 1 election to recognise full actuarial gains and losses at transition date through retained earnings was adopted. At the date of transition, an amount of \$603,000 was recognised as an asset of the Consolidated Entity and the Company with a corresponding increase in retained earnings, in addition to a reduction in provisions by \$324,000 relating to the reversal of a defined benefit obligation.

For the year ended 30 June 2005, an actuarial assessment resulted in a reduction of the net asset position of the plans in the Consolidated Entity and the Company by \$324,000. This has been recognised as an increase in administration expenses in the income statement.

Share based payments

Under previous GAAP, no expense was recognised for options or performance shares issued to employees.

Under AIFRS, 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 performance shares are granted taking into account market and non-market based performance conditions and expensed over the vesting period after which the employees become unconditionally entitled to the options or performance shares.

The fair value of the options granted has been 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.

No adjustment has been made for options granted prior to 7 November 2002 which vested before 1 July 2004. Options granted after 7 November 2002 and remaining unvested at 1 July 2004 have been recognised in the opening balance sheet through retained earnings, resulting in a nil impact on transition.

For the year ended 30 June 2005, employee benefits expense and retained earnings for the Consolidated Entity increased by \$2,592,000 (Company: \$1,809,000) representing the share based payments expense for the period. This was made up of \$789,000 (Company: \$195,000) relating to distribution, marketing and field technical expenses, \$1,369,000 (Company: \$1,180,000) relating to administration expenses and \$434,000 (Company: \$434,000) relating to research and development expenses.

(f) Leased assets – make good provisions

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

Under previous GAAP, the costs of returning the asset to the lessor in its original condition were not recognised until the expenditure was

incurred, whereas under AIFRS 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. The Consolidated Entity is expected to incur the liability within the next 12 years. An offsetting asset of the same value is also recognised and it classified in plant and equipment. This asset is amortised to the income statement over the life of the lease.

In the Consolidated Entity, at transition date a provision for make good lease costs associated with these operating leases of \$1,328,000 (Company: \$1,233,000) was made along with an increase in plant and equipment of \$1,175,000 (Company: \$1,126,000) and a decrease in retained earnings of \$153,000 (Company: \$107,000).

During the year ended 30 June 2005, \$103,000 of the initial amount recorded was expensed, increasing distribution, marketing and field technical expenses in the Consolidated Entity by \$21,000 (Company: nil) and administration expenses by \$82,000 (Company: \$82,000).

(g) Foreign operations

Under previous GAAP, the assets and liabilities of self-sustaining foreign operations were translated at the rates of exchange ruling at reporting date. Equity items and goodwill were translated at historical rates. The income statements were translated at the average exchange rates. Exchange differences on translation were recognised directly in the foreign currency translation reserve.

The assets and liabilities of integrated operations were translated using the temporal method. Monetary assets and liabilities were translated at exchange rates prevailing at reporting date while non-monetary assets and liabilities and revenue and expense items were translated at the average exchange rates on the dates of the relevant transactions. Exchange differences arising on translation were recorded in the income statement.

Under AIFRS, each entity in the Consolidated Entity maintains its accounts in its functional currency, being the currency of the primary economic environment in which the entity operates.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated from the entity's functional currency to the Consolidated Entity's presentation currency of Australian dollars at exchange rates prevailing at reporting date, while revenue and expenses are translated to Australian dollars at average exchange rates. Foreign exchange differences arising on translation are recognised in the foreign currency translation reserve.

The AASB 1 election to reset the existing foreign currency translation reserve balance to nil has not been adopted.

The impact on the transition balance sheet of the Consolidated Entity was to reduce reserves and to increase retained earnings by \$513,000, representing the reclassification of foreign exchange translation losses from a foreign controlled branch to the foreign currency translation reserve.

The impact to the Consolidated Entity and Company for the year ended 30 June 2005 was an increase in research and development expenses by \$385,000 and a like increase to reserves. In addition, the value of goodwill for the Consolidated Entity decreased by \$13,920,000 (Company: nil) with a corresponding decrease to the foreign currency translation reserve as a result of valuing goodwill at exchange rates prevailing at reporting date rather than at historical rates.

