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Cochlear®

Financial Report

Cochlear Limited ACN 002 618 073 and its controlled entities for the year ended 30 June 2013

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Directors' Report Cochlear Limited for the year ended 30 June 2013

The directors present their report, together with the Consolidated Financial Report of the Consolidated Entity (Cochlear), being Cochlear Limited (the Company) and its controlled entities, for the year ended 30 June 2013, and the Auditor's Report thereon.

Directors

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

Information on the directors is presented in the Annual Report. This information includes the qualifications, experience and special responsibilities of each director. It also gives details of the directors' other directorships. Information on the Company Secretary including his qualifications and experience is presented in the Annual Report.

Directors' meetings

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

	Board of directors		Audit Committee		Medical Science Committee		Nomination Committee		Human Resources Committee		Technology and Innovation Committee	
	Held	Attended	Held	Attended	Held	Attended	Held	Attended	Held	Attended	Held	Attended
Mr R Holliday-Smith	12	12	5	5	-	-	4	4	6	6	3	3
Mrs YA Allen	12	12	5	5	-	-	4	4	2	2	3	3
Mr PR Bell	12	12	-	-	-	-	4	4	6	6	3	3
Prof E Byrne, AO	12	12	-	-	4	4	4	4	-	-	3	2
Mr A Denver	12	12	5	5	4	4	4	4	6	6	3	3
Mr DP O'Dwyer	12	12	5	5	4	4	4	4	6	6	3	3
Dr CG Roberts	12	12	-	-	4	4	-	-	-	-	3	3

Principal activities and review of operations and results

Operations

Business model

Cochlear's mission is:

"We help people hear and be heard. We empower people to connect with others and live a full life. We transform the way people understand and treat hearing loss. We innovate and bring to market a range of implantable hearing solutions that deliver a lifetime of hearing outcomes."

Cochlear's strategy is focused on customer experience, operational excellence, product innovation, people engagement and value creation.

Cochlear's product innovation strategy is to create and bring to market a segmented portfolio of innovative and quality products. Cochlear offers a range of advanced solutions to address different types of hearing loss such as:

- cochlear implants, designed to help those people with moderate to profound sensorineural hearing loss; and
- bone conduction implants, designed to help those people with conductive hearing loss, mixed hearing loss or single-sided deafness.

Cochlear's implant systems comprise an implant which is inserted during surgery and an external sound processor. This external sound processor can be upgraded with new technology as it becomes available.

For the financial year ended 30 June 2013 (F13), 89% of Cochlear's sales revenue was from cochlear implant (Nucleus) products and 11% from bone conduction (Baha) products. This proportion of sales is consistent with that for the prior year.

The barriers to increasing the penetration of the candidate base include:

- awareness of implantable solutions as a viable option;
- patient motivation;
- lack of clear referral paths;
- affordability and funding availability; and
- clinic capacity.

Directors' Report Cochlear Limited for the year ended 30 June 2013

Cochlear operates in a complex industry. Each country has differing penetration rates and reasons for that level of penetration owing to differing cultural and economic situations.

Cochlear estimates that more than a quarter of a million people have been implanted with one of its implants. Cochlear's business model includes supporting these customers with innovative and compatible products, through the sale of sound processor upgrades and accessories and ongoing product support.

Cochlear aims to remain the market leader in implantable hearing solutions. There is no published market share data so Cochlear uses various data points to internally estimate market share. Cochlear estimates it has a market leading share of implantable hearing solutions, including approximately 65% share of cochlear implants.

Cochlear's global headquarters is based on the Macquarie University campus in Sydney, Australia. At this location are the corporate offices, manufacturing, research and development as well as the Asia Pacific regional headquarters.

Cochlear manages its sales and distribution through three regions, each comprising a main regional head office plus regional offices:

- Americas, which includes the United States of America (USA), Canada and Latin America;
- EMEA, which includes Europe, the Middle East and Africa; and
- Asia Pacific, which includes Australasia and Asia.

Cochlear has a deep geographical reach, selling in over 100 countries. Cochlear has a direct presence in approximately 20 countries and uses distributors and agents in the balance.

Manufacturing for the cochlear implant product range continues to be based in Australia, at three sites: Lane Cove and Macquarie University, both in Sydney, and Brisbane. Lane Cove will continue to manufacture Cochlear's legacy products. New implant ranges will be manufactured at Cochlear's Macquarie University headquarters. The Brisbane site is responsible for manufacturing the non-implant components.

The bone conduction implant product range continues to be manufactured in Sweden.

Cochlear's supply chain operates with product being distributed from its manufacturing sites in Australia and Sweden to its regional distribution centres in the USA, the United Kingdom and Panama. The product is then further distributed to the end customer.

The proportion of Cochlear's sales to end customers by region is approximately: Americas 40%, EMEA 40% and Asia Pacific 20%.

Foreign exchange has a significant impact on Cochlear's consolidated results. Cochlear has a partial natural hedge with over 90% of sales in foreign currency and over 50% of costs in foreign currency. To help manage the portion not covered by the natural hedge, foreign exchange contracts on foreign currency cash flows back to Australia are taken out. These contracts cover a three year period at a declining level of cover. The Australian dollar (AUD) strengthened again during the year against the Japanese yen (JPY) and Euro (EUR) and weakened slightly against the United States dollar (USD). These are hedged currencies.

Future foreign exchange contracts are detailed in Note 27 to the financial statements.

Operating result F13

Revenue

Sales of cochlear implant units were up 16% to 26,674.

Sales revenue was up 1% from that for last year to $715.0 million. In constant currency terms (ie restating F12 at F13 foreign exchange rates), sales revenue was up 3%.

The sales to existing cochlear implant recipients or "customer base" sales are included in the sales numbers for cochlear implants. Revenue from sound processor upgrades, that is sales of new sound processors to existing recipients, can be cyclical. F13 sound processor upgrade sales were down $23.6 million from those for the prior year. Sound processor upgrade sales, particularly in the second half of the year, were negatively impacted by customers holding back purchases ahead of the release of new products.

Sales of bone anchored solutions of $78.6 million were up 1% from those for last year and up 2% in constant currency terms.

Foreign currency contracts applied against foreign cash inflows resulted in a gain of $37.7 million this year (2012: gain of $74.4 million). This was in line with movement in foreign currency rates according to Cochlear's hedging policy. Over the past few years, the AUD has appreciated and Cochlear's favourable rate contracts have been rolling off and replaced with contracts at higher rates applicable at the time they were taken out.

Regional sales

- Americas sales revenue of $284.4 million declined 4% (down 5% in constant currency). In the USA, the market softened as sales were negatively impacted by the expectation of new product releases. Sound processor upgrade revenue was down $17.0 million as customers held off purchases ahead of the release of Cochlear's Nucleus 6 sound processor.

  In the last quarter of F13, the USA business introduced a Future Technology Exchange Program (FTEP) where new implant recipients could exchange their sound processors for new technology at no additional cost once the new technology is approved for sale. Revenue on cochlear implant system sales of $4.6 million was deferred under the FTEP and will be recognised when the new sound processor is delivered to customers.

