

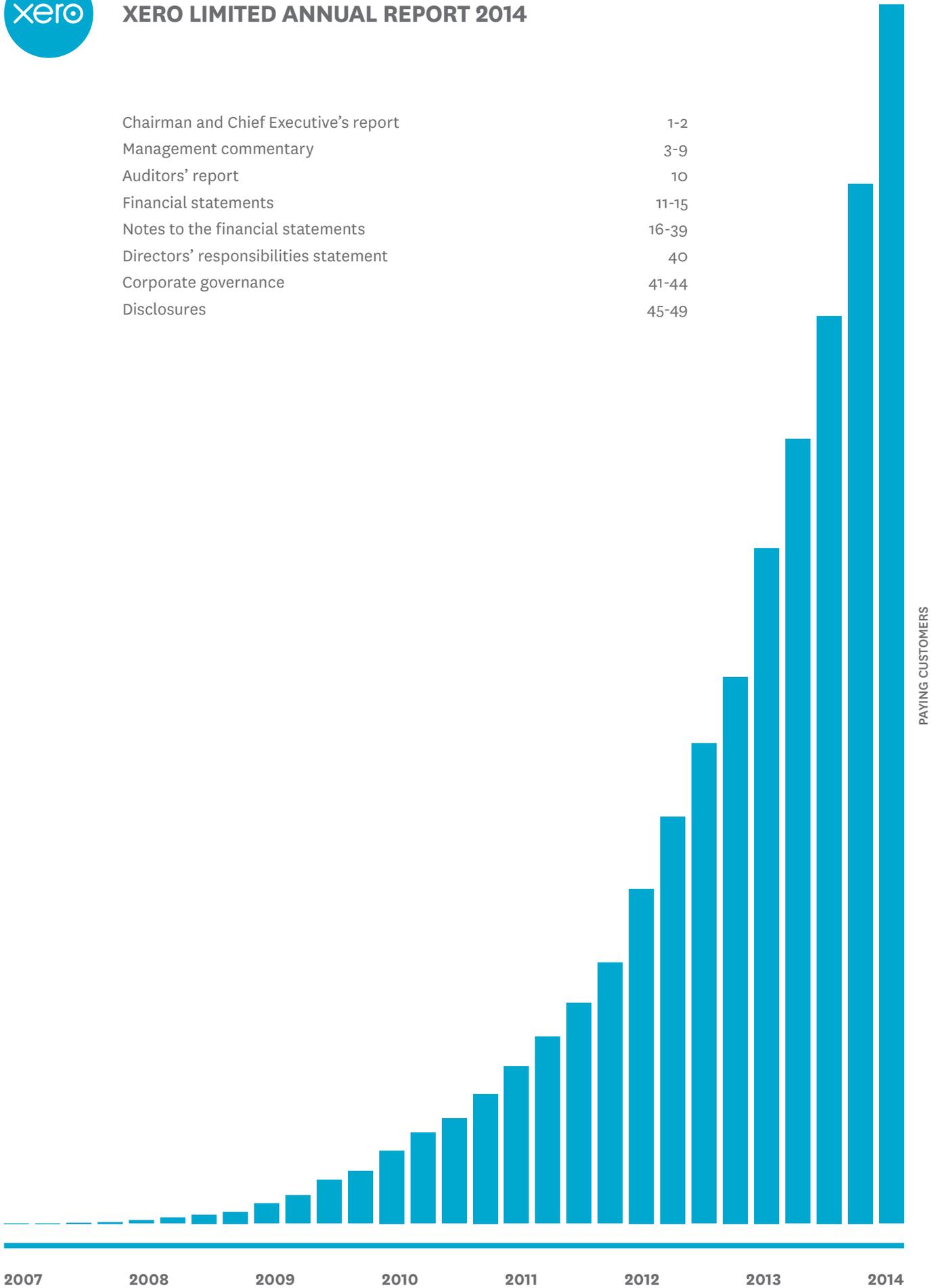


XERO LIMITED ANNUAL REPORT 2014



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CHAIRMAN AND CHIEF EXECUTIVE'S REPORT

DEAR SHAREHOLDER

Xero's focus during the 2014 financial year was building its team for future growth. 376 new Xeros joined the Company, resulting in 758 staff globally by year end. During this period of rapid growth, the Company grew to 284,000 customers and generated operating revenue of \$70.1m. We emerged as the leading accounting software provider in New Zealand, and the leading online accounting software provider in Australia and the United Kingdom.

With the platform for growth established in New Zealand, Australia and the United Kingdom, the Company has increased its focus on the important US market. The initial US market entry phase allowed the Company to raise a further US\$150m in funding; appoint high profile, US based global technology executives to the Board; attract a high quality CEO for Xero North America; and enter into a number of high profile strategic partnerships.

During this phase we developed a detailed understanding of the US market, and with that knowledge and experience Xero is now building out the balance of the management team and moving appropriate global functions to the US. While independent product reviews place Xero strongly against competitors, there are numerous opportunities to create a 'best in class' product for the US market. US specific product development will be a significant focus in the forthcoming year.

Xero has invested over \$250m in building its small business platform and supporting functions. With few other examples of such investment, the competitive landscape is squarely Xero versus Intuit. Xero has already proven its calibre and ability to win in its three initial markets.

The Board is aware of how sentiment can move across investment sectors. In October, when the Board agreed to raise substantial funding, there was a possibility the markets would change. That prudence proved to be appropriate, placing Xero in the strong position of not requiring additional funding to execute its current plans. Meanwhile, current and potential future competitors may find it more challenging to obtain the necessary resources to compete.

INVESTMENT AND GROWTH

We are pursuing a growth agenda to become the long-term global leader in small business accounting software. To support this growth, the Company has ramped up investment in its internal infrastructure, systems and global marketing and sales teams. This investment will allow us to grow and support millions of customers and create long-term shareholder value.

People

The Company welcomes its New York based independent Chairman of the Board, Chris Liddell, who co-authors this letter. Chris most recently held the Vice Chairman and CFO roles at General Motors, where he led the Company's global finance operations and its US\$23 billion IPO in November 2010. Prior to this, Chris was a Senior Vice President and CFO at Microsoft.

As signalled during the year, to support growth and increase our presence in the US and Australia, the Company has strengthened the Board with the appointment of US based Bill Veghte, who runs HP's Enterprise Group where he is the Executive Vice President and General Manager, and Sydney based banking executive Lee Hatton, as independent non-executive Directors.

Our new CEO of North America, Peter Karpas, brings a wealth of experience in the US small business market and is making significant progress building a world class leadership team.

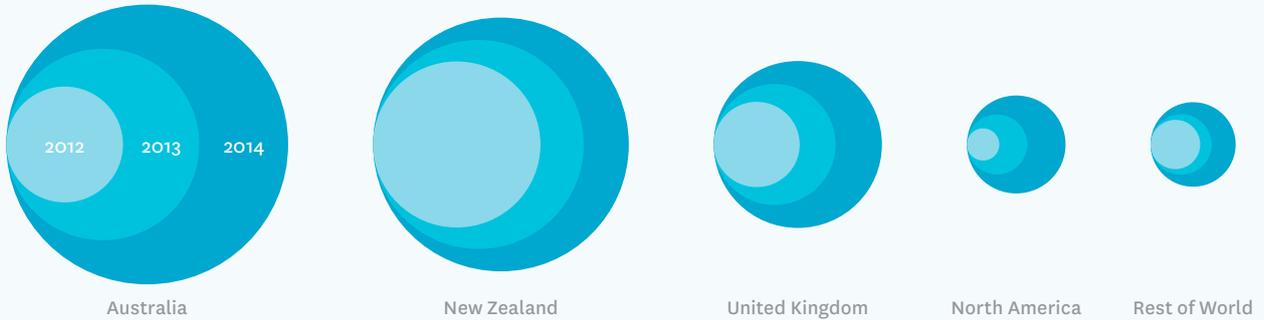
The 376-strong employee expansion over the last year has been most prevalent in the US. Software teams and global marketing capabilities have grown in San Francisco. In Denver, a contact, sales and operations centre has been established to support US growth.

To ensure we have access to global talent we have established a distributed development model with high performance teams in Auckland, Wellington, Melbourne, Canberra, San Francisco and New York.

Performance highlights

	12 months ended 31 March 2014	12 months ended 31 March 2013	12 months ended 31 March 2012
Total operating revenue	\$70.1m	\$38.4m	\$18.8m
Net loss after tax	(\$35.5m)	(\$14.4m)	(\$7.9m)
	At 31 March 2014	At 31 March 2013	At 31 March 2012
Cash and cash equivalents	\$209.9m	\$78.2m	\$39.0m
Paying customers	284,000	157,000	78,000
Annualised Committed Monthly Revenue	\$93.0m	\$51.5m	\$25.5m

Regional revenue growth



Strategic alliances

The Company has formed a number of strategic alliances across our markets with local partners who have both market credibility and broad reach. In the US, we are pleased to be working with Square Inc., Google, Expensify, Squarespace, ADP, Clio and we recently announced an alliance with H&R Block. Similarly, in the UK we were selected as a technology partner by KPMG. In Australia, Deloitte selected Xero as its technology platform partner for online services. In New Zealand, the Company has seen a number of Xero’s top accountants acquired by tier one accounting firms, largely due to the performance metrics these partners have achieved by transforming their practices with online accounting.

Ecosystem

One of Xero’s strengths is its vibrant ‘ecosystem’ of integrated third party solutions. There are now more than 300 add-on partners, up from 220 as of year ended 31 March 2013, covering such services as CRM, job costing, payroll and point of sale systems. It has been exciting to see a number of Xero add-ons raise significant funding themselves in the past year.

OPERATING OVERVIEW

Xero is a hybrid business that delivers application software, with complex features typically only seen in the enterprise software space, coupled with a low cost, consumer-like distribution model where scale is achieved with automation.

It was at around 50,000 customers that we set our near term target of a million customers. We’re pleased to be making substantial progress towards that goal and beyond.

In line with expectations, the Company increased its operating revenue for the year to 31 March 2014 from \$38.4m to \$70.1m, equating to 83% growth. Paying customers reached 284,000 at 31 March 2014. As anticipated, the full year loss grew to \$35.5m. Cash on hand is \$209.9m.

With a recurring revenue model, the Company commences the 2015 financial year strongly with \$93.0m in annualised subscriptions, up from \$51.5m at 31 March 2013.

Xero’s revenue is increasingly geographically diverse. At the end of March 2014, Committed Monthly Revenue by country was New Zealand 30%, Australia 44%, UK 15%, North America 7% and Rest of World 4%.

CLOSING COMMENTS

Xero is operating in an exciting space, with industry analysts acknowledging that the adoption to the cloud is accelerating ahead of earlier expectations. The Company continues to execute its business plan and with the resources in place, it remains strongly positioned.

Shareholders can take comfort in the progress of the business, the growing capabilities of its people and track record of making the right long-term decisions.

While there remains much to do, the Board is very pleased with progress, and thanks all customers, staff, partners and shareholders for their continued support.

Chris Liddell
Chairman

Rod Drury
Chief Executive

MANAGEMENT COMMENTARY

You should read the following commentary regarding Xero's financial condition and results of operations together with the consolidated financial statements and the related notes in this report. Some of the information contained in this discussion and analysis includes information with respect to the plans and strategy for the business, and it includes forward-looking statements that involve risks and uncertainties. Actual results and the timing of certain events may differ materially from future results expressed or implied by the forward-looking statements contained in the following commentary.

PRESENTATION OF BUSINESS RESULTS

Xero has elected to change how its income statement is presented. Expenses are now categorised by cost of revenues, sales and marketing, product design and development, and general and administration, rather than expense types such as employee entitlements, advertising and marketing, consulting, travel and so on.

The new presentation provides greater insight into the Company's business model. It also ensures that our reporting is more closely aligned to other major SaaS ("software as a service") companies.

DEFINITIONS

Operating revenue

Xero's main revenue source is recurring monthly fees from customers who subscribe to its online accounting software services. Within this subscription, customers also receive support services, data back-up and recovery, along with system upgrades.

Subscription revenue is driven by the number of customers and the services subscribed, which determines the monthly amount payable by the customer. A range of online accounting software services can be accessed through the partner channel (accountants, bookkeepers and similar) or directly from the online channel, with pricing dependent on the functionality required.

Operating revenue also includes other operating revenue from related services such as education and implementation of the online accounting software services, along with conference income. However, subscription revenue comprises 95% of operating revenue.

Overhead allocation

The costs associated with Xero's facilities, internal IT, and non-product related depreciation and amortisation are allocated to cost of revenues, sales and marketing, product design and development and general and administration based on respective headcount. Recruitment costs are allocated based on the number of employees hired during the period.

The total headcount at year end within facilities, internal IT and recruitment was 59 in 2014 and 23 in 2013. All costs associated with these employees are allocated as outlined, but the headcount is not recorded against the relevant function in the tables provided in the following commentary.

Cost of revenues

Cost of revenues consists of expenses directly associated with securely hosting Xero's services, sourcing relevant customer data from banks and providing support to customers. Costs include data centre capacity costs, platform costs, bank feed costs, personnel and related costs (including salaries, benefits, bonuses and share-based compensation) directly associated with cloud infrastructure and customer support, contracted third party vendor costs, related depreciation and amortisation, and allocated overheads.

Sales and marketing expenses

Sales and marketing expenses consist of personnel and related costs (including salaries, benefits, bonuses, commissions and share-based compensation) directly associated with sales and marketing teams, costs of the education department, and costs in implementation and configuration of our subscription services. Other costs included are external advertising costs, marketing costs and promotional event costs, including Xerocon conferences and roadshows, as well as allocated overhead.

Product design and development expenses

Product design and development expenses consist primarily of personnel and related costs (including salaries, benefits, bonuses and share-based compensation) directly associated with our product design and development employees, as well as allocated overhead.

Under New Zealand Equivalents to International Financial Reporting Standards ("NZ IFRS"), the proportion of product design and development expenses that create a benefit in future periods is capitalisable as an intangible asset and are then amortised to the income statement over the estimated life of the asset created. The amount amortised is included as a product design and development expense.

General and administration expenses

General and administration expenses consist of personnel and related costs (including salaries, benefits, bonuses and share-based compensation) for our executive, finance, billing, legal, human resources and administration employees. They also include legal, accounting and other professional services fees, insurance premiums, listing costs, other corporate expenses and allocated overhead.