(h) Financial instruments

The Consolidated Entity has taken the election in AASB 1 to not restate comparatives for AASB 132 and AASB 139. As such, there are no adjustments in relation to financial instruments at transition date or for the year ended 30 June 2005 as previous GAAP continued to apply.

At 1 July 2005, the Consolidated Entity has complied with the requirements of AASB 139 in order to qualify for hedge accounting. Consequently, no adjustments have been made to retained earnings. See Note 2 for the impact of this change in accounting policy at 1 July 2005.

Debt establishment costs capitalised and amortised over the term of the borrowing under previous GAAP were recalculated based on the effective interest rate method and recognised as a reduction in interest bearing liabilities rather than as a separate asset.

This resulted in a decrease in receivables of \$434,000 and a decrease in current interest bearing liabilities of \$99,000 and in non-current interest bearing liabilities of \$335,000 in the Consolidated Entity as at 30 June 2005 (Company: nil).

(i) Revenue recognition

Under previous GAAP, revenue from the sale of goods was recognised when the selling entity transferred control of an asset to the buyer whereas under AIFRS, revenue from the sale of goods is only recognised when the significant risks and rewards of ownership have transferred from the seller to the buyer with no continuing managerial involvement over the goods to the degree normally associated with ownership.

Specifically under AIFRS, the amount of revenue recognised under certain marketing programs differs to that recognised under previous GAAP.

The impact of this change in accounting policy at transition date resulted in a reduction to retained earnings of \$11,083,000 for the Consolidated Entity (Company: \$917,000), an increase in deferred revenue of \$11,376,000 (Company: \$917,000) and a decrease in reserves of \$293,000 for the Consolidated Entity (Company: nil) from the deferral of revenue that had been recognised under previous GAAP. For the year ended 30 June 2005, revenue increased by \$4,112,000 (Company: \$917,000) resulting from a release of deferred revenue of \$6,006,000 (Company: \$917,000) offset by the deferral of revenue of \$1,894,000 (Company: nil).

(j) Treasury shares

The Company operates the CELTIP. The main purpose of the Trust is to hold unvested performance shares as part of the CELTIP. Under previous GAAP, the Trust was not included in the results of the Consolidated Entity as the consolidation rules did not apply to such special purpose entities. Under AIFRS, the Trust qualifies as an equity compensation plan special purpose entity and its results are included in those for the Consolidated Entity.

At transition date, the Trust held shares of the Company. Under AIFRS, the shares are accounted for as treasury shares and treated as a reduction in the issued capital of the Consolidated Entity and the Company. The impact on the Consolidated Entity and the Company at transition date is a decrease in issued capital of \$1,371,000. No further adjustment is required for the year ended 30 June 2005.

At transition date, the Consolidated Entity and the Company had an unamortised balance of \$997,000 as a deferred asset on the balance sheet, representing the amount paid to the Trust in order for it to purchase shares of the Company. Under AIFRS, this deferred asset is not amortised. The impact at transition date was to increase retained earnings by \$374,000 representing the amortisation of the asset to that date, and a decrease to the deferred asset of \$997,000 for the Consolidated Entity and the Company. The impact for the year ended 30 June 2005 was a decrease to administration expenses of \$499,000 and a decrease to the deferred asset of \$499,000 for the Consolidated Entity and the Company.

(k) Taxation

Previous GAAP required the application of the income statement liability method of tax effect accounting, whilst AIFRS requires the balance sheet method, whereby income tax expense comprises current and deferred taxes. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

There were no changes to retained earnings or the deferred tax balances for the Consolidated Entity at transition date or for the year ended 30 June 2005 as a result of the change in basis of accounting for income tax.

The tax impact on the Consolidated Entity of the transition adjustments on the deferred tax balances was an increase in deferred tax assets of \$3,160,000 and a decrease of \$916,000 in the Company. This resulted in an increase in retained earnings in the Consolidated Entity of \$3,160,000 and a decrease of \$916,000 in the Company.