- EMEA sales revenue of $283.0 million decreased 1% (increased 3% in constant currency). EMEA revenue growth continues to reflect the portfolio of geographies in the region, with varying growth rates in different countries.

  In the last quarter of F13, the EMEA business introduced an FTEP in selected countries. Revenue on cochlear implant system sales of $1.8 million was deferred under the FTEP and will be recognised when the Nucleus 6 sound processor is delivered to customers.

- Asia Pacific sales revenue of $147.6 million increased 20% (increased 24% in constant currency). A Central Government tender sale into China of approximately 2,800 units was supplied in F13. Approximately 1,800 units were delivered in the first half of F13 and the balance in the second half. Cochlear did not recognise any Central Government of China tender sales in the prior year.

  Australia continued its double digit cochlear implant unit sales growth. This demonstrates that there continues to be solid growth prospects for the other regions. For example, sales in Canada are less than those in Australia, but the Canadian population is one and a half times the size of that of Australia. There are no statistically different demographics applicable to hearing impairment in the two countries.

Product sales

As well as a portfolio of geographies, there is also a portfolio of products impacting Cochlear's revenue:

- cochlear implant sales revenue increased 2% (increased 3% in constant currency) to $636.4 million. Sound processor upgrade sales fell $23.6 million as customers held off upgrading their sound processor ahead of the release of new technology. The cochlear implant offering covers a portfolio of electrodes including the Nucleus CI422 with Slim Straight electrode which was launched last year and has been well received by the market;
- bone conduction implant sales revenue grew 1% (increased 2% in constant currency) to $78.6 million. There have been a number of new entrants in the bone conduction implant industry over the last three years and Cochlear has lost market share over that time. Cochlear introduced its Baha DermaLock Abutment for soft tissue preservation during F13; and
- the acoustics implant solutions business made its first sales during the second half of F13. This business has expanded Cochlear's product portfolio through the acquisition of Otologics LLC technology in F13. The Codacs product range is awaiting European regulatory approval. Cochlear believes this segment remains an important part of its product offering and will further broaden the indications for new candidates.

Profit

Cochlear's cost of goods sold to sales revenue of 29.1% is marginally above that for last year of 28.9%. Over the last five years, Cochlear's cost of goods sold to sales revenue percentage has been maintained despite the appreciation of the AUD. This has been achieved through productivity improvements.

The CI500 series implant was voluntarily recalled in September 2011. Recall costs of $138.8 million were recognised in the prior year as a charge to cost of sales ($101.3 million after tax). There were no additional costs provisioned for the product recall in F13.

Selling, general and administration expenses were down 1% as a result of a disciplined approach to expenditure. Due to lower than budgeted sales this year, short-term and long-term employee incentive costs were below 100% achievement. Cochlear upgraded its Oracle enterprise resource planning (ERP) system to Release 12 during the year. This project and various process improvements cost approximately $14 million and are being depreciated over seven years commencing in the last quarter of F13.

R&D expenses of $124.7 million increased 5%, reflecting the deliberate strategy to maintain momentum in the future development work of R&D. Cochlear acquired the assets of Otologics LLC during the first half of F13, augmenting the further development of the acoustic product range.

During F13, there was a net loss of $2.5 million (2012: loss of $0.3 million) on the translation of foreign assets. This is reported through Note 5 to the financial statements.

The earnings before interest and tax (EBIT) of $178.9 million for F13 was $36.4 million lower than that for the prior year (excluding the product recall costs). EBIT to total revenue of 23.8% was below that for last year of 27.6%.

Net interest expense increased $1.9 million to $6.2 million due to higher borrowings. Interest cover was 29 times (2012: 18 times).

The effective tax rate of 23.2% increased by 1.9 percentage points. Excluding the impact of the product recall in F12, last year's tax rate was 25.1%, making this year's rate down 1.9 percentage points.

NPAT increased 133% to $132.6 million. Excluding the product recall cost in F12, NPAT decreased 16%.

Overall, NPAT was negatively impacted by $46.0 million due to both translation and transaction movements in foreign exchange rates during the year.

Financial position

Inventories of $131.6 million were up 30% (2012: $101.3 million). Inventory days increased to 231 days (2012: 182 days). This reflects a planned build-up of inventories back to target levels following last financial year's recall, a build of inventories ahead of new product launches (particularly Nucleus 6), acquisition of inventories from Otologics LLC, and build of acoustics inventories.

Trade receivables of $187.6 million were up 30% (2012: $144.7 million). In constant currency, trade receivables were up 21%. Debtor days increased to 80 days (2012: 73 days). Debtor days increased in the Americas and EMEA as a higher proportion of sales came from emerging markets which have longer credit terms. A further provision of $0.6 million was made in F13, bringing the total provision to $3.6 million. In Asia Pacific, the debtor days also increased due to the tender sale into China which is on extended credit terms. There is approximately $15 million still owing on this China tender sale at 30 June 2013 which is anticipated to be collected in F14.

Trade payables and accruals decreased by $17.8 million mainly due to the payment for assets from Otologics LLC of $10 million. This amount was recognised as a liability at 30 June 2012. The product recall provision was reduced by $16.4 million to $36.6 million at 30 June 2013.

Intangible assets of $235.8 million (2012: $206.7 million) are a significant proportion of Cochlear's total assets. Some $171.0 million of this total relates to goodwill arising from the earlier acquisitions of businesses, principally the Entific business in 2005. All intangible assets are tested for impairment on an annual basis. There were no impairments or write-downs of intangible assets in F13.

The final dividend of $1.27 per share brought the full year dividend to $2.52 per share, up 3%. This reflects the Board's continued confidence in Cochlear's long-term sustainable growth. The dividend payout ratio is above Cochlear's historic payout ratios. The plan is over time to return the payout ratio to historic levels as profits grow.

Net debt was $117.8 million at 30 June 2013 (2012: net cash of $2.9 million). The increase in debt was driven by:

- an increase in working capital as discussed above;
- acquisition of assets from Otologics LLC of $13.6 million;
- expenditure on development of the ERP system of $14.4 million; and
- payment of dividends of $142.5 million.

At year end, debt facilities of $300 million were in place with terms of three and five years. At 30 June 2013, the unused portion of the facility was $128.7 million. All bank covenants were met at year end.

Outlook

There continue to be more people in the world diagnosed with hearing loss who could benefit from Cochlear's products than are treated each year. There remains a significant, unmet and addressable clinical need which will continue to underpin long-term sustainable growth.

The clinical and business environments in which Cochlear operates are dynamic and evolving. Cochlear is committed to identifying and supporting the clinical trends as they will shape its future operating environment. A good example of this is the ongoing trend for bilateral implantation.

F14 will continue to see the introduction of new products across Cochlear's product range. Several are in the process of obtaining regulatory approval. Cochlear believes these new products will continue to underpin demand and sales growth for the business.

A key product launch in F14 is the next generation sound processor, Nucleus 6. Nucleus 6 is the first of a range of products to be released based on a new custom chipset that has been in development for over six years and contains significant new functionality improving hearing performance and ease of use for cochlear implant recipients of all ages. Nucleus 6 includes the industry's only auditory scene classifier, which analyses the sound environment and automatically applies the best sound processing technology. In addition, it contains direct wireless connectivity, integrated hearing aid functionality and the smallest and most water resistant behind the ear sound processor on the market.