BUSINESS RESULTS

The consolidated performance of Xero Limited for the years ended 31 March 2014 and 2013 is summarised as follows:

	2014 (\$000s)	2013 (\$000s)	% Change
Year ended 31 March			
Operating revenue	70,091	38,353	83%
Other income	1,383	936	48%
Total revenue and other income	71,474	39,289	82%
Cost of revenues	24,516	13,916	76%
Gross profit	46,958	25,373	85%
<i>Percent of operating revenue</i>	67%	66%	
Total operating expenses	85,920	41,657	106%
<i>Percent of operating revenue</i>	123%	109%	
Operating deficit	(38,962)	(16,284)	139%
<i>Percent of operating revenue</i>	-56%	-42%	
Net loss after tax	(35,546)	(14,443)	146%
<i>Percent of operating revenue</i>	-51%	-38%	
Cash balance	209,886	78,244	168%

The 2014 result reflects a year of continued investment in building the business capability to deliver future growth. The strong growth in operating revenue is discussed below. Total operating expenses and the net loss after tax increased in line with expectations.

The net cash outflow from operating and investing activities for the 2014 year was \$48.4m. It should be noted that in a SaaS business a significant portion of the cash outflow during the period will drive revenue in future periods. In particular, sales and marketing costs of \$55.1m expended to acquire new partners and customers will deliver substantial future subscription revenue.

OPERATING REVENUE

	2014 (\$000s)	2013 (\$000s)	% Change
Year ended 31 March			
Subscription revenue	66,551	36,088	84%
Other operating revenue	3,540	2,265	56%
Total operating revenue	70,091	38,353	83%

The 83% increase in operating revenue was primarily driven by customer numbers increasing from 157,000 to 284,000 during the 2014 year, an increase of 81%. Foreign exchange adversely affected New Zealand dollar reported operating revenue with changes in average revenue per user ("ARPU") impacting to a lesser degree.

With a market share of less than 10% in the major markets outside of New Zealand, Xero expects strong revenue growth to continue for the foreseeable future.

OPERATING REVENUE – CONSTANT CURRENCY

Given that approximately two thirds of Xero's revenue is denominated in foreign currencies, the strong New Zealand dollar during the year ended 31 March 2014 adversely affected reported operating revenue. On a constant currency basis, Xero grew operating revenue by 92% during the period.

	2014 (\$000s)	2013 (\$000s)	% Change
Year ended 31 March – constant currency			
Subscription revenue – constant currency	69,916	36,088	94%
Total operating revenue – constant currency	73,610	38,353	92%

This analysis is a non-GAAP financial measure, which has been provided to assist in understanding and assessing the company's financial performance during the year, excluding the impact of foreign currency fluctuations. The constant dollar revenue translates revenue for the year ended 31 March 2014 at the effective exchange rates used for the year ended 31 March 2013.

CUSTOMER NUMBERS

	2014	2013	% Change
Paying customers			
New Zealand	102,000	73,000	40%
Australia	109,000	51,000	114%
United Kingdom	47,000	22,000	114%
North America	18,000	6,000	200%
Rest of World	8,000	5,000	60%
Total paying customers	284,000	157,000	81%

Total customers at 31 March 2014 has grown by 127,000 or 81% to 284,000.

ANNUALISED SUBSCRIPTIONS AND ARPU

Annualised subscriptions represent monthly recurring revenue recorded in the March 2014 month multiplied by 12. Accordingly, it provides a 12 month view on revenue assuming any promotions have ended and other factors such as customers and pricing remain unchanged during the period.

	2014 Annualised subscriptions (\$000s)	2014 ARPU actual* (\$)	2014 ARPU constant FX** (\$)	2013 Annualised subscriptions (\$000s)	2013 ARPU actual* (\$)	Annualised subscriptions % change
Year ended 31 March						
New Zealand	28,600	23.4	23.4	19,800	22.6	44%
Australia	40,600	31.0	36.2	20,500	33.5	98%
United Kingdom	14,200	25.2	24.0	7,000	26.5	103%
North America	6,200	28.7	29.5	2,200	30.6	182%
Rest of World	3,400	35.4	36.4	2,000	33.3	70%
Total	93,000	27.3	29.0	51,500	27.3	81%

*Monthly average revenue per user (ARPU) based on annualised subscriptions and closing customers numbers.

**Monthly ARPU applying foreign exchange rates applicable in the calculation of ARPU for 2013.

The impact of foreign exchange is again evident in comparing ARPU and "ARPU Constant FX" for the 2014 year. Annualised subscriptions at 31 March 2014 would be \$99m if foreign exchange rates applicable in the calculation for the 2013 year applied.

Strong growth is reflected in all regions which, as outlined, is largely driven by customer growth. However, changes in ARPU also had some impact. The following is noted when comparing "ARPU Constant FX" for the 2014 year and ARPU for the 2013 year:

- ARPU for New Zealand and Australia increased due to higher ARPU products forming a greater proportion of total products and, in Australia, price changes implemented during the year;
- ARPU for the United Kingdom and United States decreased due to lower ARPU products forming a greater proportion of total products;
- ARPU for the Rest of World increased given price changes implemented during the year.

COST OF REVENUES

	2014 (\$000s)	2013 (\$000s)	% Change
Year ended 31 March			
Cost of revenues	24,516	13,916	76%
Percent of operating revenue	35%	36%	-1%
	2014	2013	% Change
At 31 March			
Headcount	182	94	94%

Cost of revenues were \$24.5m for the year ended 31 March 2014, \$10.6m higher than the previous period. This increase was due to higher headcount, resulting in increased personnel related costs of \$3.7m (an increase of 73%) and higher direct costs (including hosting costs and bank feed costs), which increase as customers grow.

Cost of revenues has reduced to 35% of operating revenue from 36% in the previous period. While management has a range of work programs to lower cost of revenues substantially, 2014 represented a year of building capability – this investment will continue in 2015. We expect cost of revenues to continue to reduce as a percent of operating revenue, thereby increasing the gross margin.

SALES AND MARKETING

	2014 (\$000s)	2013 (\$000s)	% Change
Year ended 31 March			
Sales and marketing	55,105	22,043	150%
<i>Percent of operating revenue</i>	79%	57%	22%
	2014	2013	% Change
At 31 March			
Headcount	222	127	75%

Sales and marketing expenses were \$55.1m for the year ended 31 March 2014, \$33.1m higher than in the previous period. These costs increased as a percent of operating revenue, reflecting the investment in recruiting senior management and filling out global teams, along with the implementation of additional marketing initiatives.

Employee numbers in the sales and marketing function increased by 75% during the period, resulting in increased personnel related costs of \$14.9m (an increase of 134%). External sales and marketing costs, including the cost of advertising campaigns, online marketing, running Xerocon conferences and road shows increased by \$10.7m during the period.

As sales and marketing costs are primarily focused on acquiring new customers, the efficiency of the sales and marketing spend is determined by comparing it to the revenue these customers will generate. A common measure is to calculate the sales and marketing cost to acquire each new customer and then calculate the number of months it will take to recover this cost based on the monthly ARPU, i.e. total sales and marketing costs divided by new customers divided by monthly ARPU.

This measure is referred to as “months to recover CAC (cost of acquiring customers)”.

At a group level there was an increase in “months to recover CAC” in 2014. This increase was largely driven by the increased investment in Australia, United Kingdom and United States, where we are in the “recruit” and “educate” phase of our partner channel (accountants and bookkeepers) sales strategy. In New Zealand where we are in the “educate” and “grow” phase this sales and marketing measure improved, giving us confidence in the long term validity and efficiency of this approach.

Sales and marketing costs will increase in absolute dollar terms as investment toward growing global market share continues however we expect to see a significant reduction in “months to recover CAC” and in sales and marketing costs as a percent of operating revenue.

PRODUCT DESIGN AND DEVELOPMENT

	2014 (\$000s)	2013 (\$000s)	% Change
Year ended 31 March			
Total product design and development costs (including capitalised development costs)	34,089	18,898	80%
<i>Percent of operating revenue</i>	49%	49%	0%
Less capitalised development costs	(20,899)	(9,905)	111%
Product design and development expenses excluding amortisation of capitalised development costs	13,190	8,993	47%
Add amortisation of capitalised development costs	5,219	2,625	99%
Product design and development expenses	18,409	11,618	58%
<i>Percent of operating revenue</i>	26%	30%	-4%
	2014	2013	% Change
At 31 March			
Headcount	236	117	102%

The total product design and development expenses including overhead allocations were \$34.1m for the year ended 31 March 2014, \$15.2m higher than in the previous period. Of this, \$20.9m was capitalised with the balance of \$13.2m included as an expense in the income statement. Amortisation of product design and development expenditure capitalised of \$5.2m was also included as an expense in the income statement, giving a total expense for the period of \$18.4m.

The increase in total costs was driven by a 102% growth in product design and development headcount, thereby increasing personnel expenditure by \$10m (an increase of 57%) and resulting in an increase of allocated overheads. An increase in the capitalisation rate resulted in the income statement expense reducing as a percent of operating revenue, with this reduction partly offset by a \$3.0m increase in the amortisation of capitalised costs. The increase in the capitalisation rate in 2014 resulted from more activity and spend on product development compared to product maintenance.

Product design and development costs will increase in absolute dollar terms and are expected to increase as a percent of operating revenue as Xero continues to deliver innovation and the best product in each market.

GENERAL AND ADMINISTRATION

	2014 (\$000s)	2013 (\$000s)	% Change
Year ended 31 March			
General and administration	12,406	7,996	55%
<i>Percent of operating revenue</i>	18%	21%	-3%
	2014	2013	% Change
At 31 March			
Headcount	59	21	181%

General and administration costs were \$12.4m for the year ended 31 March 2014, \$4.4m higher than in the previous period. This increase is primarily due to additional personnel related expenses of \$2.3m (an increase of 61%) as headcount was added to support the business as it rapidly grows in all regions where it operates.

General and administration costs reduced to 18% of operating revenue from 21% in the previous period. While these costs will increase in absolute dollar terms, they are expected to continue to decline as a percentage of operating revenue.

OTHER INCOME AND INTEREST INCOME

	2014 (\$000s)	2013 (\$000s)	% Change
Year ended 31 March			
Government grant income	1,257	936	34%
Rental income	126	-	NM*
Total other income	1,383	936	48%
Interest income	5,062	1,838	175%

*NM stands for not meaningful.

Government grants have been received from Callaghan Innovation relating to Xero's research and development investment in technology. Grant income for the year was \$1.3m, which is 34% higher than in the previous period due to an increase in qualifying costs incurred during the year. Although this particular grant is not expected to continue in future periods, Xero will explore other opportunities in this area.

Interest income for the year ended 31 March 2014 was \$5.1m, an increase of \$3.2m or 175% on the previous year due to higher cash balances following the \$180m capital raise in October 2013.

SEGMENT INFORMATION

	New Zealand (\$000s)	Australia (\$000s)	United Kingdom (\$000s)	North America (\$000s)	Rest of World (\$000s)	Corporate (\$000s)	Total (\$000s)
Year ended 31 March 2014							
Total revenue, other income and interest income	24,010	29,298	10,429	3,714	2,672	6,413	76,536
Cost of revenues	(8,540)	(10,183)	(3,613)	(1,206)	(974)	-	(24,516)
Sales and marketing	(5,443)	(21,080)	(7,418)	(20,383)	(781)	-	(55,105)
Other expenses	-	-	-	-	-	(30,815)	(30,815)
Segment contribution	10,027	(1,965)	(602)	(17,875)	917	(24,402)	(33,900)
Year ended 31 March 2013							
Total revenue, other income and interest income	16,359	13,734	5,477	1,345	1,377	2,835	41,127
Cost of revenues	(6,037)	(4,870)	(1,974)	(506)	(529)	-	(13,916)
Sales and marketing	(5,387)	(8,792)	(3,513)	(4,194)	(157)	-	(22,043)
Other expenses	-	-	-	-	-	(19,614)	(19,614)
Segment contribution	4,935	72	(10)	(3,355)	691	(16,779)	(14,446)

Subscription and other revenue is allocated to each country with regard to where the paying customer resides. Cost of revenues is allocated to each country based on a consistent percent of subscription revenue with sales and marketing costs including direct in-country costs along with an allocation of centrally managed costs and overheads.

Revenue for Corporate comprises interest and grant income with costs being all product design and development costs, general and administration costs, along with depreciation and amortisation.

New Zealand The substantial contribution reflects the ability to build a highly profitable model. As the partner channel matures revenue will continue to grow faster than sales and marketing costs. The contribution will improve further as efficiencies are realised in the cost of revenues.

Australia A significant brand marketing campaign was undertaken during the latter part of the 2014 year, which is expected to assist the continued growth of the Australian customer base. This, along with significant improvements in sales and marketing efficiency, should result in a material increase in the contribution from Australia in the 2015 year.

United Kingdom The increased investment during the 2014 year reflects a focus on further accelerating the sales and marketing activity and growing the team in order to take advantage of Xero's leadership position in the UK market.

North America There was significant investment in the 2014 year as Xero completed the market entry phase. While this investment appeared high relative to revenue and customers, a solid platform has been built and investment will continue in order to take advantage of market segments where Xero anticipates a high likelihood of success.

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF XERO LIMITED

REPORT ON THE FINANCIAL STATEMENTS

We have audited the financial statements of Xero Limited ("the Company") on pages 11 to 39, which comprise the statements of financial position as at 31 March 2014, the income statements, statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information for both the Company and the Group. The Group comprises the Company and the entities it controlled at 31 March 2014 or from time to time during the financial year.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Directors are responsible for the preparation of these financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand) and International Standards on Auditing. These standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider the internal controls relevant to the Company and the Group's preparation of financial statements that give a true and fair view of the matters to which they relate, in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company and the Group's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

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

We have no relationship with, or interests in, Xero Limited or any of its subsidiaries other than in our capacities as auditors and providers of assurance, advisory and taxation services. These services have not impaired our independence as auditors of the Company and the Group.

OPINION

In our opinion, the financial statements on pages 11 to 39:

- (i) comply with generally accepted accounting practice in New Zealand;
- (ii) comply with International Financial Reporting Standards; and
- (iii) give a true and fair view of the financial position of the Company and the Group as at 31 March 2014, and their financial performance and cash flows for the year then ended.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

We also report in accordance with Sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993. In relation to our audit of the financial statements for the year ended 31 March 2014:

- (i) we have obtained all the information and explanations that we have required; and
- (ii) in our opinion, proper accounting records have been kept by the Company as far as appears from an examination of those records.

RESTRICTION ON DISTRIBUTION OR USE

This report is made solely to the Company's shareholders, as a body, in accordance with Section 205(1) of the Companies Act 1993. Our audit work has been undertaken so that we might state to the Company's shareholders those matters which we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's shareholders, as a body, for our audit work, for this report or for the opinions we have formed.