The impact of the AIFRS adjustments for the year ended 30 June 2005 was an increase in the income tax expense of the Consolidated Entity of \$2,321,000 (Company: \$1,185,000) and a decrease in deferred tax assets of \$1,440,000 (Company: \$1,920,000).

The recognition of a deferred tax liability was not required in relation to non-amortising intangible assets acquired in a business combination under previous GAAP, whereas under AIFRS, a deferred tax liability is recognised in relation to non-amortised intangible assets acquired in a business combination.

The effect of this difference was to increase goodwill by \$2,460,000 in the Consolidated Entity and to decrease the deferred tax asset amount by \$2,460,000. The adjustment to deferred tax asset is reflected in the commentary above.

Summary of transitional adjustments

The following table sets out the adjustments to the balance sheets of the Company and the Consolidated Entity at transition to AIFRS as at 1 July 2004 and for the AIFRS comparative period balance sheet as at 30 June 2005:

	Note	Consolidated 1 July 2004			Consolidated 30 June 2005			Company 1 July 2004			Company 30 June 2005		
		Previous GAAP	Transition impact	AIFRS	Previous GAAP	Transition impact	AIFRS	Previous GAAP	Transition impact	AIFRS	Previous GAAP	Transition impact	AIFRS
Amounts \$'000													
Current assets													
Cash and cash equivalents		75,946	-	75,946	106,077	-	106,077	58,526	-	58,526	72,191	-	72,191
Receivables	(a), (e), (h), (i)	66,656	8,770	75,426	82,961	8,412	91,373	34,674	2,881	37,555	56,497	2,741	59,238
Inventories	(b)	44,837	-	44,837	49,120	398	49,518	33,429	-	33,429	25,726	-	25,726
Other	(a)	12,963	(9,164)	3,799	12,872	(8,686)	4,186	5,048	(3,275)	1,773	5,033	(2,916)	2,117
Total current assets		200,402	(394)	200,008	251,030	124	251,154	131,677	(394)	131,283	159,447	(175)	159,272
Non-current assets													
Receivables		9,633	(175)	9,458	10,125	(187)	9,938	9,458	-	9,458	9,970	(32)	9,938
Other financial assets	(a), (h)	-	175	175	335	(148)	187	6,444	-	6,444	18,489	32	18,521
Plant and equipment	(a), (f)	29,523	(2,724)	26,799	28,589	(3,965)	24,624	26,947	(2,773)	24,174	20,838	(954)	19,884
Intangible assets	(a), (b), (c), (g), (k)	7,190	7,048	14,238	191,764	2,565	194,329	-	7,048	7,048	-	8,263	8,263
Deferred tax assets	(k)	17,791	3,160	20,951	23,904	(1,440)	22,464	7,000	(916)	6,084	9,669	(1,920)	7,749
Total non-current assets		64,137	7,484	71,621	254,717	(3,175)	251,542	49,849	3,359	53,208	58,966	5,389	64,355
Total assets		264,539	7,090	271,629	505,747	(3,051)	502,696	181,526	2,965	184,491	218,413	5,214	223,627
Current liabilities													
Payables		31,657	-	31,657	46,539	-	46,539	17,156	-	17,156	18,914	-	18,914
Interest bearing liabilities	(h)	25,867	-	25,867	64,206	(99)	64,107	2,100	-	2,100	1,273	-	1,273
Current tax liabilities		4,781	-	4,781	12,455	-	12,455	-	-	-	8,380	-	8,380
Provisions	(e)	22,352	(324)	22,028	24,541	-	24,541	14,386	(324)	14,062	16,829	-	16,829
Other	(i)	21,639	11,376	33,015	38,132	7,264	45,396	12,664	917	13,581	18,322	-	18,322
Total current liabilities		106,296	11,052	117,348	185,873	7,165	193,038	46,306	593	46,899	63,718	-	63,718
Non-current liabilities													
Interest bearing liabilities	(h)	-	-	-	139,286	(335)	138,951	-	-	-	-	-	-
Provisions	(f)	3,256	1,328	4,584	4,780	1,328	6,108	2,087	1,233	3,320	3,470	1,233	4,703
Other		9,458	-	9,458	9,938	-	9,938	9,458	-	9,458	9,938	-	9,938
Total non-current liabilities		12,714	1,328	14,042	154,004	993	154,997	11,545	1,233	12,778	13,408	1,233	14,641
Total liabilities		119,010	12,380	131,390	339,877	8,158	348,035	57,851	1,826	59,677	77,126	1,233	78,359
Net assets		145,529	(5,290)	140,239	165,870	(11,209)	154,661	123,675	1,139	124,814	141,287	3,981	145,268
Equity													
Issued capital	(j)	50,746	(1,371)	49,375	50,746	(1,371)	49,375	50,746	(1,371)	49,375	50,746	(1,371)	49,375
Reserves	(g), (i)	(995)	(806)	(1,801)	10,424	(14,341)	(3,917)	-	(513)	(513)	-	(128)	(128)
Retained earnings		89,267	(3,113)	86,154	99,959	4,503	104,462	72,929	3,023	75,952	90,541	5,480	96,021
Total equity attributable to equity holders of the parent		139,018	(5,290)	133,728	161,129	(11,209)	149,920	123,675	1,139	124,814	141,287	3,981	145,268
Minority interest		6,511	-	6,511	4,741	-	4,741	-	-	-	-	-	-
Total equity		145,529	(5,290)	140,239	165,870	(11,209)	154,661	123,675	1,139	124,814	141,287	3,981	145,268