Cochlear received regulatory approval for the Nucleus 6 in Europe and limited approval in the USA in August 2013. The Nucleus 6 has now been launched in Europe and will be launched in the USA in the first half of F14.

Cochlear is also introducing new bone conduction products in F14 and is expanding the available indications with its first successful clinical trial of Baha Attract.

First sales of the Carina Met product, part of the acoustic implant product range, were made at the end of F13. Cochlear anticipates sales of the acoustic implant product range to slowly build up over the coming years. In the short term, they will remain an immaterial proportion of Cochlear's business.

Cochlear continues to experience the portfolio effect across the range of countries it sells into. Some countries experience strong growth, some remain flat and some experience a slowdown. Overall, the trend is for long-term sustainable growth.

Several of the emerging markets are heavily biased to tender sales, including the Central Government of China's tenders. Cochlear reviews these tenders carefully and participates at a level that makes commercial sense.

Cochlear remains committed to funding market growth initiatives. These include candidate identification and support; reimbursement and government policy aimed at enhancing cochlear implantation; referral path initiatives; and geographic expansion.

At 30 June 2013, Cochlear had foreign currency equivalent of $437.6 million in foreign exchange contracts. In F14, the average exchange rate for the USD contracts is 0.97 and the average for EUR contracts is 0.72. At rates applicable on 30 June 2013, a net loss on foreign exchange contracts in F14 is forecast.

Business risks

Cochlear's principal business risks are outlined below. These are significant risks that may adversely affect Cochlear's business strategy, financial position or future performance. It is not possible to identify every risk that could affect Cochlear's business, and the actions taken to mitigate the risks described below cannot provide absolute assurance that a risk will not materialise.

- *Product innovation and competition*

  Cochlear is exposed to the risk of failing to develop and produce the most innovative products for customers. Increased competition exposes Cochlear to the risk of losing market share as well as a decrease in average selling prices in the industry. Cochlear is also exposed to the risk of technological advancement by third parties where alternative products are developed and sold that render Cochlear's products obsolete. This could result in a loss of sales.

  In F13, Cochlear invested over 16% of revenue in R&D. Cochlear also works with over 100 external research partners. The creation of new intellectual property and the protection of new and existing intellectual property are a key focus for Cochlear. Cochlear currently has patents over a range of features of its technologies.

- *Patent litigation*

  Cochlear operates in an industry that has substantial intellectual property and patents protecting that intellectual property. Cochlear is exposed to the risk that it will be litigated against for claims of patent infringement. This could result in Cochlear paying royalties to be able to continue to manufacture product, or injunctions preventing Cochlear selling products it had developed.

- *Misappropriation of know-how and intellectual property*

  Cochlear is exposed to the risk of its know-how and intellectual property being misappropriated either through hacking of its systems or by employees, consultants and others who from time-to-time have access to Cochlear's know-how and intellectual property. This could result in competitors using this information and increasing their competitiveness. Cochlear could lose market share as a result of this.

  Cochlear monitors its systems and has confidentiality agreements in place with employees and third parties that are exposed to its know-how and intellectual property.

- *Regulation*

  Cochlear operates in a highly regulated industry. Medical devices are subject to strict regulations of regulatory bodies in the USA, Europe, Asia and Australia as well as many other local bodies in countries where Cochlear's products are sold. If Cochlear or a third party supplier fails to satisfy regulatory requirements or the regulations change and amendments are not made, this could result in the imposition of sanctions. Delays in achieving regulatory approval can impact Cochlear's ability to sell its latest technology. These risks could result in the loss of sales and reputational harm.

  Cochlear has a worldwide quality assurance system in place.

- *Reimbursement*

  The majority of Cochlear's customers rely on a level of reimbursement from insurers and government health authorities to fund their purchases. There is increasing pressure on healthcare budgets globally. Cochlear is also subject to healthcare related taxes imposed by government agencies and this could negatively impact the ability of candidates to access Cochlear's products (eg the Medical Device Excise Tax in the USA).

  Cochlear continues to work with reimbursement and government agencies throughout the world to emphasise the benefits and cost effectiveness of the intervention.

- *Product liability*

  The manufacturing, testing, marketing and sale of Cochlear's products involve product liability risk. As the developer, manufacturer, marketer and distributor of certain products, Cochlear may be held liable for damages arising from use of its products during development or after the product has been approved for sale.

  Cochlear maintains product liability insurance and operates a worldwide quality assurance system related to the design, testing and manufacture of its products. In September 2011, Cochlear initiated a worldwide voluntary recall of its unimplanted Nucleus CI500 cochlear implant range. Management's best estimate of the probable costs related to the recall was expensed and provided for in F12 as disclosed in Note 29 to the financial statements.

- *Interruption to product supply*

  Cochlear relies on third-party companies for the supply of key materials and services. This carries the risk of delays and disruptions in supplies. Certain materials are available from a single source only and regulatory requirements make substitution costly, time-consuming or commercially unviable. Lifetime and strategic purchases of certain items are made.

Cochlear manufactures its cochlear implant products in Sydney, with the latest generation products to be manufactured at Cochlear's Macquarie University headquarters and legacy products in Lane Cove. Cochlear manufactures its bone conduction implant products in Sweden. There is the potential risk of disruption to sales should a manufacturing facility be unable to operate. Any new manufacturing facility will require regulatory approval prior to being able to produce and sell product from it. This approval could take many months.

Cochlear monitors its suppliers and identifies second source supply where possible. Inventories are managed and purchased in sufficient quantities for continued product supply in the short term. Cochlear also regularly reviews its disaster recovery plans for its manufacturing sites.

- *Foreign exchange rates*

  Cochlear is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of the legal entities. The currencies in which these transactions primarily are denominated are AUD, USD, EUR, JPY, Sterling (GBP), Swedish kroner (SEK) and Swiss francs (CHF). Over 90% of Cochlear's revenues and over 50% of costs are denominated in currencies other than AUD.

  Currency risk is hedged in accordance with the treasury risk policy. The treasury risk policy aims to manage the impact of short-term fluctuations on Cochlear's earnings. Over the longer term, permanent changes in market rates will have an impact on earnings. Derivative financial instruments (forward exchange contracts) are used to hedge exposure to fluctuations in foreign exchange rates in a declining ratio of coverage out to three years.

- *Credit*

  Cochlear's exposure to credit risk is influenced mainly by the geographical location and characteristics of individual customers. Cochlear does not have a significant concentration of credit risk with a single customer. The majority of debtors are government supported clinics or major hospital chains.

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

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

  In addition, absolute country limits are in place and Chief Financial Officer approval is required to increase a limit. These limits are periodically reviewed by the Audit Committee.

- *Interest rates*

  Cochlear is exposed to interest rate risks in Australia.

  Interest rate risk is hedged on a case-by-case basis by assessing the term of borrowings and the purpose for which the funds are obtained. Hedging against interest rate risk is achieved by entering into interest rate swaps. At 30 June 2013, no hedging had been entered into.

Note: The following non-IFRS financial measures are included in this document:
• excluding recall costs; and
• constant currency.
Refer to page 117 for a discussion of these items.