PricewaterhouseCoopers

Chartered Accountants
Wellington, New Zealand
22 May 2014

FINANCIAL STATEMENTS

XERO LIMITED – INCOME STATEMENTS – FOR THE YEAR ENDED 31 MARCH 2014					
	Notes	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Subscription revenue	4	66,551	36,088	-	16,281
Other operating revenue	4	3,540	2,265	50,095	10,071
Total operating revenue		70,091	38,353	50,095	26,352
Other income	4	1,383	936	1,257	936
Total revenue and other income		71,474	39,289	51,352	27,288
Cost of revenues		24,516	13,916	15,076	12,480
Gross profit		46,958	25,373	36,276	14,808
<i>Operating expenses</i>					
Sales and marketing		55,105	22,043	49,765	14,408
Product design and development		18,409	11,618	18,498	11,152
General and administration		12,406	7,996	9,223	7,358
Total operating expenses	4	85,920	41,657	77,486	32,918
Operating deficit		(38,962)	(16,284)	(41,210)	(18,110)
Interest income	4	5,062	1,838	5,009	1,827
Net loss before tax		(33,900)	(14,446)	(36,201)	(16,283)
Income tax expense	5	(808)	(231)	-	-
Net loss from continuing operations		(34,708)	(14,677)	(36,201)	(16,283)
Net (loss)/profit from discontinued operations	6	(838)	234	(1,168)	125
Net loss after tax for the period attributable to the shareholders of the Company		(35,546)	(14,443)	(37,369)	(16,158)
<i>Earnings per share</i>					
Basic and diluted loss per share	7	(\$0.29)	(\$0.13)		

XERO LIMITED – STATEMENTS OF COMPREHENSIVE INCOME – FOR THE YEAR ENDED 31 MARCH 2014					
		Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Net loss after tax		(35,546)	(14,443)	(37,369)	(16,158)
Other comprehensive income					
Exchange difference on translation of international subsidiaries*		(40)	(11)	-	-
Total other comprehensive expense for the year, net of tax		(40)	(11)	-	-
Total comprehensive loss for the year attributable to the shareholders of the Company		(35,586)	(14,454)	(37,369)	(16,158)

*Exchange differences are reclassified to the Income Statements on disposal of international subsidiaries.
The accompanying notes form an integral part of these financial statements.

XERO LIMITED – STATEMENTS OF CHANGES IN EQUITY – FOR THE YEAR ENDED 31 MARCH 2014

	Notes	Share capital (\$000s)	Treasury stock (\$000s)	Share based payment reserve (\$000s)	Accumulated losses (\$000s)	Foreign currency translation reserve (\$000s)	Total equity (\$000s)
Year ended 31 March 2014							
<i>Group</i>							
Balance at 1 April 2013		155,551	(5,529)	3,096	(50,394)	(72)	102,652
Net loss after tax		-	-	-	(35,546)	-	(35,546)
Other comprehensive loss		-	-	-	-	(40)	(40)
Total comprehensive loss		-	-	-	(35,546)	(40)	(35,586)
<i>Transactions with owners:</i>							
Issue of shares (net of issue costs)	13	179,562	-	-	-	-	179,562
Issue of shares – key management	16	1,550	-	-	-	-	1,550
Issue of shares – employee restricted share plan	19	3,792	(3,792)	-	-	-	-
Accrual of share-based employee benefits		-	-	4,689	-	-	4,689
Vesting of shares – employee restricted share plan		-	2,429	(2,429)	-	-	-
Exercising of employee share options	13	611	-	(119)	-	-	492
Accrual for equity portion of purchase of Max Solutions Holdings Limited	13	-	-	1,000	-	-	1,000
Vesting of shares – purchase of Max Solutions Holdings Limited		-	1,333	(1,333)	-	-	-
Accrual for equity portion of purchase of Paycycle assets	13	-	-	209	-	-	209
Vesting of shares – purchase of Paycycle assets		-	431	(431)	-	-	-
Issue of shares – software development	13	370	-	-	-	-	370
Balance as at 31 March 2014		341,436	(5,128)	4,682	(85,940)	(112)	254,938
<i>Group</i>							
Balance at 1 April 2012		93,251	(6,874)	1,883	(35,951)	(61)	52,248
Net loss after tax		-	-	-	(14,443)	-	(14,443)
Other comprehensive loss		-	-	-	-	(11)	(11)
Total comprehensive loss		-	-	-	(14,443)	(11)	(14,454)
<i>Transactions with owners:</i>							
Issue of shares (net of issue costs)	13	59,882	-	-	-	-	59,882
Issue of shares – employee restricted share plan	19	1,818	(1,818)	-	-	-	-
Accrual of share-based employee benefits		-	-	1,665	-	-	1,665
Vesting of shares – employee restricted share plan		-	1,399	(1,399)	-	-	-
Vesting of shares – purchase of Max Solutions Holdings Limited		-	1,333	(1,333)	-	-	-
Accrual for equity portion of purchase of Max Solutions Holdings Limited		-	-	2,222	-	-	2,222
Vesting of shares – purchase of Paycycle assets		-	431	(431)	-	-	-
Accrual for equity portion of purchase of Paycycle assets		-	-	489	-	-	489
Issue of shares – purchase of Spotlight Workpapers Limited		600	-	-	-	-	600
Balance as at 31 March 2013		155,551	(5,529)	3,096	(50,394)	(72)	102,652

XERO LIMITED – STATEMENTS OF CHANGES IN EQUITY – FOR THE YEAR ENDED 31 MARCH 2014

	Notes	Share capital (\$000s)	Treasury stock (\$000s)	Share based payment reserve (\$000s)	Accumulated losses (\$000s)	Total equity (\$000s)
Year ended 31 March 2014						
<i>Parent</i>						
Balance at 1 April 2013		155,551	(5,529)	3,096	(52,585)	100,533
Net loss after tax		-	-	-	(37,369)	(37,369)
Total comprehensive loss		-	-	-	(37,369)	(37,369)
<i>Transactions with owners:</i>						
Issue of shares (net of issue costs)	13	179,562	-	-	-	179,562
Issue of shares – key management	16	1,550	-	-	-	1,550
Issue of shares – employee restricted share plan	19	3,792	(3,792)	-	-	-
Accrual of share-based employee benefits		-	-	4,689	-	4,689
Vesting of shares – employee restricted share plan		-	2,429	(2,429)	-	-
Exercising of employee share options	13	611	-	(119)	-	492
Accrual for equity portion of purchase of Max Solutions Holdings Limited	13	-	-	1,000	-	1,000
Vesting of shares – purchase of Max Solutions Holdings Limited		-	1,333	(1,333)	-	-
Accrual for equity portion of purchase of Paycycle assets	13	-	-	209	-	209
Vesting of shares – purchase of Paycycle assets		-	431	(431)	-	-
Issue of shares – software development	13	370	-	-	-	370
Balance as at 31 March 2014		341,436	(5,128)	4,682	(89,954)	251,036
<i>Parent</i>						
Balance at 1 April 2012		93,251	(6,874)	1,883	(36,427)	51,833
Net loss after tax		-	-	-	(16,158)	(16,158)
Total comprehensive loss		-	-	-	(16,158)	(16,158)
<i>Transactions with owners:</i>						
Issue of shares (net of issue costs)	13	59,882	-	-	-	59,882
Issue of shares – employee restricted share plan	19	1,818	(1,818)	-	-	-
Accrual of share-based employee benefits		-	-	1,665	-	1,665
Vesting of shares – employee restricted share plan		-	1,399	(1,399)	-	-
Accrual for equity portion of purchase of Max Solutions Holdings Limited		-	-	2,222	-	2,222
Vesting of shares – purchase of Max Solutions Holdings Limited		-	1,333	(1,333)	-	-
Accrual for equity portion of purchase of Paycycle assets		-	-	489	-	489
Vesting of shares – purchase of Paycycle assets		-	431	(431)	-	-
Issue of shares – purchase of Spotlight Workpapers Limited		600	-	-	-	600
Balance as at 31 March 2013		155,551	(5,529)	3,096	(52,585)	100,533

The accompanying notes form an integral part of these financial statements.

XERO LIMITED – STATEMENTS OF FINANCIAL POSITION – AS AT 31 MARCH 2014

	Notes	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Assets					
<i>Current assets</i>					
Cash and cash equivalents	8	209,886	78,244	201,227	75,511
Trade and other receivables	9	14,374	5,876	15,060	7,177
Total current assets		224,260	84,120	216,287	82,688
<i>Non-current assets</i>					
Property, plant and equipment	10	9,856	7,274	5,429	4,588
Intangible assets	11	34,828	17,585	34,822	15,001
Investment in subsidiaries		-	-	3,488	3,438
Deferred tax benefit	5	486	102	-	-
Other receivables	9	2,371	1,341	1,670	1,213
Total non-current assets		47,541	26,302	45,409	24,240
Total assets		271,801	110,422	261,696	106,928
Liabilities					
<i>Current liabilities</i>					
Trade and other payables	12	7,105	3,090	5,388	3,573
Employee entitlements		9,026	4,471	5,272	2,822
Income tax payable	5	732	209	-	-
Total current liabilities		16,863	7,770	10,660	6,395
Total liabilities		16,863	7,770	10,660	6,395
Net assets		254,938	102,652	251,036	100,533
Equity					
Share capital	13	336,308	150,022	336,308	150,022
Share based payment reserve		4,682	3,096	4,682	3,096
Accumulated losses		(85,940)	(50,394)	(89,954)	(52,585)
Foreign currency translation reserve		(112)	(72)	-	-
Total equity		254,938	102,652	251,036	100,533

The accompanying notes form an integral part of these financial statements.

XERO LIMITED – STATEMENTS OF CASH FLOWS – FOR THE YEAR ENDED 31 MARCH 2014

	Notes	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Operating activities					
<i>Cash was provided from:</i>					
Receipts from customers		67,136	37,476	93	24,171
Other income		1,086	788	960	788
Interest received		2,613	1,208	2,559	1,196
		70,835	39,472	3,612	26,155
<i>Cash was applied to:</i>					
Payments to suppliers and employees		(87,780)	(44,639)	(28,912)	(35,837)
Sales tax		(3,395)	(2,190)	-	(666)
Income tax (paid)/received		(679)	(175)	-	1
		(91,854)	(47,004)	(28,912)	(36,502)
Net cash flows from operating activities	14	(21,019)	(7,532)	(25,300)	(10,347)
Investing activities					
<i>Cash was provided from:</i>					
Disposal of property, plant and equipment		-	158	-	250
Rental bond repaid		-	20	-	20
		-	178	-	270
<i>Cash was applied to:</i>					
Purchase of property, plant and equipment		(5,150)	(4,566)	(2,537)	(1,897)
Capitalised development costs		(21,540)	(7,654)	(11,081)	(6,395)
Intangible assets		(63)	(28)	(64)	(28)
Rental bonds		(627)	-	-	-
Investment and advances to subsidiaries		-	(1,200)	(15,356)	(2,796)
		(27,380)	(13,448)	(29,038)	(11,116)
Net cash flows from investing activities		(27,380)	(13,270)	(29,038)	(10,846)
Financing activities					
<i>Cash was provided from:</i>					
Director's loan repayment		-	100	-	100
Employees exercising options		492	-	492	-
Share issue		180,000	60,000	180,000	60,000
		180,492	60,100	180,492	60,100
<i>Cash was applied to:</i>					
Cost of share issue		(438)	(118)	(438)	(118)
Net cash flows from financing activities		180,054	59,982	180,054	59,982
Net increase in cash held		131,655	39,180	125,716	38,789
Foreign currency translation adjustment		(13)	88	-	-
Cash and cash equivalents at beginning of the year		78,244	38,976	75,511	36,722
Cash and cash equivalents at end of the year	8	209,886	78,244	201,227	75,511

The accompanying notes form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. REPORTING ENTITY AND STATUTORY BASE

Xero Limited ("Xero") is a limited liability company, domiciled and incorporated in New Zealand and registered under the New Zealand Companies Act 1993. The registered office of the Company is 3 Market Lane, Wellington 6011, New Zealand.

The financial statements presented are for Xero Limited (the "Parent"/"Company") and its subsidiaries (together "the Group") for the year ended 31 March 2014.

Xero Limited is an issuer for the purposes of the Financial Reporting Act 1993 and is listed on the New Zealand Stock Exchange (NZX) and the Australian Securities Exchange (ASX).

The consolidated financial statements of the Group for the year ended 31 March 2014 were authorised for issue in accordance with a resolution of the Directors on 22 May 2014.

The Group's principal activity is the provision of a platform for online accounting and business services to small businesses and their advisors.

2. BASIS OF ACCOUNTING

(a) Basis of preparation The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice. They comply with New Zealand Equivalents to International Financial Reporting Standards ("NZ IFRS"), and other applicable Financial Reporting Standards, as appropriate for profit oriented entities. The financial statements comply with International Financial Reporting Standards ("IFRS").

The financial statements have been prepared in accordance with the requirements of the Financial Reporting Act 1993 and Companies Act 1993.

The Company and Group are profit oriented entities for financial reporting purposes.

The consolidated financial statements have been prepared using the historical cost convention.

The consolidated and Parent financial statements are presented in New Zealand dollars (\$) (the "presentation currency"), which is the Company's functional currency. Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency").

Transactions denominated in a foreign currency are converted at the functional currency exchange rate at the date of the transaction. Foreign currency receivables and payables at balance date are translated at exchange rates existing at balance date. Exchange differences arising on the translation of monetary assets and liabilities, including foreign currency accounts payable and receivable, are recognised in the Income Statement. Foreign exchange gains and losses are presented in the Income Statement within general and administration expenses.

(b) Changes in accounting policies and disclosures Apart from the changes noted below, the accounting policies adopted are consistent with those of the previous year.

Xero has elected to change how expenses are presented in the Income Statement from a nature view to a function view. The change provides better insight into the Group's performance and operations. The comparative Income Statements and comparative segment results have been reclassified with operating expenses of \$55,573,000 for the Group and \$45,398,000 for the Parent reclassified into cost of revenue, sales and marketing, product design and development and general and administration. There is no change to the total reported loss as a result of this change.

Xero has re-presented its comparative segment results to separate the North American operations previously aggregated with the Rest of World segment. This change reflects the growing importance of North America to the Group's operations and changes to management accountabilities during the period. There is no change to the overall Group reported loss as a result of these changes.

The Group has adopted External Reporting Board Standard A1, Accounting Standards Framework (For-profit Entities Update) (XRB A1). XRB A1 establishes a for-profit tier structure and outlines which suite of accounting standards entities in different tiers must follow. The Group is a Tier 1 entity. There was no impact on the current or prior year financial statements.

The Group has applied the following standards for the first time: IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 19 Employee Benefits (Revised 2011), IFRS 13 Fair Value Measurement, Amendments to IAS 1 Presentation of Financial Statements and IFRS 12 Disclosure of Interests in Other Entities. The adoption of these standards has not had a material impact on these financial statements and has not resulted in any restatements of prior period balances.

Certain other comparative information has also been reclassified to conform with the current period's presentation.

(c) Standards or interpretations issued but not yet effective and relevant to the Group There are no standards or amendments that have been issued but are not yet effective, that are expected to have a significant impact on the Company or the Group.

The Company and Group have not adopted any standards prior to their effective date.