Notes to the financial statements Cochlear Limited and its controlled entities for the year ended 30 June 2006

Reconciliation of net profit (including minority interest) for the year ended 30 June 2005

The following table sets out the adjustments to the income statements of the Company and of the Consolidated Entity for the year ended 30 June 2005:

Amounts \$'000	Note	Consolidated 2005			Company 2005		
		Previous GAAP	Transition impact	AIFRS	Previous GAAP	Transition impact	AIFRS
Revenue	(i)	344,854	4,112	348,966	234,277	917	235,194
Cost of sales		(99,699)	-	(99,699)	(91,886)	-	(91,886)
Gross profit		245,155	4,112	249,267	142,391	917	143,308
Other income		618	-	618	5,946	-	5,946
Distribution, marketing and field technical expenses	(c), (e), (f)	(100,736)	(232)	(100,968)	(15,016)	(195)	(15,211)
Administration expenses	(c), (e), (f), (i)	(26,530)	1,268	(25,262)	(19,117)	(1,086)	(20,203)
Research and development expenses	(c), (e), (g)	(43,760)	2,295	(41,465)	(36,012)	2,293	(33,719)
Operating profit before net financing income		74,747	7,443	82,190	78,192	1,929	80,121
Financial income		3,045	-	3,045	2,658	-	2,658
Financial expenses		(2,928)	-	(2,928)	(1,244)	-	(1,244)
Net financing income		117	-	117	1,414	-	1,414
Profit before tax		74,864	7,443	82,307	79,606	1,929	81,535
Income tax expense	(k)	(21,512)	(2,321)	(23,833)	(19,162)	(1,185)	(20,347)
Net profit (including minority interest)		53,352	5,122	58,474	60,444	744	61,188
Attributable to:							
Equity holders of the parent		54,520	5,122	59,642	60,444	744	61,188
Minority interest		(1,168)	-	(1,168)	-	-	-
Net profit (including minority interest)		53,352	5,122	58,474	60,444	744	61,188
Basic earnings per share (cents)		100.5		110.1			
Diluted earnings per share (cents)		100.5		109.7			

Summary of impact of transition to AIFRS on retained earnings

The impact of the transition to AIFRS on retained earnings as at 1 July 2004 and 30 June 2005 is summarised below:

Amounts \$'000	Consolidated		Company	
	1 July 2004	30 June 2005	1 July 2004	30 June 2005
Retained earnings under previous GAAP	89,267	99,959	72,929	90,541
AIFRS reconciliation				
Defined benefit asset	929	324	929	324
Change in functional currency	513	128	513	128
Capitalised development expenditure	3,149	6,263	3,149	6,263
Consolidation of Trust (CELTIP)	374	872	374	872
Change to revenue recognition policies	(11,083)	(5,554)	(917)	-
Make good costs on leases	(153)	(254)	(107)	(187)
Impact of taxation	3,158	(397)	(918)	(1,920)
Reversal of goodwill amortisation	-	3,121	-	-
Retained earnings under AIFRS	86,154	104,462	75,952	96,021
Attributable to:				
Equity holders of the parent	85,527	102,667	75,952	96,021
Minority interest	627	1,795	-	-
Retained earnings under AIFRS	86,154	104,462	75,952	96,021

The above changes increase/(decrease) the deferred tax assets as follows:

Amounts \$'000	Consolidated		Company	
	1 July 2004	30 June 2005	1 July 2004	30 June 2005
Capitalised development expenditure	(945)	(1,879)	(945)	(1,879)
Defined benefit asset	(278)	(97)	(278)	(97)
Make good costs on leases	46	76	32	56
Revenue recognition policies	4,337	2,920	275	-
Identifiable intangible assets	-	(2,460)	-	-
Net increase/(decrease) in deferred tax assets	3,160	(1,440)	(916)	(1,920)

32. Events subsequent to reporting date

Other than the matters noted below, there has not arisen in the interval between reporting date and the date of this Financial Report, any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the Consolidated Entity, the results of those operations, or the state of affairs of the Consolidated Entity in future financial years:

Dividends

For dividends declared after 30 June 2006, see Note 7.

Directors' Declaration Cochlear Limited and its controlled entities for the year ended 30 June 2006

In the opinion of the directors of Cochlear Limited:

- (a) the financial statements, notes, and the remuneration disclosures contained in the Remuneration Report in the Directors' Report, as set out on pages 38 to 103, are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of the Company and Consolidated Entity as at 30 June 2006 and of their performance, as represented by the results of their operations and their cash flows, for the financial year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001;
- (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable;
- (c) the remuneration disclosures that are contained in sections of the Remuneration Report in the Directors' Report comply with AASB 124 Related Party Disclosures; and
- (d) the directors have been given the declarations required by section 295A of the Corporations Act 2001 from the Chief Executive Officer and the Chief Financial Officer for the year ended 30 June 2006.

Dated at Sydney this 15th day of August 2006.

Signed in accordance with a resolution of the directors:



Director



Director

Independent Audit Report to the members of Cochlear Limited

Scope

The Financial Report, Remuneration disclosures and directors' responsibility

The Financial Report comprises the income statements, statements of recognised income and expense, balance sheets, statement of cash flows, accompanying notes 1 to 32 to the Financial Statements, and the Directors' Declaration for both Cochlear Limited (the Company) and Cochlear Limited and its controlled entities (the Consolidated Entity), for the year ended 30 June 2006. The Consolidated Entity comprises both the Company and the entities it controlled during that year.

As permitted by the Corporations Regulations 2001, the Company has disclosed information about the remuneration of directors and executives (Remuneration disclosures) required by Australian Accounting Standard AASB 124 *Related Party Disclosures* labelled "audited" under the heading "Remuneration Report" in the Directors' Report and not in the Financial Report.

The Remuneration Report also contains information not required by AASB 124 which is not subject to our audit.

The directors of the Company are responsible for the preparation and true and fair presentation of the Financial Report and the Remuneration Report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the Financial Report. The directors are also responsible for preparing the relevant reconciling information regarding the adjustments required under AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*. The directors are also responsible for the Remuneration disclosures contained in the Directors' Report.

Audit approach

We conducted an independent audit in order to express an opinion to the members of the Company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the Financial Report is free of material misstatement and that the Remuneration disclosures comply with AASB 124. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the Financial Report presents fairly, in accordance with the Corporations Act 2001, Australian Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Company's and the Consolidated Entity's financial position, and of their performance as represented by the results of their operations and cash flows and whether the Remuneration disclosures comply with AASB 124.