Consolidated results

The consolidated results for the financial year are:

	2013 $000	2012 $000
Revenue	752,721	778,996
Profit before income tax	172,637	72,157
Net profit after tax but before product recall costs	132,563	158,139
Product recall costs net of tax	-	101,336
Net profit	132,563	56,803
Basic earnings per share (cents)	233.0	100.0
Diluted earnings per share (cents)	232.4	99.8

Directors' Report Cochlear Limited for the year ended 30 June 2013

Dividends

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

Type	Cents per share	Total amount $000	Date of payment	% franked	Tax rate for franking credit
In respect of the previous financial year:					
Final - ordinary shares	125.0	71,216	20 September 2012	35%	30%
In respect of the current financial year:					
Interim - ordinary shares	125.0	71,295	12 March 2013	40%	30%

The final dividend in respect of the current financial year has not been provided for in the Financial Report as it was not declared until after 30 June 2013. Since the end of the financial year, the directors declared a final 127 cents per share dividend, 30% franked at the tax rate of 30%, amounting to a total of $72,441,984.

Environmental regulations

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

Non-audit services

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

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

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

	Consolidated	
	2013 $	2012 $
Audit services		
Auditors of the Company:		
KPMG:		
- audit and review of financial reports	1,336,981	1,286,910
- other regulatory compliance services	58,925	69,672
Total audit services	**1,395,906**	**1,356,582**
Non-audit services		
Auditors of the Company:		
KPMG:		
- taxation compliance services	1,211,162	1,128,460
Total non-audit services	**1,211,162**	**1,128,460**

State of affairs

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

Remuneration Report – audited

Table of contents

Section	Title	Description
1.0	Introduction	Describes the scope of the Remuneration Report and the individuals whose remuneration details are disclosed.
2.0	Remuneration governance	Describes the role of the Board and the Human Resources Committee, and the use of remuneration consultants when making remuneration decisions.
3.0	Non-executive director remuneration	Provides details regarding the fees paid to non-executive directors.
4.0	Executive remuneration	Outlines the principles applied to executive remuneration decisions and the framework used to deliver this framework including the performance and remuneration linkages.
5.0	Employee share scheme and other share information	Provides details regarding Cochlear's employee equity plans including that information required by the Corporations Act 2001 and applicable accounting standards.
6.0	Service contracts and employment agreements	Provides details regarding the contractual arrangements between the Cochlear and the executives whose remuneration details are disclosed.

1.0 Introduction

Cochlear is a geographically diverse business, subject to rapid and changing competitive forces, including currency variations, and with a long history of growth. The Board remains committed to a strong growth focus and has developed its executive remuneration policies to direct behaviours towards achieving sustainable growth in shareholder value over the long term. At the same time, these policies must be flexible enough to enable Cochlear to attract, motivate and retain high performing executives in many locations in a dynamic environment.

The Board's philosophy and approach to executive remuneration have always been to balance fair remuneration for skills and expertise with a risk and reward framework that supports longer-term growth of Cochlear as a global business. A planned review of executive remuneration during the financial year ended 30 June 2012 (F12) was undertaken in F13 following the Company's last Annual General Meeting (AGM). Key initiatives included:

- an independent assessment and evaluation of the F12 Remuneration Report;
- an independent survey of shareholders was commissioned to better understand the reasons for the 'no' vote on the Remuneration Report at the 2012 AGM;
- the principal institutional proxy advisor firms were consulted for specific feedback;
- the Chairman and Human Resources Committee (HRC) Chairman met with a cross section of major shareholders to canvas their views;
- an internal review of executive key management personnel (KMP) remuneration was undertaken; and
- independent benchmark assessments were commissioned in respect of Board and selected KMP remuneration.

Following this detailed and comprehensive review process, a number of changes have been adopted in respect of Cochlear's executive KMP remuneration policies. Specific details of the changes are included in the Remuneration Report and can be summarised as follows:

1. the Remuneration Report has been reformatted with improved disclosure principles adopted to ensure shareholders are presented with a clear and comprehensive analysis of Board and executive KMP remuneration;
2. the use of performance shares for executive KMP long-term incentive (LTI) has been suspended;
3. performance rights for executive KMP LTI have been introduced;
4. changes in the eligibility criteria for participation in the Cochlear LTI will result in fewer executive participants;
5. the remuneration mix for the CEO/President and other executive KMP has been reweighted;
6. the short-term incentive (STI) opportunity for selected executives has been increased;
7. as a consequence, the deferral of STI into performance rights has been introduced effective from 1 July 2013 for up to 30% of STI cash;
8. the use of options for selected executive KMP LTI has been retained because options are consistent with our objective to continue as a growth company. Shareholders interviewed were largely supportive and other than one shareholder they expressed no reservations with this policy assuming an appropriate allocation methodology and market accepted hurdle conditions were applied;
9. the LTI allocation methodology (including the option valuation for LTI dollar value) has been changed. The option value will now be calculated independently applying the 'gross contract value' of the option at the calculation date, before any discounts for performance or service. The notional variable remuneration opportunity for selected executives has been adjusted to partly compensate for this change, which is material;
10. the performance conditions to apply to the F13 LTI were reviewed. The earnings per share (EPS) hurdle rates will remain unchanged at the high end of market expectations. The total shareholder return (TSR) hurdle rate has been modified after consideration of shareholder feedback. See Section 4.4.2;
11. selected Board and executive KMP remuneration has been independently benchmarked to ensure the remuneration of these key roles meets external expectations;
12. director fees will remain unchanged in F14, apart from a minor increase in Chairman fees for Audit Committee and HRC to reflect the additional responsibilities and time commitments required; and
13. the remuneration mix for all executive KMP was reviewed to ensure it met external benchmark standards. Changes adopted have been explained in the Remuneration Report.

On balance, Cochlear's approach to Board and executive KMP remuneration is to adopt a fair and equitable approach which will reward and motivate a successful and experienced executive team to deliver ongoing business growth which meets the expectations of all shareholders.

The Board welcomes feedback from shareholders on our remuneration practices or on the communication of remuneration matters in the F13 Remuneration Report.

1.1 Scope

This Remuneration Report sets out, in accordance with the relevant Corporations Act 2001 (Corporations Act) and accounting standard requirements, the remuneration arrangements in place for KMP of Cochlear during F13.