2. BASIS OF ACCOUNTING (CONTINUED)

(d) Critical accounting estimates In applying the Group's accounting policies, management continually evaluates judgements, estimates and assumptions based on experience and other factors, including expectations of future events that may have an impact on the Group. All judgements, estimates and assumptions made are believed to be reasonable based on the most current set of circumstances available to the Group. Actual results may differ from the judgements, estimates and assumptions.

The significant judgements, estimates and assumptions made by management in the preparation of these financial statements are outlined below.

Deferred tax assets The Group recognises a deferred tax asset in relation to tax losses, only to the extent of the Group's deferred tax liabilities. The Parent has not recognised a deferred tax asset in respect of losses and other temporary differences given the uncertainty of the timing of profitability and the requirement for ownership continuity. Deferred tax assets are recognised in the subsidiaries in respect of losses and other temporary differences to the extent that it is probable they will be available to be utilised by future taxable profits.

Capitalised development costs The Group capitalises its development costs based on a proportion of employee costs. The percentages applied are in line with industry standards. The Group regularly reviews the carrying value of capitalised development costs to ensure they are not impaired. The development costs are amortised over five years, the expected useful life of the asset.

A reduction in the useful life of capitalised development costs from five to four years, would have resulted in an increase in amortisation expense of \$1.8 million in the year ended 31 March 2014.

3. SEGMENT INFORMATION

Segment reporting An operating segment is a component of an entity that engages in business activities from which it may earn revenue and incur expenses, whose operating results are regularly reviewed by the entity's Chief Operating Decision Maker to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available. Operating segments are aggregated for disclosure purposes where they have similar products and services, production processes, customers, distribution methods and regulatory environment.

Previously the Chief Operating Decision Maker was determined to be the Board of Directors. Due to the development of the Group and changes to the financial information that is reported internally, the Chief Operating Decision Maker has now been determined as the Global Executive Team.

The Group currently operates in one business segment, providing an online accounting solution for small businesses and their advisors.

Cost of revenues is allocated to each country based on a consistent percent of subscription revenue. Sales and marketing costs including direct in-country costs along with an allocation of centrally managed costs and overheads. Operating expenses for Corporate represent all product design and development and general and administration expenses.

As noted in note 2, the comparative segment results have been reclassified to present expenses by function. There is no change to the total Group reported loss as a result of this change.

The assets and liabilities of the Group are reported to and reviewed by the Global Executive Team in total and are not allocated by operating segment. Therefore, operating segment assets and liabilities are not disclosed.

	New Zealand (\$000s)	Australia (\$000s)	United Kingdom (\$000s)	North America (\$000s)	Rest of World (\$000s)	Corporate (\$000s)	Total (\$000s)
Group – For the year ended 31 March 2014							
Subscription revenue	23,183	27,642	9,807	3,274	2,645	-	66,551
Other operating revenue	827	1,655	622	315	27	94	3,540
Other income	-	1	-	125	-	1,257	1,383
Interest income	-	-	-	-	-	5,062	5,062
Total	24,010	29,298	10,429	3,714	2,672	6,413	76,536
Cost of revenues	(8,540)	(10,183)	(3,613)	(1,206)	(974)	-	(24,516)
Sales and marketing	(5,443)	(21,080)	(7,418)	(20,383)	(781)	-	(55,105)
Product design and development	-	-	-	-	-	(18,409)	(18,409)
General and administration	-	-	-	-	-	(12,406)	(12,406)
Total expenses	(13,983)	(31,263)	(11,031)	(21,589)	(1,755)	(30,815)	(110,436)
Segment contribution	10,027	(1,965)	(602)	(17,875)	917	(24,402)	(33,900)

At 31 March 2014, \$40.7 million of the Group's property, plant and equipment and intangible assets was domiciled in New Zealand (2013: \$22.2 million).

3. SEGMENT INFORMATION (CONTINUED)

	New Zealand (\$000s)	Australia (\$000s)	United Kingdom (\$000s)	North America (\$000s)	Rest of World (\$000s)	Corporate (\$000s)	Total (\$000s)
Group – For the year ended 31 March 2013							
Subscription revenue	15,654	12,628	5,120	1,313	1,373	-	36,088
Other operating revenue	705	1,106	357	32	4	61	2,265
Other income	-	-	-	-	-	936	936
Interest income	-	-	-	-	-	1,838	1,838
Total	16,359	13,734	5,477	1,345	1,377	2,835	41,127
Cost of revenues	(6,037)	(4,870)	(1,974)	(506)	(529)	-	(13,916)
Sales and marketing	(5,387)	(8,792)	(3,513)	(4,194)	(157)	-	(22,043)
Product design and development	-	-	-	-	-	(11,618)	(11,618)
General and administration	-	-	-	-	-	(7,996)	(7,996)
Total expenses	(11,424)	(13,662)	(5,487)	(4,700)	(686)	(19,614)	(55,573)
Segment contribution	4,935	72	(10)	(3,355)	691	(16,779)	(14,446)

4. REVENUES AND EXPENSES

Subscription revenue Subscription revenue comprises the recurring monthly fee from customers who subscribe to Xero's online accounting software services. Customers are invoiced monthly in arrears, with no set contractual term. Revenue is recognised as the services are provided to the customer. Revenues that are unbilled at year end is recognised in the Statements of Financial Position as accrued income and included within trade and other receivables.

Interest Interest income is recognised on an accruals basis using the effective interest rate method.

Government grants Government grants are recognised at their fair value where there is reasonable assurance that the grants will be received and all attaching conditions have been complied with.

Sales tax The Income Statements and the Statements of Cash Flows have been prepared so that all components are stated exclusive of sales tax, except where sales tax is not recoverable. All items in the Statements of Financial Position are stated net of sales tax with the exception of receivables and payables, which include sales tax invoiced. Sales tax includes Goods and Services Tax and Value Added Tax where applicable.

Overhead allocation The presentation of the Income Statements by function requires certain overhead costs to be allocated to functions. These allocations require management to apply judgement. Facilities, internal information technology costs and depreciation and amortisation not relating to product software development have been allocated to each function on a headcount basis. Recruitment costs have been allocated according to the number of employees hired during the period. The amortisation of product related software development is included in product design and development.

	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent* 2014 (\$000s)	Parent* 2013 (\$000s)
Operating revenue				
Subscription revenue	66,551	36,088	-	16,281
Other operating revenue	3,540	2,265	50,095	10,071
Total operating revenue	70,091	38,353	50,095	26,352

*Operating revenue for the Parent company includes \$50.0 million of revenue received from subsidiary companies (2013: \$9.3 million).

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	Notes	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Other income					
Government grants		1,257	936	1,257	936
Rental income		126	-	-	-
Total other income		1,383	936	1,257	936

Cost of revenues and operating expenses

Employee entitlements		60,388	29,245	38,927	22,070
Employee entitlements – share-based payments		8,497	5,270	3,904	4,262
Employee entitlements capitalised		(19,787)	(8,466)	(19,787)	(8,393)
IT infrastructure costs		10,510	7,527	6,016	6,401
Advertising and marketing		16,232	5,623	2,050	1,603
Consulting and subcontracting		4,353	1,922	2,409	1,308
Lease/rental		4,481	1,771	1,496	1,174
Travel related		3,537	1,453	1,126	642
Communication and office administration		2,788	1,370	1,485	942
Staff recruitment		1,843	824	628	605
Superannuation costs		1,759	765	711	467
Loss on foreign exchange transactions		690	442	839	417
Directors' fees	16	280	243	280	243
Auditors remuneration	15	206	183	158	134
Expenses paid to subsidiary companies	16	-	-	41,403	7,960
Loss/(gain) on disposal of property, plant and equipment		11	(13)	5	(14)
Other operating expenses		5,728	3,086	3,125	1,868
Total cost of revenues and operating expenses excl. depreciation and amortisation		101,516	51,245	84,775	41,689

Depreciation and amortisation expense

Amortisation of development costs	11	6,412	3,186	6,412	2,749
Amortisation of other intangible assets	11	214	12	203	12
Property, plant and equipment	10	2,294	1,130	1,172	948
Total depreciation and amortisation		8,920	4,328	7,787	3,709
Total cost of revenues and operating expenses		110,436	55,573	92,562	45,398

Depreciation and amortisation expense

Included in

Cost of revenues		1,515	277	402	270
Sales and marketing expenses		1,036	443	229	174
Product design and development expenses		6,143	3,484	6,973	3,094
General and administration expenses		226	124	183	171
Total depreciation and amortisation expense		8,920	4,328	7,787	3,709

Interest income

Interest income – bank		4,974	1,794	4,921	1,783
Interest income – loans to key management personnel	16	88	44	88	44
Net interest income		5,062	1,838	5,009	1,827
Net operating loss before tax		(33,900)	(14,446)	(36,201)	(16,283)

5. CURRENT AND DEFERRED INCOME TAX

Tax expense comprises current and deferred tax. Income tax is recognised in the Income Statements except when it relates to items recognised directly in the Statements of Comprehensive Income, in which case the income tax is recognised in the Statements of Comprehensive Income.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax is based on the expected manner of realisation of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the end of the reporting period.

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.

Current income tax

The tax on the Group's loss before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to the profits or loss of the consolidated entities as follows:

	Note	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Accounting loss before income tax		(33,900)	(14,446)	(36,201)	(16,283)
At the statutory income tax rate of 28%		(9,492)	(4,045)	(10,136)	(4,559)
Non-deductible expenditure		386	413	336	380
Adjustment in respect of prior periods		225	59	135	42
Tax rate variance of subsidiaries		136	-	-	-
Total tax losses not recognised		9,553	3,804	9,665	4,137
Income tax expense reported in Income Statements		808	231	-	-

Comprising:

Income tax payable from continuing operations		1,155	248	-	-
Income tax payable from discontinued operation	6	47	65	-	-
Deferred tax		(347)	(17)	-	-
Income tax expense (including discontinued operation)		855	296	-	-

Income tax payable

Opening balance		209	71	-	(1)
Income tax liability for the year		1,202	313	-	-
Income tax (paid)/received		(679)	(175)	-	1
Current tax payable		732	209	-	-

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Deferred income tax

The analysis of deferred tax assets and deferred tax liabilities is as follows:

	Group employee entitlements (\$000s)	Group tax depreciation (\$000s)	Group tax losses (\$000s)	Group net (\$000s)
<i>Deferred tax asset/(liability) balances:</i>				
At 1 April 2013	385	(1,133)	850	102
Adjustment in respect of prior periods	(13)	-	13	-
Charged to Income Statements	717	(364)	(6)	347
Effect of changes in foreign currency	-	-	37	37
At 31 March 2014	1,089	(1,497)	894	486
At 1 April 2012	524	(762)	323	85
Adjustment in respect of prior periods	(194)	-	194	-
Charged to Income Statements	55	(371)	333	17
At 31 March 2013	385	(1,133)	850	102
	Parent employee entitlements (\$000s)	Parent tax depreciation (\$000s)	Parent tax losses (\$000s)	Parent net (\$000s)
<i>Deferred tax asset/(liability) balances:</i>				
At 1 April 2013	274	(1,212)	938	-
Adjustment in respect of prior periods	68	-	(68)	-
Charged to Income Statements	279	(371)	92	-
At 31 March 2014	621	(1,583)	962	-
At 1 April 2012	327	(762)	435	-
Adjustment in respect of prior periods	63	37	(100)	-
Charged to Income Statements	(116)	(487)	603	-
At 31 March 2013	274	(1,212)	938	-

The Group's deferred tax assets are expected to reverse after 12 months. Deferred tax assets and liabilities have been offset where the balances are due to/receivable from the same counterparties. Deferred income tax assets are recognised for carried forward tax losses to the extent of the Company's deferred tax liabilities. The Company has unrecognised New Zealand tax losses available to carry forward of \$78,490,000 (2013: \$49,657,000) subject to shareholder continuity being maintained as required by New Zealand tax legislation.

6. DISCONTINUED OPERATION

On 28 August 2013 the Group announced the cessation of the development of its personal financial management tool Xero Personal and closure of the service on 30 November 2014. The Group has accounted for the closure of Xero Personal as a discontinued operation as it is a significant change in strategy.

The impact on the Income Statements relating to the discontinued operation is set out below. Apart from software development assets written off, there are no significant assets or liabilities relating to discontinued operation. The impact on the Statements of Cash Flows is not materially different from the revenue and operating expense amounts set out below.

	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Operating revenue	377	680	-	506
Operating expenses	(293)	(162)	(293)	(162)
Amortisation	(133)	(219)	(133)	(219)
Software development intangible asset write-off	(742)	-	(742)	-
Income tax expense relating to discontinued operation	(47)	(65)	-	-
Net (loss)/profit from discontinued operation	(838)	234	(1,168)	125

7. EARNINGS PER SHARE

The Group presents basic and diluted earnings per share ("EPS") data for its ordinary shares.

Basic EPS is calculated by dividing the Group profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares on issue during the period.

Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares on issue for the effects of all dilutive potential ordinary shares, which comprise treasury stock, share options and Restricted Share Units ("RSUs") granted to employees and Directors.

	Group 2014 (000s)*	Group 2013 (000s)*
Weighted average number of issued ordinary shares	120,553	110,403
Weighted average number of ordinary shares for diluted earnings per share	122,521	110,820
Net loss after tax for continuing operations	(\$34,708)	(\$14,677)
Basic loss per share for continuing operations (in New Zealand dollars)	(\$0.29)	(\$0.13)
Diluted loss per share for continuing operations (in New Zealand dollars)	(\$0.28)	(\$0.13)
Net loss after tax	(\$35,546)	(\$14,443)
Basic and diluted loss per share (in New Zealand dollars)	(\$0.29)	(\$0.13)

*Except for per share amounts.

8. CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short-term and highly liquid investments with original maturities of six months or less.

	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Cash at bank	14,886	68,244	6,227	65,511
Short term deposits	195,000	10,000	195,000	10,000
Total cash and cash equivalents	209,886	78,244	201,227	75,511

9. TRADE AND OTHER RECEIVABLES

The Group's financial assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and have been classified as loans and receivables under NZ IAS 39. Loans and receivables are recognised initially at fair value plus transaction costs and subsequently carried at amortised cost using the effective interest method less provision for impairment. Prepayments are not financial assets.

The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Financial assets are impaired when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The carrying amount of an asset is reduced through the use of a provision account, and the amount of the loss is recognised in the Income Statements. When a receivable is uncollectible, it is written off against the provision account for receivables. Subsequent recoveries of amounts previously written off are credited against the Income Statements.