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

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

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

Audit opinion

In our opinion:

- (1) the Financial Report of Cochlear Limited is in accordance with:
 - (a) the Corporations Act 2001, including:
 - (i) giving a true and fair view of the Company's and Consolidated Entity's financial position as at 30 June 2006 and of their performance for the financial year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
 - (b) other mandatory financial reporting requirements in Australia; and
- (2) the Remuneration disclosures that are labelled as audited and contained in the Remuneration Report in the Directors' Report comply with AASB 124 *Related Party Disclosures*.

KPMG

Sydney, 15 August 2006

John Wigglesworth, Partner

Additional information

Additional information required by Australian Stock Exchange Listing Rules and not disclosed elsewhere in this report – the information presented is as at 4 August 2006:

Shareholdings

Substantial shareholders

Name	Number of ordinary shares held	%
Commonwealth Bank Group	4,356,753	7.95
The Capital Group Companies, Inc	3,285,602	5.99
Total	7,642,355	13.94

Distribution of shareholders

Number of shares held	Number of ordinary shareholders
1 – 1,000	16,186
1,001 – 5,000	3,242
5,001 – 10,000	201
10,001 – 100,000	127
100,001 – over	36
Total	19,792

Non-marketable parcels – 43 shareholders held less than a marketable parcel.

Twenty largest shareholders

Name	Number of ordinary shares held	%
JP Morgan Nominees Australia Ltd	7,818,999	14.26
National Nominees Ltd	7,216,648	13.17
Westpac Custodian Nominees Ltd	7,077,487	12.91
ANZ Nominees Ltd (Cash Income a/c)	4,109,787	7.50
Citicorp Nominees Pty Ltd	1,495,698	2.73
Queensland Investment Corporation	891,050	1.63
Cogent Nominees Pty Ltd	877,519	1.60
Citicorp Nominees Pty Ltd (CFS WSLE Imputation Fnd a/c)	592,446	1.08
AMP Life Ltd	555,681	1.01
UBS Nominees Pty Ltd	522,698	0.95
Citicorp Nominees Pty Ltd (CFS WSLE Geared Share Fnd a/c)	507,691	0.93
HSBC Custody Nominees (Australia) Ltd	408,804	0.75
Citicorp Nominees Pty Ltd (CFS Imputation Fnd a/c)	404,762	0.74
Cogent Nominees Pty Ltd (SMP Accounts)	337,231	0.62
IAG Nominees Pty Ltd	309,457	0.56
Citicorp Nominees Pty Ltd (CFS WSLE Aust Share Fnd a/c)	287,997	0.53
Bond Street Custodians Pty Ltd (Macq Aust Mkt Neutral Fnd)	274,385	0.50
Citicorp Nominees Pty Ltd (CFS WSLE Industrial Share a/c)	247,869	0.45
UBS Wealth Management Australia Nominees Pty Ltd	236,885	0.43
Dr Christopher Graham Roberts	225,000	0.41

The 20 largest shareholders held 62.76% of the ordinary shares of the Company.

On market buy-back

There is no current on market buy-back.

Other information

Cochlear Limited, incorporated and domiciled in Australia, is a publicly listed company limited by shares.

Glossary

AIFRS Australian equivalents to International Financial Reporting Standards.

AGM Annual General Meeting.

ASIC Application Specific Integrated Circuit.

ASX Australian Stock Exchange.

Beam Digital technology for listening in crowds. Designed to focus in on sounds coming directly in front of the listener and soften surrounding sounds by use of directional and omni-directional microphones.

BTE Behind-the-ear speech processor.

CE (Conformité Européenne) The CE mark indicates that a product complies with all the applicable European directives, especially the Medical Device Directive.

DACS Direct Acoustic Cochlear Stimulator.

ERP Enterprise resource planning.

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

FDA United States Food and Drug Administration.

F05 Financial Year 2005: 1 July 2004 to 30 June 2005.

F06 Financial Year 2006: 1 July 2005 to 30 June 2006.

F07 Financial Year 2007: 1 July 2006 to 30 June 2007.

ISO (International Organisation for Standardisation) Responsible for the development and publication of international standards in various technical fields.

MHLW Ministry of Health, Labour and Welfare, Japan.

Previous GAAP Previous Australian Generally Accepted Accounting Principles.