1.2 Key management personnel

Key management personnel have authority and responsibility for planning, directing and controlling the activities of Cochlear and comprise the non-executive directors, and executive KMP (being the executive director and other senior executives named in this report). Details of the KMP as at year end are set out in the table below:

	Title (at year end)	Change in F13
Non-executive directors		
Rick Holliday-Smith	Chairman Member, Human Resources Committee Member, Audit Committee Chairman, Nomination Committee Member, Technology and Innovation Committee	No change. Full year Appointed member, Technology and Innovation Committee, April 2013
Yasmin Allen	Director Chairman, Audit Committee Member, Human Resources Committee Member, Nomination Committee Member, Technology and Innovation Committee	No change. Full year Appointed member, of Human Resources Committee, January 2013
Paul Bell	Director Chairman, Human Resources Committee Member, Nomination Committee Member, Technology and Innovation Committee	No change. Full year
Edward Byrne, AO	Director Member, Nomination Committee Chairman, Medical Science Committee Member, Technology and Innovation Committee	No change. Full year Appointed member, Technology and Innovation Committee, April 2013
Andrew Denver	Director Member, Human Resources Committee Member, Audit Committee Member, Nomination Committee Member, Medical Science Committee Chairman, Technology and Innovation Committee	No change. Full year Appointed Chairman, Technology and Innovation Committee, April 2013
Donal O'Dwyer	Director Member, Human Resources Committee Member, Audit Committee Member, Nomination Committee Member, Medical Science Committee Member, Technology and Innovation Committee	No change. Full year Appointed member, Medical Science and Technology and Innovation Committees, April 2013
Executive director		
Chris Roberts	Chief Executive Officer (CEO)/President Member, Medical Science Committee Member, Technology and Innovation Committee	No change. Full year
Other executive KMP		
Richard Brook	President, European Region	No change. Full year
Jan Janssen	Senior Vice President, Design and Development	No change. Full year
Neville Mitchell	Chief Financial Officer and Company Secretary	No change. Full year
Mark Salmon	President, Asia Pacific Region	No change. Full year
Chris Smith	President, Americas Region	No change. Full year

There were no key management personnel departures during F13.

2.0 Remuneration governance

This section of the Remuneration Report describes the role of the Board and the HRC, and the use of remuneration consultants when making remuneration decisions.

2.1 Role of the Board and the Human Resources Committee

The Board is responsible for Cochlear's remuneration strategy and policy. Consistent with this responsibility, the Board has established the HRC which comprises solely independent non-executive directors (NEDs).

The role of the HRC is set out in its Charter, which is reviewed annually and was last revised and approved by the Board in December 2012. In summary, the HRC's role is to:

- ensure that the appropriate procedures exist to assess the remuneration levels of the Chairman, other NEDs, executive directors, direct reports to the CEO/President, Board Committees and the Board as a whole;
- ensure that Cochlear meets the requirements of Australian Securities Exchange (ASX) Diversity Guidelines;
- ensure that Cochlear adopts, monitors and applies appropriate remuneration policies and procedures;
- ensure that reporting disclosures related to remuneration meet the Board's disclosure objectives and all relevant legal requirements;
- develop, maintain and monitor appropriate talent management programs including succession planning, recruitment, development; and retention and termination policies and procedures for senior management; and
- develop, maintain and monitor appropriate superannuation arrangements for Cochlear.

The HRC's role and interaction with Board, internal and external advisors, are further illustrated below:

The Board
Reviews, applies judgement and, as appropriate, approves the HRC's recommendations.

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The Human Resources Committee
The HRC operates under the delegated authority of the Board.
The HRC is empowered to source any internal resources and obtain external independent professional advice it considers necessary to enable it to make recommendations to the Board on the following:

Remuneration policy, composition and quantum of remuneration components for executive KMP, and performance targets	Remuneration policy in respect of NEDs	Talent management policies and practices including superannuation arrangements	Design features of employee and executive STI and LTI plan awards, including setting of performance and other vesting criteria

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External consultants	Internal resources

Further information on the HRC's role, responsibilities and membership is contained in the Corporate Governance Report on pages 13 to 21 of this Annual Report. The HRC terms of reference can also be viewed in the Investor Centre, Corporate Governance section of the Cochlear website, www.cochlear.com.

2.2 Use of remuneration consultants

From 1 July 2011, the existing practice was formalised and all proposed remuneration consultancy contracts (within the meaning of section 206K of the Corporations Act) became subject to prior approval by the Board or the HRC in accordance with the Corporations Act.

During F13, several remuneration consultancy contracts were entered into by Cochlear and accordingly the disclosures required under section 300A(1)(h) of the Corporations Act are set out as follows:

Advisor/consultant — F13	Services provided	Remuneration consultant for the purposes of the Corporations Act
Ian Crichton, Remuneration Consultant, CRA Plan Managers Pty Limited	1. benchmarking of selected KMP roles, and recommendations on CEO/President remuneration;	Yes
	2. preparation and review of F13 Remuneration Report;	No
	3. analysis of Cochlear remuneration strategy and LTI offer methodology; and	No
	4. survey of shareholders (including selected proxy advisor firms) to ascertain reasons for 'no' vote on F12 Remuneration Report at the 2012 AGM	No
Ernst & Young	1. benchmarking of selected KMP roles only;	No
	2. LTI plan review and global due diligence; and	No
	3. remuneration review trends and benchmarking	No

Key questions regarding use of remuneration consultants	
Did the remuneration consultant provide remuneration recommendations in relation to any of the executive KMP for F13?	Yes, benchmark data, recommendation and analysis provided.
How much was the remuneration consultant paid by Cochlear for remuneration related and other services?	CRA Plan Managers Pty Limited – remuneration services $24,127; other services $69,807.
What arrangements did Cochlear make to ensure that the making of the remuneration recommendation would be free from undue influence by the executive KMP?	Cochlear made the following arrangements: • Cochlear implemented a protocol to govern the procedure for procuring advice relating to KMP remuneration. The protocol contained a summary of the process for the engagement of the remuneration consultant, the provision of information to the remuneration consultant and the communication of remuneration recommendations; and • the remuneration consultant agreed to adhere to the protocol procedures and was required to advise the HRC whether or not it had been subjected to undue influence and to provide a Statement of Independence.
Is the Board satisfied that the remuneration information provided was free from any such undue influence? What are the reasons for the Board being so satisfied?	Yes, the Board is satisfied. The reasons are as follows: • the Chairman of the HRC had oversight of all requests for remuneration information; • the protocol with respect to the procurement of remuneration related advice was adhered to, including with respect to engagement of the remuneration consultant, the provision of information to the remuneration consultant and the communication of remuneration data requests and the provision of reports directly to the HRC Chairman; • at appropriate times, the remuneration consultant provided written confirmation that it had not been subjected to any undue influence; • the HRC met on several occasions with the remuneration consultant in the absence of executive KMP. There were no concerns raised by the remuneration consultant with respect to any undue influence being exerted by the executive KMP; and • the HRC did not observe any evidence that undue influence had been applied.

Directors' Report Cochlear Limited for the year ended 30 June 2013

3.0 Non-executive director remuneration

3.1 NED remuneration

Principle	Comment
Fees are set by reference to key considerations	Fees for NEDs are based on the nature of the NEDs' work and their responsibilities. The remuneration rates reflect the complexity of Cochlear and the extent of the geographical regions in which Cochlear operates. In determining the level of fees, survey data on comparable companies is considered. NEDs' fees are recommended by the HRC and determined by the Board. Shareholders approve the aggregate amount available for the remuneration of NEDs. A minor increase in HRC and Audit Committee Chairman fees will be introduced in F14. All other fees will remain unchanged.
Remuneration is structured to preserve independence whilst creating alignment (see also section 3.4)	To preserve independence and impartiality, NEDs are not entitled to any form of incentive payments including options and the level of their fees is not set with reference to measures of Cochlear performance. However, to create alignment between directors and shareholders, the Board has adopted guidelines that request NEDs to hold (or have a benefit in) shares in Cochlear equivalent in value to at least one year's base fees. Cochlear does not offer loans to fund share ownership.
Aggregate Board and committee fees are approved by shareholders	The total amount of fees paid to NEDs in F13 is within the aggregate amount approved by shareholders at the AGM in October 2011 of $2,000,000 per year.