	Note	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
<i>Current assets</i>					
Trade receivables		3,722	2,163	278	1,092
Provision for doubtful debts		(30)	(47)	-	(15)
Trade receivables from related parties	16	-	-	8,513	3,688
Accrued income		3,250	1,505	-	613
Prepayments		2,658	1,100	1,467	704
Interest receivable		3,107	745	3,107	745
Government grant receivable		337	318	337	318
Sales tax receivable		-	-	177	32
Rental bonds		149	92	-	-
Loans to key management	16	1,181	-	1,181	-
Total current trade and other receivables		14,374	5,876	15,060	7,177
<i>Non-current assets</i>					
Loans to key management	16	1,595	1,138	1,595	1,138
NZX and rental bonds		776	203	75	75
Total non-current and other receivables		2,371	1,341	1,670	1,213

Trade receivables are related primarily to the monthly subscription charged for the Xero service. Subscriptions are charged monthly in arrears and paid by direct debit. At 31 March 2014, trade receivables of the Group of \$116,000 were past due and are considered partially impaired (2013: \$72,000).

10. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at historical cost less depreciation.

Depreciation on assets is charged on a straight-line method to allocate the difference between their original costs and the residual values over their estimated useful lives, as follows:

	Term of lease
Leasehold improvements	
Motor vehicles	5 years
Computer equipment	2-3 years
Furniture and equipment	2-7 years

The assets' residual values and useful lives are reviewed and adjusted if appropriate at each balance date. If an asset's carrying amount is greater than its estimated recoverable amount, the carrying amount is written down immediately to its recoverable amount.

	Leasehold improvements (\$000s)	Motor vehicles (\$000s)	Computer equipment (\$000s)	Furniture and equipment (\$000s)	Total (\$000s)
Group – Year ended 31 March 2014					
<i>Cost</i>					
Balance as at 1 April 2013	4,897	176	2,091	1,651	8,815
Additions	1,100	27	1,734	2,340	5,201
Disposals	-	(16)	(363)	(8)	(387)
Foreign exchange adjustment	(258)	-	(67)	(61)	(386)
Balance as at 31 March 2014	5,739	187	3,395	3,922	13,243
<i>Depreciation</i>					
Balance as at 1 April 2013	411	54	771	305	1,541
Depreciation expense	842	42	910	500	2,294
Disposals	-	(12)	(356)	(8)	(376)
Foreign exchange adjustment	(29)	-	(30)	(13)	(72)
Balance as at 31 March 2014	1,224	84	1,295	784	3,387
Net carrying amount	4,515	103	2,100	3,138	9,856
Group – Year ended 31 March 2013					
<i>Cost</i>					
Balance as at 1 April 2012	2,784	116	1,003	870	4,773
Additions	2,114	120	1,207	784	4,225
Disposals	-	(60)	(118)	(3)	(181)
Foreign exchange adjustment	(1)	-	(1)	-	(2)
Balance as at 31 March 2013	4,897	176	2,091	1,651	8,815
<i>Depreciation</i>					
Balance as at 1 April 2012	14	78	404	82	578
Depreciation expense	397	36	474	223	1,130
Disposals	-	(60)	(107)	-	(167)
Balance as at 31 March 2013	411	54	771	305	1,541
Net carrying amount	4,486	122	1,320	1,346	7,274

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	Leasehold improvements (\$000s)	Motor vehicles (\$000s)	Computer equipment (\$000s)	Furniture and equipment (\$000s)	Total (\$000s)
Parent – Year ended 31 March 2014					
<i>Cost</i>					
Balance as at 1 April 2013	3,083	176	1,449	1,153	5,861
Additions	540	-	832	1,217	2,589
Disposals	-	-	(277)	(6)	(283)
Transferred to subsidiaries	(260)	(176)	(21)	(281)	(738)
Balance as at 31 March 2014	3,363	-	1,983	2,083	7,429
<i>Depreciation</i>					
Balance as at 1 April 2013	362	54	598	259	1,273
Depreciation expense	383	-	514	275	1,172
Disposals	-	-	(272)	(6)	(278)
Transferred to subsidiaries	(58)	(54)	-	(55)	(167)
Balance as at 31 March 2014	687	-	840	473	2,000
Net carrying amount	2,676	-	1,143	1,610	5,429
Parent – Year ended 31 March 2013					
<i>Cost</i>					
Balance as at 1 April 2012	2,754	116	833	765	4,468
Additions	329	120	717	390	1,556
Disposals	-	(60)	(101)	(2)	(163)
Balance as at 31 March 2013	3,083	176	1,449	1,153	5,861
<i>Depreciation</i>					
Balance as at 1 April 2012	8	78	327	65	478
Depreciation expense	354	36	364	194	948
Disposals	-	(60)	(93)	-	(153)
Balance as at 31 March 2013	362	54	598	259	1,273
Net carrying amount	2,721	122	851	894	4,588

11. INTANGIBLE ASSETS

Costs that are directly associated with the development of software are recognised as intangible assets where the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use or sell it;
- there is an ability to use or sell the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalised as part of the capitalised software development costs include software development employee costs. Other development expenditure that does not meet these criteria is recognised as an expense as incurred. Development costs previously recognised as expenses are not recognised as assets in a subsequent period. Computer software development costs recognised as assets are amortised over their estimated useful lives.

Other intangible assets acquired are initially measured at cost. Internally generated assets, excluding capitalised development costs, are not capitalised and expenditure is recognised in the Income Statement in the year in which the expenditure is incurred.

The useful lives of the Group's intangible assets are assessed to be finite. Assets with finite lives are amortised over their useful lives and tested for impairment whenever there are indications that the assets may be impaired.

Amortisation is recognised in the Income Statement on a straight-line basis over the estimated useful life of the intangible asset, from the date it is available for use. The estimated useful lives are as follows:

Capitalised software development costs	5 years
Software licence costs	2-3 years
Patents, domains and trademark costs	10 years

Research costs and costs associated with maintaining internal computer software programs are recognised as an expense as incurred.

At each reporting date, the Group assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, the Group makes a formal estimate of the recoverable amount. Where the carrying value of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

The recoverable amount is the greater of fair value less costs to sell or the asset's value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

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	Note	Software development* (\$000s)	Software licences (\$000s)	Patents, domains and trademarks (\$000s)	Total (\$000s)
Group – Year ended 31 March 2014					
<i>Cost</i>					
Balance as at 1 April 2013		25,455	–	142	25,597
Additions		24,366	316	62	24,744
Written off as a discontinued operation	6	(1,378)	–	–	(1,378)
Disposals		–	(40)	–	(40)
Balance as at 31 March 2014		48,443	276	204	48,923
<i>Amortisation and impairment</i>					
Balance as at 1 April 2013		7,965	–	47	8,012
Amortisation**		6,545	198	16	6,759
Written off as a discontinued operation	6	(636)	–	–	(636)
Disposals		–	(40)	–	(40)
Balance as at 31 March 2014		13,874	158	63	14,095
Net carrying amount		34,569	118	141	34,828
Group – Year ended 31 March 2013					
<i>Cost</i>					
Balance as at 1 April 2012		14,742	–	113	14,855
Additions		10,717	–	29	10,746
Foreign exchange adjustment		(4)	–	–	(4)
Balance as at 31 March 2013		25,455	–	142	25,597
<i>Amortisation and impairment</i>					
Balance as at 1 April 2012		4,560	–	35	4,595
Amortisation**		3,405	–	12	3,417
Balance as at 31 March 2013		7,965	–	47	8,012
Net carrying amount		17,490	–	95	17,585

*Included in software development are projects in progress with a year end balance of \$2.95 million (2013: \$1.3 million).

**Includes amortisation attributable to discontinued operation.

11. INTANGIBLE ASSETS (CONTINUED)

	Note	Software development* (\$000s)	Software licences (\$000s)	Patents, domains and trademarks (\$000s)	Total (\$000s)
Parent – Year ended 31 March 2014					
<i>Cost</i>					
Balance as at 1 April 2013		22,436	-	140	22,576
Additions		24,365	299	64	24,728
Disposals		-	(35)	-	(35)
Written off as a discontinued operation	6	(1,378)	-	-	(1,378)
Transferred from subsidiaries		3,019	-	-	3,019
Balance as at 31 March 2014		48,442	264	204	48,910
<i>Amortisation and impairment</i>					
Balance as at 1 April 2013		7,528	-	47	7,575
Amortisation**		6,545	187	16	6,748
Disposals		-	(35)	-	(35)
Written off as a discontinued operation	6	(636)	-	-	(636)
Transferred from subsidiaries		436	-	-	436
Balance as at 31 March 2014		13,873	152	63	14,088
Net carrying amount		34,569	112	141	34,822
Parent – Year ended 31 March 2013					
<i>Cost</i>					
Balance as at 1 April 2012		12,516	-	112	12,628
Additions		9,920	-	28	9,948
Balance as at 31 March 2013		22,436	-	140	22,576
<i>Amortisation and impairment</i>					
Balance as at 1 April 2012		4,560	-	35	4,595
Amortisation**		2,968	-	12	2,980
Balance as at 31 March 2013		7,528	-	47	7,575
Net carrying amount		14,908	-	93	15,001

*Included in software development are projects in progress with a year end balance of \$2.95 million (2013: \$1.3 million).

**Includes amortisation attributable to discontinued operation.

Capitalised software development is an internally generated cost except for \$6.0 million of externally purchased assets (2013: \$1.3 million), and including \$4.7 million of additions during the year.

12. TRADE AND OTHER PAYABLES

The Group recognises trade and other payables initially at fair value and subsequently measured at amortised cost using the effective interest method. The amounts are unsecured, non-interest bearing and usually paid within 45 days of recognition.

	Note	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Trade payables		3,561	1,312	1,727	936
Trade payables due to related parties	16	-	-	2,685	2,081
Accrued expenses		2,188	1,061	948	527
Income in advance		212	159	28	29
Sales tax payable		1,144	558	-	-
Total trade and other payables		7,105	3,090	5,388	3,573

13. SHARE CAPITAL

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. Where any Group company purchases the Company's equity share capital, the consideration paid is deducted from equity attributable to the Company's equity holders until the shares are cancelled or transferred outside the Group.

Movement in ordinary shares on issue

	Notes	Group 2014 (000s)	Group 2013 (000s)	Parent 2014 (000s)	Parent 2013 (000s)
Balance as at 1 April		117,219	106,782	117,219	106,782
Issue of ordinary shares		9,917	10,000	9,917	10,000
Issue of ordinary shares – Spotlight Workpapers Software		10	90	10	90
Issue of ordinary shares – loans to key management	16	97	-	97	-
Issue of ordinary shares – exercising of employee share options		142	5	142	5
Issue of ordinary shares – employee restricted share plan	19	225	342	225	342
Ordinary shares on issue at 31 March		127,610	117,219	127,610	117,219
Treasury stock		(1,009)	(1,841)	(1,009)	(1,841)
Ordinary shares on issue at 31 March		126,601	115,378	126,601	115,378

All shares have been issued, are fully paid and have no par value.

In October 2013 the Company raised \$180 million of capital at \$18.15 per share by issuing 9.92 million ordinary shares. Transaction costs of \$438,000 have been netted off the amount recognised in equity.

During the period the Company issued 225,006 shares under the Employee Restricted Share Plan, at an average price of \$16.85.

During the period, employees exercised 142,000 options under the Employee Share Option Scheme, with an average exercise price of \$3.47.

The Parent issued 10,000 shares and capitalised \$370,000 of software development costs as consideration for the satisfaction of certain key performance indicators in relation to the integration of Spotlight Workpapers Software, acquired by the Company in July 2012.

The Parent recognised \$209,000 of employee costs in the period for the final vesting of shares for the purchase of Paycycle assets, acquired by the Group in August 2011.

The Parent recognised \$1,000,000 of costs in the period for the vesting of shares to the former owners of Max Solutions Holdings Limited, acquired by the Group in the year ended 31 March 2012.

Treasury stock includes shares issued in relation to the purchase of Paycycle assets and Max Solutions Holdings Limited and the Employee Restricted Share Plan that have yet to vest.

14. RECONCILIATION OF OPERATING CASH FLOWS

	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
<i>Reconciliation from the net loss after tax to the net cash from operating activities</i>				
Net loss after tax	(35,546)	(14,443)	(37,369)	(16,158)
<i>Adjustments:</i>				
Depreciation	2,294	1,130	1,172	948
Amortisation	6,626	3,198	6,615	2,761
Deferred tax	(347)	(17)	-	-
Loss on foreign exchange transactions	690	442	839	417
Loss/(gain) on disposal on property, plant and equipment	11	(13)	5	(14)
Share-based employee entitlements	6,971	3,976	3,060	2,734
Bad debts	125	114	-	40
Discontinued operations	875	219	875	219
<i>Changes in working capital items:</i>				
(Increase)/decrease in trade receivables and prepayments	(4,825)	(2,523)	(656)	(1,206)
(Increase)/decrease in interest receivable	(2,450)	(651)	(2,450)	(651)
Increase/(decrease) in trade payables and accruals	403	(743)	802	(251)
Increase/(decrease) in current tax payable	523	138	-	(1)
Increase/(decrease) in employee entitlements	3,578	1,572	1,808	804
Increase/(decrease) in income in advance	53	69	(1)	11
Net cash flows from operating activities	(21,019)	(7,532)	(25,300)	(10,347)

15. AUDITORS' REMUNERATION

	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
<i>Amounts received or due and receivable by PwC for:</i>				
Audit of financial statements	124	97	76	52
Accounting advice and other assurance services*	43	43	43	39
Treasury policy advice	4	-	4	-
Taxation services**	35	43	35	43
Total fees paid to auditors	206	183	158	134

*Services relate to review of the Group's half year result, audit of the Company's share register and technical accounting advice.

**Services relate to the provision of services for the annual tax return, tax advice on the Group's incentive plans and the taxation of offshore employees.

16. RELATED PARTIES

The Company entered into the following transactions and had receivable/(payable) balances with the following subsidiaries:

	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Xero (UK) Limited		
Operating revenue received from subsidiary	7,282	2,585
Operating expenses paid to subsidiary	5,309	872
Due from subsidiary	1,817	713
Xero Australia Pty Limited		
Operating revenue received from subsidiary	18,829	5,657
Operating expenses paid to subsidiary	13,235	2,654
Due from subsidiary	3,443	2,481
Xero, Inc. (United States)		
Operating revenue received from subsidiary	4,508	1,063
Operating expenses paid to subsidiary	22,859	4,434
Due from subsidiary	3,253	494
Xero (NZ) Limited		
Operating revenue received from subsidiary	19,383	-
Due to subsidiary	(2,685)	-
Max Solutions Holdings Limited (amalgamated on 1 April 2013)		
Due to subsidiary	-	(2,078)
Spotlight Workpapers Limited (amalgamated on 1 April 2013)		
Due to subsidiary	-	(3)
Total		
Operating revenue received from subsidiaries	50,002	9,305
Operating expenses paid to subsidiaries	41,403	7,960
Due from subsidiaries	8,513	3,688
Due to subsidiaries	(2,685)	(2,081)

Inter-group reorganisation

As part of a group reorganisation, the New Zealand and Rest of World sales and marketing operations were transferred from the Parent to Xero (NZ) Limited, including the transfer of assets and liabilities to Xero (NZ) Limited, with a book value of \$2.4 million and \$0.3 million respectively. During the period Xero (NZ) Limited transferred software development assets with a book value of \$2.6 million to the Parent.