Processor/speech processor The externally worn part of the cochlear implant.

R&D Research and development.

SmartSound Set of sound processing algorithms which enhance hearing performance.

TGA Therapeutic Goods Administration, Australia.

Company information

Stock exchange listing

Australian Stock Exchange Limited

ASX code COH

Share registrar

Computershare Investor Services Pty Limited

60 Carrington Street

Sydney NSW 2000, Australia

Tel: +61 2 8234 5000

Solicitors

Clayton Utz

Auditors

KPMG Chartered Accountants

Bankers

Australia Westpac Banking Corporation

Japan The Bank of Tokyo-Mitsubishi

UFJ, Limited

Sweden Skandinaviska Enskilda Banken AB

United Kingdom NatWest Bank

United States Wells Fargo Bank West, NA

Annual General Meeting

The Annual General Meeting will be held at 2pm on Tuesday 24 October 2006 at the Four Seasons Hotel,

199 George Street, Sydney

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

Financial calendar

2006

Dividend record date	31 August
Payment of final dividend	21 September
Annual General Meeting	24 October

2007

Interim profit announcement	13 February
Interim dividend record date	23 February*
Payment of interim dividend	13 March*
Final profit announcement	14 August
Annual General Meeting	23 October

* Indicative dates only.

Nucleus is a registered trademark of Cochlear Limited. Baha is a registered trademark of Entific Medical Systems AB, a Cochlear group company. Cochlear, the cochlear logo, Freedom, Beam, Contour, Contour Advance, SmartSound, Custom Sound, ESPrit and Baha Divino are trademarks of Cochlear Limited.

Design

Cross Media Communications Pty Ltd

Company ASX announcement record

8 JUNE 2006 Gold award

Cochlear Limited announces that the previous night it was awarded Gold for the Nucleus Freedom cochlear implant system at the International Medical Design Excellence Awards held in New York.

5 MAY 2006 \$270 million order for China

Cochlear Limited announces the receipt of an approximately \$270 million order for cochlear implants to supply Nucleus cochlear implants in Taiwan and China over approximately six years.

10 MARCH 2006 Share price increase

Cochlear Limited notes that the strong increase in share price that day appears to be in response to the recall of a competitor product.

14 FEBRUARY 2006 Record financial results for half year ended 31 December 2005

Cochlear Limited announces record revenue for the six months of \$221.1 million, a 34% increase over the previous corresponding period, and core earnings of \$47.3 million, an increase of 43% over the 31 December 2004 half year.

14 DECEMBER 2005 Full year earnings upgrade

Cochlear Limited announces an increase in its full year F06 guidance of core earnings to approximately \$80 million, an increase of 37% over the prior year.

20 OCTOBER 2005 Chairman's address

Cochlear Limited Chairman Tommie CE Bergman addresses shareholders at the Annual General Meeting.

16 AUGUST 2005 2005 full year financial results

Cochlear Limited announces total revenue for the year of \$348.5 million, a 22% increase over the prior financial year; and core earnings of \$58.3 million, an increase of 58% over the prior financial year. The final dividend was 45 cents per share fully franked.

Cochlear™



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Cochlear Americas 400 Inverness Parkway, Suite 400, Englewood CO 80112, USA Tel: 1 303 790 9010 Fax: 1 303 792 9025
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Cochlear GmbH Karl-Wiechert-Allee 76A, D-30625 Hannover, Germany Tel: 49 511 542 770 Fax: 49 511 542 7770
Cochlear Europe Ltd 9 Weybridge Business Park, Addlestone Road, Addlestone, Surrey KT15 2UF, United Kingdom Tel: 44 1932 87 1500 Fax: 44 1932 87 1526
Cochlear (HK) Ltd Rm 2106, 21/F Wing On Centre, 111 Connaught Rd, Central, Hong Kong Tel: 852 2530 5773 Fax: 852 2530 5183
Nihon Cochlear Co Ltd Ochanomizu-Motomachi Bldg, 2-3-7 Hongo, Bunkyo-Ku, Tokyo 113-0033, Japan Tel: 81 3 3817 0241 Fax: 81 3 3817 0245
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