3.2 NED fees and other benefits

Elements	Details		
Board/committee fees per annum - F13	Board Chairman fee[1]	$438,000	
	Board NED base fee	$146,000	
	Committee fees	**Committee Chair**	**Committee member**
	Audit	$35,000	$20,000
	Human Resources	$25,000	$10,000
	Nomination	No fee	No fee
	Medical Science	$20,000	$10,000
	Technology and Innovation[2]	$20,000	$10,000
Post-employment benefits			
Superannuation	Superannuation contributions have been made at a rate of 9% of the base fee (but only up to the Australian Government's prescribed maximum contributions limit) which satisfies the Company's statutory superannuation contributions. The contribution rate will increase in future years in line with mandated legislative increases. Contributions are not included in the base fee.		
Retirement scheme	From 2003, no new NED was entitled to join the Cochlear directors' retirement scheme. NEDs appointed prior to this were members of the scheme, which provided NEDs with more than five years' service, retirement benefits of up to three times their annual remuneration over the previous three years. On 23 October 2006, the Board determined that it should implement changes to NED remuneration consistent with developing market practice and guidelines, by discontinuing the ongoing accrual of benefits under the existing retirement scheme once the remaining members of the scheme reached their five year service period. The benefits accrued to that date are indexed by reference to the bank bill rate. All directors transitioned from the retirement scheme during F07. As at 30 June 2013, Edward Byrne is the only NED entitled to this benefit. The accrued entitlement for Edward Byrne under the Cochlear directors' retirement scheme as at 30 June 2013 was $410,817.		
Other benefits			
Equity instruments	NEDs do not receive any performance related remuneration, options or performance shares.		
Other fees/benefits	NEDs receive reimbursement for costs directly related to Cochlear business. No payments were made to NEDs during F13 for travel allowances, extra services or special exertions.		

1. Committee fees are not paid to the Chairman of the Board.
2. Fees for the Technology and Innovation Committee will only be paid commencing 1 July 2013. No fees were paid for this Committee during F13.

Directors' Report Cochlear Limited for the year ended 30 June 2013

3.3 NED total remuneration

Amounts $		Short-term benefits	Post-employment benefits		
	Year	Fees	Termination benefits[2]	Superannuation benefits	Total
Rick Holliday-Smith (Chairman)	**F13**	**438,000**	**-**	**16,470**	**454,470**
	F12	438,000	-	15,775	453,775
Yasmin Allen[1]	**F13**	**185,192**	**-**	**15,888**	**201,080**
	F12	181,000	-	15,295	196,295
Paul Bell	**F13**	**171,000**	**-**	**15,338**	**186,338**
	F12	171,000	-	14,880	185,880
Edward Byrne	**F13**	**166,000**	**12,293**	**14,940**	**193,233**
	F12	166,000	16,485	14,672	197,157
Andrew Denver[1]	**F13**	**186,000**	**-**	**15,753**	**201,753**
	F12	176,000	-	15,088	191,088
Donal O'Dwyer	**F13**	**186,000**	**-**	**15,961**	**201,961**
	F12	186,000	-	15,503	201,503
Total	**F13**	**1,332,192**	**12,293**	**94,350**	**1,438,835**
	F12	1,318,000	16,485	91,213	1,425,698

1. Increases related to additional Board Committee responsibilities.
2. Amounts accrued for interest during the financial year relating to the directors' retirement scheme.

3.4 Minimum shareholding guidelines

The Board has approved minimum shareholding guidelines for NEDs, the CEO/President and those executives who report directly to the CEO/President. Under these guidelines, all NEDs are requested to accumulate a minimum shareholding in Cochlear shares equivalent in value to one year's base fees and all executive KMP are required to accumulate a minimum shareholding in Cochlear shares equivalent to one year's fixed remuneration.

The guidelines were implemented in March 2007. All current NEDs and executive KMP covered by the guidelines are holding the minimum shareholding in conformity with these guidelines at the date of this report.

4.0 Executive remuneration

4.1 Executive KMP remuneration

Cochlear's executive remuneration policies are designed to attract, motivate and retain a highly qualified and experienced group of executives employed across diverse geographies. Fixed remuneration components are determined having regard to the specific skills and competencies of the executive KMP with reference to both internal and external relativities, particularly local market conditions. The 'at risk' components of remuneration are strategically directed to encourage management to strive for superior (risk balanced) performance by rewarding the achievement of targets that are challenging, clearly defined, understood and communicated within the ambit of accountability of the relevant executive KMP.

Executive KMP remuneration objectives are exemplified through three categories of remuneration, as illustrated below:

Executive KMP remuneration objectives

Shareholder value creation through equity components	An appropriate balance of 'fixed' and 'at risk' components	The creation of reward differentiation to drive performance values and behaviours	Attract, motivate and retain executive talent across diverse geographies

Total target remuneration (TTR) is set by reference to the relevant geographic market

Fixed	At risk	
Total fixed remuneration (TFR)	**Short-term incentives (STI)**	**Long-term incentives (LTI)**
TFR is set based on relevant market relativities, reflecting responsibilities, performance, qualifications, experience and geographic location	STI performance criteria are set by reference to Cochlear group and/or regional revenue and EBIT and individual performance targets relevant to the specific position	LTI targets are linked to both Cochlear group internal EPS growth and external relative TSR outperformance measures

Remuneration will be delivered as:

Base salary plus any fixed elements related to local markets, including superannuation or equivalents	**F13:** Paid in cash semi-annually **F14:** Part cash and part equity (performance rights). The equity component will be subject to service and deferred for 2 years Part cash and part equity (from F14) (deferred). The equity component is subject to service and deferred for 2 years	**F13:** Equity in options or shares **F14:** Equity in options or performance rights. All equity is held subject to service and performance for 3 years from grant date. The equity is at risk until vesting. Performance is tested once at the vesting date

Strategic intent and market positioning

TFR will generally be positioned at the median compared to relevant market based data considering expertise and performance in the role	Performance incentive is directed to achieving Board approved targets reflective of market circumstances TFR + STI is intended to be positioned in the 3rd quartile of the relevant benchmark comparison	LTI is intended to reward executive KMP for sustainable long-term growth aligned to shareholders' interests. LTI allocation values are intended to be positioned at the top of the 3rd quartile of the relevant benchmark comparison
↕	↕	↕

Total target remuneration

TTR is intended to be positioned in the 3rd quartile compared to relevant market benchmark comparisons. 4th quartile TTR may result if outperformance is achieved

4.2 Remuneration composition mix and timing of receipt

4.2.1 Current remuneration mix and amendments for F14

Cochlear endeavours to provide an appropriate and competitive mix of remuneration components balanced between fixed and at risk and paid in both cash and deferred equity. The broad remuneration composition mix for executive KMP can be illustrated as follows:

Remuneration mix F13

Position	TFR (Cash) at target	STI (Cash) at target	LTI (Equity) at target
CEO/President	40%	30% of TTR	30% of TTR
Other executive KMP	At least 52%	Up to 24% of TTR	Up to 24% of TFR

Cochlear's CEO/President and executive KMP remuneration composition will be changed effective from 1 July 2013 for F14.