Balances with subsidiary companies are unsecured and are repayable on demand.

Operating revenue/(expenses) includes management fees, distributor costs, transaction fees and market support payments between the Parent and its subsidiaries.

16. RELATED PARTIES (CONTINUED)

The Group and Company entered into the following transactions and had the following balances receivable with related parties:

Loans to key management

	2014 (\$000s)	2013 (\$000s)
Opening balance	1,138	1,094
Loans issued to key management	1,550	-
Interest charged on loans	88	44
Closing balance	2,776	1,138

Secured loans have been issued to key management to purchase shares in the Company at market price. Simple interest is accrued at a rate of 4% per annum, with the loans and interest being repayable three years from the date of issue. The fair value of the loans does not materially differ from the carrying value.

Other related parties – Directors

	Transaction value for year 2014 (\$000s)	Transaction value for year 2013 (\$000s)	Balance outstanding 2014 (\$000s)	Balance outstanding 2013 (\$000s)
Graham Shaw – Jeff Gray European Limited	28	87	-	-
Sam Morgan – Kiwi Landing Pad Limited	-	44	-	-

During the year, consideration of \$252,000 was provided to Directors in strategic advisory fees, outside their capacity as Directors.

All transactions and outstanding balances with these related parties are priced on an arm's length basis and are to be settled in cash and under normal commercial terms. None of the balances are secured.

Some members of key management and Directors subscribe to the Xero services provided by the Group. None of these related party transactions are significant to any party.

No amounts with any related parties have been written off or foregone during the year (2013: Nil).

Key management personnel remuneration

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, and include the Directors, the Chief Executive, his direct reports and the country managers. The following table summarises remuneration paid to key management personnel.

	2014 (\$000s)	2013 (\$000s)
Short-term employee benefits	2,781	2,329
Directors' fees	280	243
Share options (under the Employee Share Options Scheme)	313	52
Restricted share units	80	-
Share-based payments (under Employee Restricted Share Plan)	805	467

17. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES

Financial instruments Financial instruments recognised in the Statements of Financial Position include cash balances, receivables and payables. The Group's policy is that no trading in financial instruments shall be undertaken.

Capital management The capital structure of the Group consists of equity raised by the issue of ordinary shares in the Parent. The Group manages its capital to ensure that entities in the Group are able to continue as going concerns. The Group is not subject to any externally imposed capital requirements.

Classification and fair values Xero has carried out a fair value assessment of its financial assets and liabilities at 31 March 2014 in accordance with NZ IFRS 13 Fair Value Measurement.

The carrying value of the Parent's and Group's financial instruments does not materially differ from their fair value.

Set out below is the designation by category of the carrying amounts of the Parent's and Group's financial instruments.

	Loans and receivables (\$000s)	Financial liabilities at amortised cost (\$000s)	Total carrying value (\$000s)
Group – Year ended 31 March 2014			
<i>Assets</i>			
Trade and other receivables	11,311	–	11,311
Cash and cash equivalents	209,886	–	209,886
Loans to key management	2,776	–	2,776
Total financial assets	223,973	–	223,973
<i>Liabilities</i>			
Trade and other payables	–	5,663	5,663
Employee entitlements	–	9,026	9,026
Total financial liabilities	–	14,689	14,689
Group – Year ended 31 March 2013			
<i>Assets</i>			
Trade and other receivables	4,979	–	4,979
Cash and cash equivalents	78,244	–	78,244
Loans to key management	1,138	–	1,138
Total financial assets	84,361	–	84,361
<i>Liabilities</i>			
Trade and other payables	–	2,304	2,304
Employee entitlements	–	4,471	4,471
Total financial liabilities	–	6,775	6,775

17. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES (CONTINUED)

	Loans and receivables (\$000s)	Financial liabilities at amortised cost (\$000s)	Total carrying value (\$000s)
Parent – Year ended 31 March 2014			
<i>Assets</i>			
Trade and other receivables	12,310	–	12,310
Cash and cash equivalents	201,277	–	201,277
Loans to key management	2,776	–	2,776
Total financial assets	216,363	–	216,363
<i>Liabilities</i>			
Trade and other payables	–	5,303	5,303
Employee entitlements	–	5,272	5,272
Total financial liabilities	–	10,575	10,575
Parent – Year ended 31 March 2013			
<i>Assets</i>			
Trade and other receivables	6,516	–	6,516
Cash and cash equivalents	75,511	–	75,511
Loans to key management	1,138	–	1,138
Total financial assets	83,165	–	83,165
<i>Liabilities</i>			
Trade and other payables	–	3,488	3,488
Employee entitlements	–	2,822	2,822
Total financial liabilities	–	6,310	6,310

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk, credit risk and foreign currency risk.

Continued on next page ...

Interest rate risk The Group's interest rate risk arises from its cash balances. These are placed on short-term deposit at fixed rates. The repricing of these exposes the Group to cash flow interest rate risk. The Group does not enter into any interest rate hedges.

Management regularly reviews its banking arrangements to ensure that it achieves the best returns on its funds while maintaining access to necessary cash levels to service the Group's day-to-day activities.

The interest rate re-pricing profiles of the Group's financial assets and liabilities subject to interest rate risk are:

	Carrying value (\$000s)	3 months or less (\$000s)	3-12 months (\$000s)	Greater than 12 months (\$000s)
Group – Year ended 31 March 2014				
<i>Financial assets</i>				
Cash at bank	14,886	14,886	-	-
Short term deposits	195,000	175,000	20,000	-
Loans to key management	2,776	-	1,181	1,595
Total	212,662	189,886	21,181	1,595

Group – Year ended 31 March 2013

<i>Financial assets</i>				
Cash at bank	68,244	68,244	-	-
Short term deposits	10,000	-	10,000	-
Loans to key management	1,138	-	-	1,138
Total	79,382	68,244	10,000	1,138

Parent – Year ended 31 March 2014

<i>Financial assets</i>				
Cash at bank	6,227	6,227	-	-
Short term deposits	195,000	175,000	20,000	-
Loans to key management	2,776	-	1,181	1,595
Total	204,003	181,227	21,181	1,595

Parent – Year ended 31 March 2013

<i>Financial assets</i>				
Cash at bank	65,511	65,511	-	-
Short term deposits	10,000	-	10,000	-
Loans to key management	1,138	-	-	1,138
Total	76,649	65,511	10,000	1,138

Cash at bank is subject to floating interest rates. Short term deposits and loans to key management are subject to fixed interest rates. All other financial assets and liabilities of the Group are not subject to interest rate risk.

As at 31 March 2014 if interest rates had been 1.0% higher/lower with all other variables held constant, the impact on interest income, net loss and accumulated losses of the Group would have been \$1,951,000 lower/higher (2013: \$721,000). This analysis assumes the cash and cash equivalents balance was consistent throughout the year at the year end balance.

17. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES (CONTINUED)

Liquidity risk Liquidity risk is the risk that the Company, or Group cannot pay contractual liabilities as they fall due. During the year the Group raised \$180 million of cash from issuing new shares. Following the receipt of the proceeds of the capital raising, the Group has sufficient cash to meet its requirements in the foreseeable future. The Group has no debt.

The undiscounted contractual cash flows of the Company and Groups financial liabilities are equal to the carrying value and are due within six months or less.

Credit risk Where the Group has a receivable from another party, there is a credit risk in the event of non-performance by that other party. Financial instruments that potentially subject the Group to credit risk principally consist of bank balances, short term deposits and receivables.

The Group manages credit risk by placing its cash and short-term investments with high credit quality financial institutions with Standard & Poor's A band credit ratings. The credit risk associated with trade receivables is small because of the inherently low individual transaction value and the spread over many customers.

Maximum exposure to credit risk at balance date

	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Cash and cash equivalents	209,886	78,244	201,227	75,511
Receivables	11,716	4,776	5,080	2,785
Non-current receivables	2,371	1,341	1,670	1,213
Total	223,973	84,361	207,977	79,509

Foreign currency risk The Group faces the risk of movements in foreign currency exchange rates against the New Zealand dollar. The Group operates in three other currencies, being UK pounds, Australian dollars and US dollars. As a result the Group's Income Statements and Statements of Financial Position can be affected by movements in exchange rates.

Xero is exposed to currency risk from the operations of foreign subsidiaries and foreign currency denominated expenses in the Parent company. The significant exposure is United States dollar ("USD") outflows. The Group forward purchases a proportion of its USD requirements in advance to manage the impacts of movements in the exchange rate. In addition the Group generates Australian dollar inflows that are converted to New Zealand dollars on a regular basis.

If the New Zealand dollar had weakened by 10% against all other operating currencies, with all other variables remaining constant, the impact on the Group's position at 31 March 2014 would have been an increase in the net loss and accumulated losses of 122,000 (2013: net decrease of \$193,000).

18. COMMITMENTS AND CONTINGENCIES

There were capital commitments for building fitouts of \$158,000 at 31 March 2014 (2013: \$390,000). There were no contingent liabilities at 31 March 2014 (2013: Nil).

19. SHARE BASED PAYMENTS

The Group operates equity-settled, share-based compensation plans, under which employees render services in exchange for non-transferable share options, Restricted Share Units ("RSUs") or shares. The value of the employee services rendered for the grant of non-transferable share options, RSUs and shares is recognised as an expense over the vesting period, and the amount is determined by reference to the fair value of the options, RSUs and shares granted.

Employee Restricted Share Plan

The Xero Limited Employee Restricted Share Plan ("RSP") was introduced for selected executives and employees of the Group. Under the RSP, ordinary shares in Xero Limited are issued to a trustee, Xero Trustee Limited, a wholly owned subsidiary, and allocated to participants, on grant date, using funds lent to them by the Company.

The price for each share issued during the year under the RSP is the higher of the market price of the share on the date on which the shares are allocated or the invitation price.

Under the RSP, shares are beneficially owned by the participants. The length of retention period before the shares vest is between one and three years. If the individual is still employed by the Group at the end of this specific period, the employee is given a cash bonus that must be used to repay the loan and shares are then transferred to the employee. The number of shares awarded is determined by the Remuneration Committee of the Board of Directors. The weighted average grant date fair value of restricted shares issued during the year was \$16.85 (2013: \$5.61) and is determined by the share price on grant date. Shares with a grant date fair value of \$2,429,000 vested during the year (2013: \$1,399,000). The Group has no legal or constructive obligation to repurchase the shares or settle the RSP for cash.

	Number of shares 2014 (000s)	Number of shares 2013 (000s)
Unvested shares as at 1 April	587	758
Awarded pursuant to the Employee Restricted Share Plan	282	445
Forfeited	(58)	(49)
Vested	(434)	(567)
Unvested shares as at 31 March – allocated to employees	377	587
Forfeited shares not yet reallocated – held by Trustee	9	8
	386	595
Percentage of total ordinary shares	0.3%	0.5%
Ageing of unvested shares		
Balance of shares to vest within one year	240	377
Balance of shares to vest after one year	137	210
	377	587

The number of shares awarded pursuant to the RSP does not equal the number of shares created for the scheme as forfeited shares are held in the trust and reissued.

19. SHARE BASED PAYMENTS (CONTINUED)**Share Options Scheme**

Share options are granted to selected employees, Directors and service providers. The exercise price of the granted options is equal to the market price of the shares on the date of the grant.

Options are conditional on the completing of the necessary years' service (the vesting period) as appropriate to that tranche. The options tranches are exercisable in equal amounts over one to five years from the grant date. No options can be exercised later than the second anniversary of the final vesting date (a total of four to six years from the grant date). The cost of stock options recognised in the Income Statements is \$1,250,000 for the year ended 31 March 2014 (2013: \$274,000). There were 97 holders of options at 31 March 2014.

The Group has no legal or constructive obligation to repurchase or settle the options in cash.

Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

	2014 Weighted average exercise price (\$)	2014 Options (000s)	2013 Weighted average exercise price (\$)	2013 Options (000s)
Outstanding at 1 April	4.08	585	2.75	200
Granted during the period	30.73	521	4.75	392
Forfeited during the period	18.15	(28)	7.70	(2)
Exercised during the period	3.47	(142)	2.75	(5)
Outstanding at 31 March	18.57	936	4.08	585
Exercisable at 31 March	5.22	63	2.75	35

Share options outstanding at the end of the year have the following expiry dates and exercise prices:

Grant-vest	Expiry date	Exercise price (\$)	2014 Options (000s)	2013 Options (000s)
2012-13	2017-18	2.75	120	195
2012-13	2016-17	3.82	93	140
2012-13	2016-17	5.31	122	142
2012-13	2016-17	4.97	100	100
2012-13	2016-17	7.70	7	8
2013-14	2017-18	17.40	146	-
2013-14	2017-18	32.50	59	-
2013-14	2017-18	38.24	164	-
2013-14	2018-19	38.24	125	-
			936	585

The weighted average fair value of options granted during the year, determined using the Black-Scholes valuation model, was \$13.16 per option (2013: \$1.21).

The significant inputs into the model were the market share price at grant date, the exercise price shown above, the expected annualised volatility of between 33% and 53%, a dividend yield of 0%, an expected option life of between one and six years and an annual risk-free interest rate of between 2.5% and 4.1%.

The volatility measured is the standard deviation of continuously compounded share returns and is based on a statistical analysis of daily share prices in the past one to six years.

Restricted Share Units

Xero granted 20,537 Restricted Share Units ("RSUs") at an exercise price of \$38.24, as remuneration and incentive for a key member of management. No cash consideration is required to be paid to exercise the RSUs. The grant date fair value of the RSUs was \$785,000 as determined by the market value of the shares on grant date. The RSUs are conditional on the employee completing up to three year's service (the vesting period) and are exercisable in equal amounts over the vesting period. The cost of the RSUs recognised in the Income Statement is \$80,000 (2013: Nil).

20. OPERATING LEASE COMMITMENTS

	Group 2014 (\$000s)	Group 2013 (\$000s)	Parent 2014 (\$000s)	Parent 2013 (\$000s)
Within one year	4,525	2,341	1,434	1,355
After one year but not more than five years	11,481	5,561	3,118	3,681
More than five years	2,503	2,161	1,348	2,161
	18,509	10,063	5,900	7,197

Operating lease commitments are for the Group's office premises.

21. GROUP ENTITIES

Consolidation subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

Inter-company transactions and balances between group companies are eliminated on consolidation

Translation of foreign group entities The financial statements of each of the Group's subsidiaries are prepared in the functional currency of that entity. The functional currency is determined for each entity based on factors such as the principal trading currency. The assets and liabilities of these entities are translated at exchange rates existing at balance date. Revenue and expenses are translated at rates approximating the exchange rates ruling at the dates of the transactions. The exchange gain or loss arising on translation is recorded in other comprehensive income and accumulated in the foreign currency translation reserve in equity.

	Principal activity	Country of incorporation	Balance date	Interest 2014 (%)	Interest 2013 (%)
Xero (NZ) Limited	Limited risk distributor	New Zealand	31 March	100	100
Xero (UK) Limited	Limited risk distributor	United Kingdom	31 March	100	100
Xero Australia Pty Limited	Limited risk distributor	Australia	31 March	100	100
Xero, Inc.	Limited risk distributor	United States	31 March	100	100
Xero Trustee Limited	Trustee	New Zealand	31 March	100	100

On 1 April 2013 the Company's wholly owned subsidiaries Max Solutions Holdings Limited, Max Solutions Limited, Spotlight Workpapers Limited and My Workpapers Limited were amalgamated into Xero (NZ) Limited.

22. EVENTS AFTER THE BALANCE SHEET DATE

On 10 April 2014 Xero announced the appointment of Lee Hatton as a Director of Xero Limited.

There were no other significant events between balance date and the date these financial statements were authorised for issue.

DIRECTORS' RESPONSIBILITIES STATEMENT

The Financial Reporting Act 1993 requires the Directors to prepare financial statements for each financial year that give a true and fair view of the financial position of the Company and Group and of the financial performance and cash flows for that period.

In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy, at any time, the financial position of the Group and to enable them to ensure that the financial statements comply with the Companies Act 1993. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Board of Directors of the Company and Group authorised these financial statements for issue on 22 May 2014.

For and on behalf of the Board of Directors



Chris Liddell
Chairman
22 May 2014



Graham Shaw
Director
22 May 2014

CORPORATE GOVERNANCE

The Board recognises the importance of good corporate governance, particularly its role in delivering improved corporate performance and protecting the interests of all stakeholders.

The Board is responsible for establishing and implementing the Company's corporate governance frameworks, and is committed to fulfilling this role in accordance with best practice while observing applicable laws, the NZX Corporate Governance Best Practice Code (NZX Code), and the Corporate Governance Principles and Recommendations (2nd Edition) issued by the ASX Corporate Governance Council (ASX recommendations).

This section sets out the Company's commitment to good corporate governance and addresses the Company's compliance with the eight fundamental principles of the ASX recommendations. In doing so, the Company's compliance with the NZX Code is also addressed.

PRINCIPLE 1 – LAY SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT

Companies should establish and disclose the respective roles and responsibilities of the Board and management

The Board is the overall and final body responsible for all decision-making within the Company, having a core objective to effectively represent and promote the interests of shareholders with a view to adding long-term value to the Company.

The Board Charter describes the Board's role and responsibilities and regulates internal Board procedures; a copy of this document is available in the Investors section on the Company's website. The Board has the responsibility to work to enhance the value of the Company in the interests of the Company and the shareholders.

The Board directs, and supervises the management of, the business and affairs of the Company including, in particular:

- ensuring that the Company's goals are clearly established, and that strategies are in place for achieving them;
- ensuring that there is an ongoing review of performance against the Company's strategic objectives;
- approving transactions relating to acquisitions and divestments and capital expenditure above delegated authority limits;
- ensuring that there is an ongoing assessment of business risks and that there are appropriate control and accountability systems in place to manage them;
- establishing policies aimed at strengthening the performance of the Company, including ensuring that management is proactively seeking to build the business through innovation, initiative, technology, new products and the development of its business capital;
- monitoring the performance of management;
- appointing the Chief Executive, setting the terms of their employment and, where necessary, terminating their employment; and
- approving and monitoring the Company's financial and other reporting and ensuring the Company's financial statements represent a true and fair view.

Delegation To enhance efficiency, the Board has delegated some of its powers to Board Committees and other powers to the Chief Executive. The terms of the delegation by the Board to the Chief Executive are documented in the Board Charter and more clearly set out in the Company's Delegated Authority Framework. This framework also establishes the authority levels for decision-making within the Company's management team.

Performance management The Remuneration Committee evaluates the performance of the Chief Executive.

Formal procedures are in place to facilitate performance evaluations of the senior management team. These are facilitated by the General Manager, Human Resources, in liaison with the Chief Executive.

Evaluations of both the Chief Executive and the senior management team are based on set criteria, including the performance of the business, the accomplishment of long-term strategic objectives, and other non-quantitative objectives agreed at the beginning of each year. During the financial year, performance evaluations of the Chief Executive and senior management team were completed in accordance with the Company's established procedures.

PRINCIPLE 2 – STRUCTURE THE BOARD TO ADD VALUE

Companies should have a Board of an effective composition, size and commitment to adequately discharge its responsibilities and duties

Composition of the Board At 31 March 2014 the Board comprised seven Directors, as follows:

- Chris Liddell (Non-executive Chair)
- Rod Drury (Executive Director)
- Craig Elliott (Non-executive Director)
- Sam Morgan (Non-executive Director)
- Graham Shaw (Non-executive Director)
- Bill Veghte (Non-executive Director)
- Craig Winkler (Non-executive Director)

The Board has a broad range of IT, financial, sales, business and other skills and expertise necessary to meet its objectives.

On 12 February 2014 Sam Knowles resigned as Director and Chairman, Chris Liddell was appointed as non-executive Chairman, and Bill Veghte was appointed as a non-executive Director. On 10 April 2014, Lee Hatton was appointed as an additional non-executive Director.

Selection and role of Chairman The Chairman of the Board is elected by the non-executive Directors. The Board supports the separation of the role of Chairman (Chris Liddell) and Chief Executive (Rod Drury). The Chairman's role is to manage the Board effectively, to provide leadership to the Board, and to facilitate the Board's interface with the Chief Executive.

Chris Liddell was appointed as Chairman of the Board during the current financial year (replacing Sam Knowles upon his resignation as a Director) and has held the role of Chairman from 12 February 2014. The Board has determined that Chris Liddell is an Independent Director.

Director independence The Board Charter requires that a minimum of two Directors be “independent”.

The Board takes into account the guidance provided under the NZX Listing Rules, the ASX Listing Rules and the ASX Recommendations, in determining the independence of Directors.

The Board will review any determination it makes as to a Director’s independence on becoming aware of any information that may have an impact on the independence of the Director. For this purpose, Directors are required to ensure that they immediately advise the Board of any relevant new or changed relationships to enable the Board to consider and determine the materiality of the relationships.

The Board considers that Chris Liddell, Craig Elliott, Graham Shaw, Sam Morgan and Bill Veghte are Independent Directors. The Board has determined that Rod Drury is not an Independent Director because of his executive responsibilities and substantial shareholding, and that Craig Winkler is not an Independent Director because he is a substantial shareholder of the Company. The Board has determined that Lee Hatton is an Independent Director.

Conflicts of interest The Board Charter outlines the Board’s policy on conflicts of interest. Where conflicts of interest do exist, Directors excuse themselves from discussions and do not exercise their right to vote in respect of such matters.

Nomination and appointment The procedures for the appointment and removal of Directors are ultimately governed by the Company’s Constitution. The Board has established a Nominations Committee whose role is to identify and recommend to the Board individuals for nomination as members of the Board and its Committees, taking into account such factors as it deems appropriate, including experience, qualifications, judgement and the ability to work with other Directors.

Directors receive formal letters of appointment setting out the arrangements relating to their appointments.

Board Committees The Board operated three Committees during the year: the Audit and Risk Management Committee, the Remuneration Committee and the Nominations Committee. The Charters of each Committee are in the Investors section on the Company’s website. The membership of each Committee at 31 March 2014 was:

1. Audit and Risk Management Committee – Graham Shaw (Chair), Chris Liddell, Craig Winkler
2. Remuneration Committee – Sam Morgan (Chair), Graham Shaw, Craig Winkler
3. Nominations Committee – Chris Liddell (Chair), Sam Morgan, Craig Winkler

Retirement and re-election The Board acknowledges and observes the relevant Director rotation/retirement rules under the NZX Listing Rules and the ASX Listing Rules.

Director remuneration Directors’ fees are currently set at a maximum of \$500,000 for the non-executive Directors. The actual amount of fees paid in the past year was \$280,000.

Board access to information and advice The Company Secretary is responsible for supporting the effectiveness of the Board by ensuring that policies and procedures are followed and co-ordinating the completion and dispatch of the Board agendas and papers.

All Directors have access to the senior management team, including the Company Secretary, to discuss issues or obtain information on specific areas in relation to items to be considered at Board meetings or other areas as they consider appropriate. Further, Directors have unrestricted access to Group records and information.

The Board, the Board Committees and each Director have the right, subject to the approval of the Chairman, to seek independent professional advice at the Company’s expense to assist them to carry out their responsibilities. Further, the Board and Board Committees have the authority to secure the attendance at meetings of outsiders with relevant experience and expertise.

Director education All Directors are responsible for ensuring they remain current in understanding their duties as Directors.

Directors’ share ownership All Directors and employees are required to comply with the Company’s Securities Trading Policy and Guidelines in undertaking any trading in the Company’s shares. A copy of this Policy can be found in the Investors section on the Company’s website. The table of Directors’ shareholdings is included in the Disclosures section of this Annual Report.

Indemnities and insurance Deeds of Indemnity have been granted by the Company in favour of the Directors in relation to potential liabilities and costs they may incur for acts or omissions in their capacity as Directors.

The Directors’ and Officers’ Liability insurance covers risks normally covered by such policies arising out of acts or omissions of Directors and employees in their capacity as such.

Board meetings The Board met formally 12 times in the year ended 31 March 2014 and there were also separate meetings of the Board Committees. At each meeting the Board considers key financial and operational information as well as matters of strategic importance.

Executives regularly attend Board meetings and are also available to be contacted by Directors between meetings.

Directors who are not members of the Committees may attend the Committee meetings.

The Board has a formal review of its performance on an annual basis. This process incorporates gaining feedback via a third party to enhance the robustness of the process.

Feedback on relevant Board performance factors is provided by executive members to enhance the working relationship between the Board and management.

Company subsidiaries The Company has five wholly owned subsidiaries, consisting of a wholly owned operating subsidiary in each of the Company’s four core markets (being Australia, New Zealand, the United Kingdom, and North America) and a wholly owned subsidiary that acts as trustee in relation to the Company’s long-term incentive scheme available to employees. Board meetings were held for each of these subsidiaries during the year ended 31 March 2014, with material matters raised in these meetings reported to the Company’s Board, as appropriate.

PRINCIPLE 3 – PROMOTE ETHICAL AND RESPONSIBLE DECISION MAKING

Companies should actively promote ethical and responsible decision-making

The Board maintains high standards of ethical conduct and the Chief Executive is responsible for ensuring that high standards of conduct are maintained by all staff. The Board adopted a “Code of Conduct” during the year, a copy of which is available in the Investors section of the Company’s website.

The Board has approved a Diversity Policy, a copy of which is available in the Investors section on the Company’s website.

At 31 March 2014, the proportion of females employed by the Company (and its wholly owned subsidiaries) was as follows: 40% in all positions; 11% in senior executive positions; and 0% on the Board; the respective figures disclosed in the Company’s Annual Report for the year ended 31 March 2013 were 42%; 21%; and 0%. The Board appointed a female director on 10 April 2014, so the current proportion of females on the Board of Directors is 12.5%. These figures include permanent full-time, permanent part-time and fixed-term employees, but not independent contractors.

The Company recognises the importance of diversity in the workplace and its positive impact on the work environment and culture. In August 2013, the Board approved measurable objectives for achieving diversity in the workplace. These are set out below, along with the Company’s progress towards achieving them.

- a. Objective: Ensure that all recruitment campaigns generate a diverse pool of talent and that all hiring decisions are based on merit, taking into account the relevant skills, qualifications, and experience of all applicants and recognising the importance of diversity in the workforce.

Progress: The Company carries out the bulk of its recruiting efforts internally. The importance of diversity is reinforced to, and well understood by, the hiring managers and recruitment team, both through training and communication of the Company’s core values. A number of the Company’s recruitment campaigns are aimed at increasing diversity in the workplace, such as sponsorship of and attendance at “Geek Girl” dinners and TEDx – Women in Tech events, graduate recruitment campaigns, and publishing case studies that represent the Company’s diverse workforce.

- b. Objective: Ensure that appropriate internal policies supporting and promoting diversity have been adopted and are well communicated to all employees.

Progress: The Company has implemented appropriate parental leave and flexi-leave arrangements. The Company has adopted and communicated a Diversity Policy and a Code of Conduct, both of which support diversity in the workplace. Copies of the Diversity Policy and Code of Conduct are made available to all staff on the Company’s intranet, and are also available in the Investors section of the Company’s website.

- c. Objective: Ensure that no impediments exist that restrict the ability to maintain a diverse workforce.

Progress: The Company’s HR function actively ensures that there are no impediments that restrict the Company from maintaining a

diverse workforce. The Company provides management training to its current and potential leaders, which includes training on being a successful leader and fostering a healthy and inclusive work environment. The Company provides numerous forums to its employees (including in an annual anonymous employee survey) to enable and encourage its employees to raise any concerns that they may have in relation to their work environment.

- d. Objective: Continually review and monitor parity of working conditions and pay across the workforce.

Progress: The Company continually reviews the working conditions of all of its employees and reviews remuneration to ensure that it is merit-based and adequately reflects the responsibilities of the position. The Company conducts annual performance and salary reviews which provide visibility to management in relation to parity of working conditions and pay across its workforce. There are numerous ways in which employees can raise concerns about working conditions within the Company, and these are regularly communicated to staff.

- e. Objective: Reinforce internally and externally that Xero is an equal opportunity employer that does not discriminate on any of the prohibited grounds of discrimination, including gender; marital status; religious, ethical or political beliefs; race; disability; and age.

Progress: The composition of the Company’s workforce demonstrates that it is an equal opportunity employer that does not discriminate on any of the prohibited grounds of discrimination. As discussed above, the Company takes active steps to monitor and encourage diversity in the workforce.

PRINCIPLE 4 – SAFEGUARD INTEGRITY IN FINANCIAL REPORTING

Companies should have a structure to independently verify and safeguard the integrity of their financial reporting

The Board is committed to a transparent system for auditing and reporting of the Company’s financial performance. The Board has established an Audit and Risk Management Committee, which performs a central role in achieving this goal.

The Audit and Risk Management Committee’s principal functions are:

- to assist the Board in ensuring that appropriate accounting policies and internal controls are established and followed;
- to assist the Board in producing accurate financial statements in compliance with all applicable legal requirements and accounting standards; and
- to ensure the efficient and effective management of business risks.

One of the main purposes of the Audit and Risk Management Committee is to ensure the quality and independence of the audit process. The Chairman of the Audit and Risk Management Committee and Chief Financial Officer work with the external auditors to plan the audit approach. All aspects of the audit are reported back to the Audit and Risk Management Committee and the auditors are given the opportunity at Audit and Risk Management Committee meetings to meet with the Board.

The Audit and Risk Management Committee has adopted a formal Charter, a copy of which is available in the Investors section on the Company’s website.