The review of Executive remuneration involved shareholder feedback and market benchmarks to understand context and positioning and detailed analysis of past remuneration outcomes using the new valuation methodology. Following the review of remuneration, the Board has decided to reweight the performance based elements of total targeted remuneration and to introduce a deferred equity component to the STI plan for executive KMP. The effect of this reweighting and by applying the new LTI allocation valuation will deliver a lower effective LTI value (through lower LTI allocations) offset by a higher STI opportunity but with up to 30% deferred into equity with a further two year vesting period. In gross terms, it is not anticipated that the total cost to the company will increase. This change was made in response to the detailed remuneration strategy review and to ensure executives are rewarded for sustained performance. The Board believes the new arrangements better reflect contemporary standards and remuneration benchmark comparisons.

The mix of remuneration for the CEO/President and executive KMP will also change effective from 1 July 2013, as shown below:

Proposed remuneration mix from 1 July 2013

Position	TFR (Cash) at target	STI (Cash and equity) at target	LTI (Equity) at target
CEO/President	33.4%	33.3% of TTR	33.3% of TTR
Other executive KMP	At least 48%	Up to 26% of TTR	Up to 26% of TTR

These proposed changes appear quite simple when presented in table format, but may give the impression that total target remuneration will increase as a result. This is not the case because there are a number of nuances that need explanation.

Total fixed remuneration (TFR)

Cochlear's approach to TFR settings will remain largely unchanged. That is, the aim is to position all executives at between the median and 75th percentile, but at the lower end of this range where possible to control fixed costs, exchange rate movements notwithstanding. This positioning has been confirmed by our recent independent remuneration benchmark assessments. Only modest increases in TFR are proposed in F14 to maintain this balanced approach.

Short-term incentives

Cochlear has consistently focused STI on achieving annual revenue and EBIT targets and personal objectives. To support our balanced approach to TFR, we have set STI targets aimed at achieving a market competitive TFR + STI towards the 3rd quartile when budgets are met. The independent remuneration benchmark assessment and our historic approach to LTI valuation indicated that Cochlear's remuneration strategy, if anything, was overweight in LTI and underweight in respect of STI. Hence, the proposed recalibration of the remuneration mix, as set out in the table above.

This notional increase in STI opportunity under the proposed remuneration mix is offset in two material ways. Firstly, effective from F14, up to 30% of STI cash target will now also be subject to an additional two year deferral (service only) and invested in performance rights creating an alignment of interests between executives and shareholders, and secondly, by changing the LTI allocation value to be consistent with shareholder expectations it effectively halves the number of options that will now be available for the LTI dollar value, when compared to our historic allocation methodology.

Long-term incentives

The Board has listened to shareholder concerns about the use of discounted accounting value in determining the number of options allocated. All LTI dollar opportunity going forward will be calculated using the 'gross contract value'. The effect of this change is material. Based on comprehensive analysis of the last few years, the change from 'accounting value' to 'gross contract value' effectively reduces the number of options available for the same LTI dollar value by a factor of 2:1. That is, if the LTI opportunity were maintained, executives would now receive approximately 50% of prior equity allocations determined under the accounting value approach.

Left unadjusted, this would simply result in a material reduction in remuneration for our key executives.

With the world economy improving, particularly in the US, this would leave us unreasonably exposed to competitive pressures. The reweighting of STI and LTI components better meets market benchmarks and ensures each remuneration element remains fair.

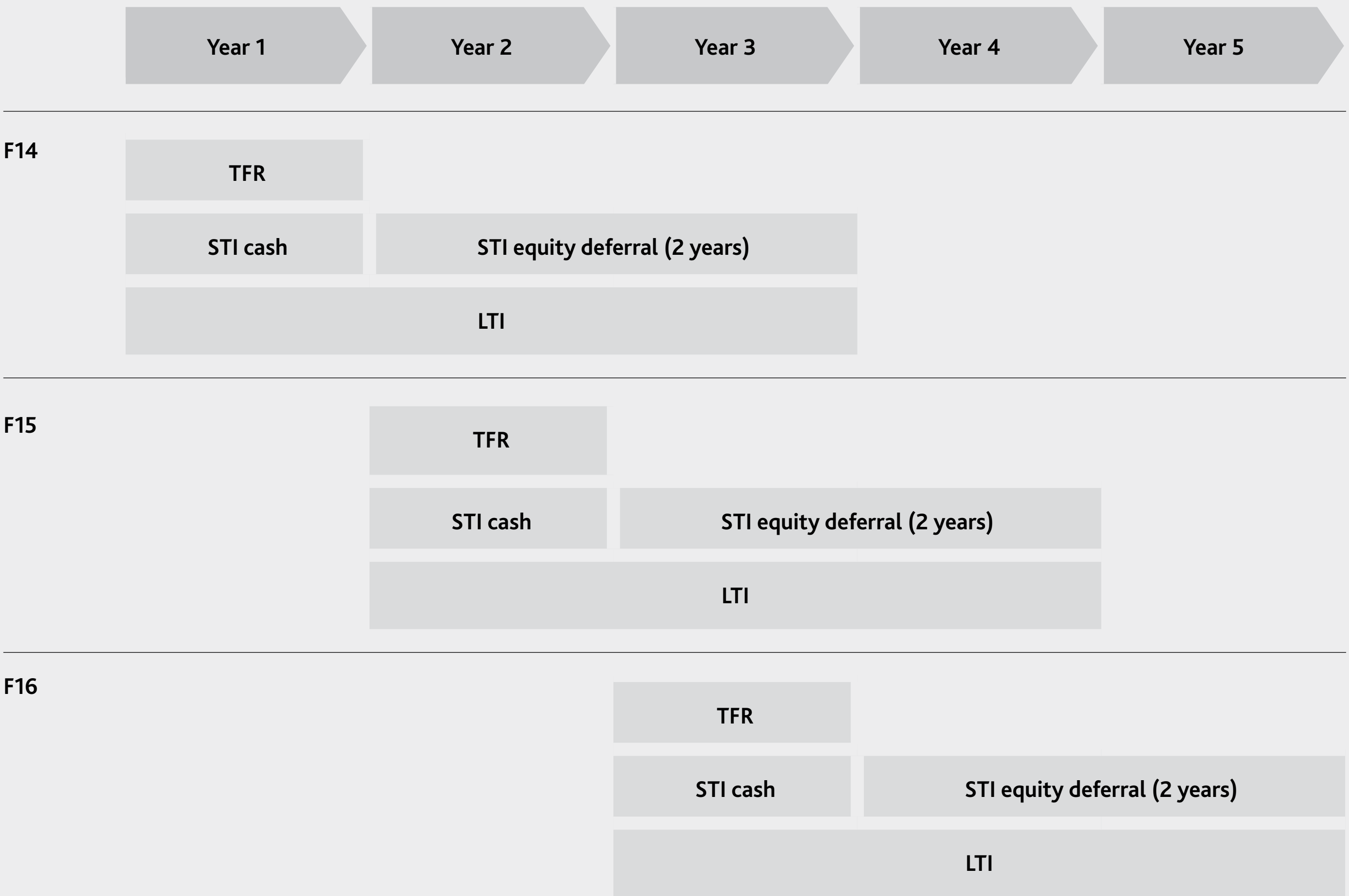
Total target remuneration

TTR under the reweighted remuneration mix will, in the opinion of the Board, deliver an overall risk adjusted outcome which is fair, market competitive and at no material extra cost to the Company.