PRINCIPLE 5 – MAKE TIMELY AND BALANCED DISCLOSURE

Companies should promote timely and balanced disclosure of all material matters concerning the company

The Board has adopted a Market Disclosure and Communications Policy, a copy of which is available in the Investors section on the Company's website. The Policy has been communicated internally to ensure that it is strictly adhered to by the Board and the Company's employees.

The Company has been listed on the NZX Main Board since 5 June 2007 and listed on the ASX since 8 November 2012 and has at all times complied with its continuous disclosure obligations under the NZX Listing Rules, the Securities Markets Act 1988 (NZ), and the ASX Listing Rules.

PRINCIPLE 6 – RESPECT THE RIGHTS OF SHAREHOLDERS

Companies should respect the rights of shareholders and facilitate the effective exercise of those rights

During the time that the Company has been listed on the NZX and the ASX, it has built a reputation of openness and has encouraged a high level of communication with shareholders and the market generally. It does this through numerous forms of communication including formal communication, social media, blogs, press releases and road-shows.

The Board encourages active participation by shareholders at the Annual Meeting of the Company, and allows shareholders to submit questions to the Board prior to, or at the Annual Meeting, to be answered by the Board at the Annual Meeting.

PRINCIPLE 7 – RECOGNISE AND MANAGE RISK

Companies should establish a sound system of risk oversight and management and internal control

The Board has an Audit and Risk Management Committee that reports to the Board regularly – please see "Principle 4" above for further detail in relation to the Audit and Risk Management Committee.

The Company's senior management maintain a Risk Register, which is reviewed at each Board meeting.

As a New Zealand company, section 295A of the Australian Corporations Act is not applicable to the Company. However, the Company's Chief Executive and Chief Financial Officer provide equivalent assurances to the Board as part of the annual external audit process.

PRINCIPLE 8 – REMUNERATE FAIRLY AND RESPONSIBLY

Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear

The Board has a Remuneration Committee whose principal function is to oversee the remuneration strategies and policies of the Company.

The Company distinguishes the structure of non-executive Directors' remuneration from that of executive Directors.

The Remuneration Committee is governed by a formal charter, a copy of which is available in the Investors section on the Company's website.

DISCLOSURES

USE OF CASH AND CASH EQUIVALENTS

In accordance with ASX Listing Rule 4.10.19, the Board has determined that the Company has used the cash and cash equivalents that it had at 1 April 2013 in a way consistent with its business objectives for the year ended 31 March 2014.

ENTRIES RECORDED IN THE INTERESTS REGISTER

The Company maintains an Interests Register in accordance with the Companies Act 1993 and the Securities Markets Act 1988. The following are particulars of entries made in the Interests Register for the period 1 April 2013 to 31 March 2014.

Directors' interests Directors disclosed interests, or cessations of interest, in the following entities pursuant to section 140 of the Companies Act 1993 during the year ended 31 March 2014.

Director/Entity	Relationship
Sam Morgan Vend Limited – Xero add-on partner	Minority indirect shareholder
Sam Morgan Visfleet Limited (vWork App) – Xero add-on partner	Director and controlling shareholder
Graham Shaw Spotlight Reporting – Xero add-on partner	Advisor
Bill Veghte Hewlett-Packard	Executive Vice President and General Manager, Enterprise Group; and minority shareholder
Bill Veghte, Chris Liddell Microsoft Corporation	Minority shareholder
Craig Winkler Vend Limited, Practice Ignition – Xero add-on partners	Minority indirect shareholder

Share dealings of Directors Directors disclosed, pursuant to section 148 of the Companies Act 1993, the following acquisitions and disposals of relevant interests in Xero shares during the year ended 31 March 2014.

Shares	Date of acquisition/ disposal	Consideration per share	Number of shares acquired/ (disposed)
Sam Knowles*	29 May 2013	\$13.04	(100,000)
Sam Knowles*	22 November 2013	\$35.45	(205,555)
Sam Knowles*	24 February 2014	\$40.00	(50,000)

*Sam Knowles resigned as a Director and Chairman on 12 February 2014.

Share options	Date of grant	Exercise price	Number of options granted
Chris Liddell*	12 February 2014	\$38.24	78,481
Bill Veghte**	12 February 2014	\$38.24	62,785

*65,000 of the options held by Chris Liddell were granted in connection with his role as US Advisor, and 13,481 of the options were for his role as Director.

**52,000 of the options held by Bill Veghte were granted in connection with his role as US Advisor, and 10,785 of the options were for his role as Director.

Shareholdings of Directors at 31 March 2014

	2014 Number of shares	2014 Number of options	2013 Number of shares	2013 Number of options
Rod Drury	21,719,779	-	21,719,779	-
Craig Elliott*	-	100,000	-	100,000
Sam Morgan	5,122,609	-	5,122,609	-
Graham Shaw	1,336,010	-	1,336,010	-
Craig Winkler (two holdings)	18,475,990	-	18,475,990	-
Chris Liddell**	-	78,481	-	-
Bill Veghte**	-	62,785	-	-

*33,333 of the options granted to Craig Elliott had vested by 31 March 2014 and were exercisable.

**None of the options granted to Chris Liddell and Bill Veghte had vested at 31 March 2014.

Remuneration of Directors Details of the total remuneration of, and the value of other benefits received by, each Director of Xero during the financial year ended 31 March 2014 are as follows:

	2014 Fees (\$000s)	2014 Remuneration (\$000s)	2013 Fees (\$000s)	2013 Remuneration (\$000s)
Rod Drury*	-	395	-	355
Craig Elliott	40	-	20	-
Sam Knowles**	69	-	80	-
Sam Morgan	40	-	40	-
Graham Shaw	50	-	50	-
Craig Winkler	40	-	40	-
Chris Liddell	23	-	-	-
Bill Veghte	18	-	-	-
Phil Norman***	-	-	13	-
	280	395	243	355

*Rod Drury is an executive Director and receives remuneration from Xero in the form of a salary and short-term incentives. He does not participate in the Xero Employee Restricted Share Plan.

**Sam Knowles ceased to be a Director on 12 February 2014.

*** Phil Norman ceased to be a Director on 26 July 2012.

Employee remuneration The following table shows the number of employees (including employees holding office as Directors of subsidiaries) whose remuneration and benefits for the year ended 31 March 2014 were within the specified bands above \$100,000. The remuneration figures shown in the table include all monetary payments actually paid during the course of the year ended 31 March 2014. They also include bonuses paid in respect of the Group's Employee Restricted Share Plan. The table does not include amounts paid post 31 March 2014 that related to the year ended 31 March 2014, such as the short-term incentive scheme bonus. The table below includes the remuneration of Rod Drury. No Director of a subsidiary receives or retains any remuneration or other benefits from Xero for acting as such.

	2014 Number of employees	2014 Number of employees acting as Directors of subsidiaries	2013 Number of employees	2013 Number of employees acting as Directors of subsidiaries
100,000 to 109,999	37	-	17	-
110,000 to 119,999	33	-	10	-
120,000 to 129,999	30	-	13	-
130,000 to 139,999	21	-	6	-
140,000 to 149,999	14	-	8	-
150,000 to 159,999	8	-	5	-
160,000 to 169,999	9	-	3	-
170,000 to 179,999	13	-	2	-
180,000 to 189,999	2	-	4	-
190,000 to 199,999	1	-	2	-
200,000 to 209,999	1	-	-	-
210,000 to 219,999	1	-	3	-
220,000 to 229,999	4	-	-	-
230,000 to 239,999	2	-	1	-
240,000 to 249,999	3	-	2	-
250,000 to 259,999	3	-	1	-
270,000 to 279,999	-	-	1	-
280,000 to 289,999	3	-	-	-
300,000 to 309,999	1	-	1	-
310,000 to 319,999	-	-	1	-
320,000 to 329,999	1	-	-	-
340,000 to 349,999	1	-	1	-
350,000 to 359,999	-	-	2	2
360,000 to 369,999	-	-	1	-
390,000 to 399,999	1	1	-	-
400,000 to 409,999	1	1	-	-
420,000 to 429,999	-	-	1	1
430,000 to 439,999	1	-	1	-
450,000 to 459,999	-	-	1	-
460,000 to 469,999	1	-	-	-
500,000 to 509,999	1	1	-	-
560,000 to 569,999	1	-	-	-
	194	3	87	3

Analysis of shareholding at 8 May 2014

	Number of holders	Number of shares	% of issued capital
1 to 1,000	8,382	2,357,899	1.85
1,001 to 5,000	1,516	3,529,688	2.77
5,001 to 10,000	365	2,658,689	2.08
10,001 to 100,000	343	7,991,478	6.26
100,001 and over	56	111,072,558	87.04
Total	10,662	127,610,312	100.00

Twenty largest shareholders at 8 May 2014

Shareholder rank and name	Holding	% of total shares on issue
1. New Zealand Central Securities Depository Limited	33,940,183	26.60
2. Anna Margaret Clare Drury and Kenneth Drury (Rod Drury)	21,719,779	17.02
3. Givia Pty Limited (Craig Winkler)	18,454,545	14.46
4. Jasmine Investment Holdings Limited (Sam Morgan)	5,122,609	4.01
5. Valar Ventures LP (Peter Thiel)	4,135,870	3.24
6. Hamish Edwards and Tineke Edwards and Andrew Finch	4,088,192	3.20
7. VV Xero Holdings LLC (Peter Thiel)	4,062,068	3.18
8. Nicola Wilson and David Wilson and Christopher Ritchie	1,664,984	1.30
9. Credit Suisse Securities (Europe) Limited	1,652,893	1.30
10. Citicorp Nominees Pty Limited	1,540,359	1.21
11. Graham Shaw and Delwyn Shaw	1,336,010	1.05
12. Nelson Nien Sheng Wang and Pei-Chun Ko	1,083,588	0.85
13. Anna Grigg and Alastair Grigg and Claymore Trustees Limited	951,776	0.75
14. W5 Limited	744,800	0.58
15. Craig Walker and Catherine Walker	663,898	0.52
16. JBWERE (NZ) Nominees Limited	545,008	0.43
17. Blackrock International Opportunities Portfolio	540,000	0.42
18. Bank Of New Zealand	500,000	0.39
19. Fletcher Brown and Karen Oakley-Harness	464,000	0.36
20. Deutsche Securities New Zealand Limited	434,500	0.34

Substantial Security Holders According to notices given under the Securities Markets Act 1988, the following persons were Substantial Security Holders in Xero Limited at 8 May 2014 in respect of the number of voting securities set opposite their names:

1. Anna Drury and Kenneth Drury (Rod Drury)	21,719,779
2. Givia Pty Limited (Craig Winkler)	18,454,545
3. Matrix Capital Management Company, LLC and Matrix Capital Management Master Fund, LP*	12,481,670
4. Peter Thiel	8,528,516

*On 30 November 2012, Matrix Capital Management Company, LLC and Matrix Capital Management Master Fund, LP filed a Substantial Security Holder Notice disclosing a total interest of 11,489,934 ordinary shares in the Company. On 16 October 2013, the Company issued a further 991,736 ordinary shares to parties named in the Substantial Security Holder Notice dated 30 November 2012.

The total number of issued voting shares of Xero Limited at 8 May 2014 was 127,610,312 (126,601,000 after excluding treasury stock).

Where voting at a meeting of the shareholders is by voice or a show of hands, every shareholder present in person, or by representative has one vote, and on a poll, every shareholder present in person or by representative has one vote for each fully paid ordinary share in the Company.

At 8 May 2014 there were 308 shareholders holding less than a marketable parcel of shares.

Restricted securities The following shares are restricted securities or securities subject to voluntary escrow under ASX listing rule 4.10.14.

All 9,917,358 shares issued by the Company in October 2013 in connection with a capital raise by the Company are subject to certain restrictions on sale until 16 October 2014.

202,043 shares in the Company that were issued in connection with the acquisition of the PayCycle assets in 2011 are restricted securities until 1 August 2014, to become unrestricted securities on that date subject to continued employment of the founders of PayCycle within the Group.

420,610 shares in the Company that were issued in connection with the acquisition of Max Solutions Holdings Limited in 2012 are restricted securities until 31 January 2015, to become unrestricted securities on that date subject to continued employment of the founders of Max Solutions Holdings Limited within the Group.

386,556 shares are held on a restricted basis in connection with Xero's Employee Restricted Share Plan.

Options There were 93 individuals, holding a total of 924,541 options at 8 May 2014.

Waivers Xero Limited had no NZX waivers granted or published by NZX within or relied upon in the 12 months ending 31 March 2014. Xero Limited has been granted waivers from the ASX which are standard for a New Zealand company listed on the ASX including confirmation that ASX will accept financial statements denominated in New Zealand dollars and prepared and audited in accordance with New Zealand Generally Accepted Accounting Principles and Auditing Standards.

Subsidiary company Directors The following people held office as Directors of subsidiary companies at 31 March 2014:

Xero (UK) Limited – Rod Drury, Gary Turner

Xero Australia Pty Limited – Rod Drury, Chris Ridd

Xero (NZ) Limited – Rod Drury, Graham Shaw

Xero, Inc. – Rod Drury

Xero Trustee Limited – Rod Drury, Graham Shaw

Victoria Crone replaced Graham Shaw as a Director of Xero (NZ) Limited on 10 April 2014.

Peter Karpas was added as a Director of Xero, Inc. on 10 April 2014.

Annual Meeting Xero's Annual Meeting of shareholders will be held in Wellington on Wednesday 23 July 2014 at 4pm. A notice of Annual Meeting and Proxy Form will be circulated to shareholders in June 2014.

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AUSTRALIAN REGISTERED
BODY NUMBER (ARBN):
160 661 183

DIRECTORS:

CHRIS LIDDELL
CHAIRMAN
ROD DRURY
CRAIG ELLIOTT
LEE HATTON
SAM MORGAN
GRAHAM SHAW
BILL VEGHTE
CRAIG WINKLER

MANAGEMENT:

ROD DRURY
CHIEF EXECUTIVE, CO-FOUNDER
ROSS JENKINS
CHIEF FINANCIAL OFFICER
DUNCAN RITCHIE
CHIEF PLATFORM OFFICER
STUART MCLEAN
CHIEF REVENUE OFFICER
PETER KARPAS
CEO NORTH AMERICA
CHRIS RIDD
MANAGING DIRECTOR
AUSTRALIA
VICTORIA CRONE
MANAGING DIRECTOR
NEW ZEALAND
GARY TURNER
MANAGING DIRECTOR
UNITED KINGDOM

COMPANY SECRETARY:

MATT VAUGHAN

AUDITOR:

PRICEWATERHOUSECOOPERS

LEGAL ADVISOR:

BELL GULLY

BANKERS:

ASB BANK LIMITED
BANK OF NEW ZEALAND LIMITED
HSBC LIMITED
NATIONAL AUSTRALIA BANK LIMITED
SILICON VALLEY BANK

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