It should also be noted that Cochlear has performance hurdles, particularly for LTI that are at the higher end of the market (S&P/ASX 100 companies) in terms of degrees of difficulty. Further, any LTI award will only have value to the executive if the performance hurdles are met to enable vesting to occur, and for option related awards, that the equity outcomes are positive in terms of share price movement (ie the share price on vesting exceeds the exercise price).

4.2.2 Remuneration – timing of receipt of the benefit for F14 onwards

The three complementary components of executive KMP remuneration are 'earned' over multiple time ranges. This is illustrated in the following chart:



Note: LTI is awarded in year 1 and earned in year 3 but expensed over the three year period.

As illustrated, executive KMP remuneration is delivered on a cascading basis, with a material component deferred for two (STI) and three (LTI) years and awarded as equity. This remuneration mix is designed to ensure executive KMP are focused on delivering results over the short, medium and long term if they are to maximise their remuneration opportunity. This is aligned to shareholder interests and expectations.

4.3 Total fixed remuneration explained

Total fixed remuneration (TFR) includes all remuneration and benefits paid to an executive KMP calculated on a total employment cost basis. In addition to base salary, selected overseas executives receive benefits that may include health insurance, car allowances and relocation allowances. In Australia, retirement benefits are generally paid in line with the statutory Superannuation Guarantee legislation prevailing. Legacy defined benefit plans were wound up in 2006. Globally, retirement benefits are generally paid in line with local legislation and practice.

Executive KMP TFR is tested regularly for market competitiveness by reference to appropriate independent and externally sourced comparable benchmark information, including for comparable ASX listed companies, and based on a range of size criteria including market capitalisation, taking into account an executive's responsibilities, performance, qualifications, experience and geographic location.

Job evaluation methodologies are applied to assist with managing internal relativities.

TFR adjustments, if any, are made with reference to individual performance, an increase in job role or responsibility, changing market circumstances as reflected through independent benchmark assessments or through promotion.

Any adjustments to executive KMP remuneration are approved by the Board, based on HRC and CEO/President recommendations.

4.4 Variable (at risk) remuneration explained

As set out in section 4.2, variable remuneration forms a significant portion of the CEO/President and other executive KMP remuneration opportunity. Apart from being market competitive, the purpose of variable remuneration is to direct executives' behaviours towards maximising Cochlear's short, medium and long-term performance. The key aspects are summarised below:

4.4.1 Short-term incentives (STI)

Purpose	The STI arrangements at Cochlear are designed to reward executives for the achievement against annual performance targets set by the Board at the beginning of the performance period. The STI program is reviewed annually by the HRC and approved by the Board. Any STI award in excess of the 100% budget opportunity is individually approved by the HRC. All STI awards to the CEO/President and other executive KMP are approved by the HRC and Board.
Performance targets	The key performance objectives of Cochlear are currently directed to achieving Board approved sales revenue and EBIT targets, and by the achievement of individual performance goals. For the current year, sales revenue and EBIT targets had equal weighting. The weighting between Cochlear group and regional sales revenue and EBIT will depend on the responsibilities and scope of influence of the executive KMP. Individual performance goals account for a 20% weighting for executive KMP based on a range of individual performance objectives including strategic objectives determined each year. 80% of STI is based on financial targets set by the Board and having regard to prior year performance, global market conditions, competitive environment, future prospects and the Board approved budgets. The specific targets are not detailed in this report due to their commercial sensitivity. Validation of performance against the measures set for: • the CEO/President involves an independent review and endorsement by the Chief Financial Officer (CFO), reviewed and approved by the HRC and Board; and • other executive KMP involves a review by the CEO/President based on inputs from the CFO. Final review is undertaken by the HRC and Board. Any anomalies or discretionary elements are approved and validated by the Board.
Rewarding performance	The STI performance ratings are determined under a predetermined matrix with the Board determination final.
Mandatory deferral of STI – new provision to commence in F14 effective from 1 July 2013	Effective from 1 July 2013, there will be a mandatory deferral of a portion of STI, introduced to reinforce alignment with shareholder interests. Grants will be earned in year 1 and then held for two years until vesting to ensure focus on short and long-term business outcomes. In addition, this plan design will offer ancillary retention benefits. The deferred component for F14 will be delivered as Cochlear performance rights calculated based on up to 30% of the STI amount depending on the position. The potential equity component will be independently determined based on the gross contract value using Cochlear's five day volume weighted average price (VWAP) following the announcement of year end results in August 2014. That is, based on a Black-Scholes-Merton pricing model without discounting for service or performance hurdles. The number of performance rights to be awarded will be subject to achievement of STI objectives at the end of the relevant financial year and offered after the year end results announcement for that financial year. Once the STI awarded as performance rights has been granted, there are no further performance measures attached to the performance rights other than continued tenure for the vesting period (two years).

Directors' Report Cochlear Limited for the year ended 30 June 2013

Table 1 - Executive KMP STI opportunity and actual F13 STI awarded

Executive KMP	Position	Target STI as a % of F13 TTR	STI awarded as a % of TTR	Actual STI award in F13 ($)	Actual STI forfeited in F13 as a % of TTR
Chris Roberts	CEO/President	30%	20.5%	701,125	9.5%
Richard Brook	President, European Region	21%	16.8%	166,468	4.2%
Jan Janssen	Senior Vice President, Design and Development	22%	15.3%	136,314	6.7%
Neville Mitchell	CFO and Company Secretary	22%	15.3%	168,523	6.7%
Mark Salmon	President, Asia Pacific Region	24%	20.3%	216,151	3.7%
Chris Smith	President, America Region	23%	12.5%	132,934	10.5%

STI payments are based on the achievement of revenue and EBIT and personal objectives. For F13, STI targets were not fully achieved but there was positive progress in repositioning of the business focused towards long-term growth. STI was focused on bringing to market as soon as possible the necessary range of new innovative hearing technologies across the full product range of cochlear implants, bone anchored solutions and acoustic products. STI was also focused towards projects to support the growing number of recipients and the increasing number of associated clinics with a range of customer initiatives and services that are seen to be competitively beneficial and part of the program aimed at achieving sustainable growth.

4.4.2 Long-term incentives (LTI)

The LTI provides an annual opportunity for executive KMP and other selected executives (based on their ability to influence and execute strategy) to receive an equity award deferred for three years, that is intended to align a significant portion of executives' overall remuneration to shareholder value over the longer term. All LTI awards remain at risk and subject to clawback (forfeiture or lapse) until vesting and must meet or exceed EPS growth rates and/or relative TSR performance hurdles over the vesting period.

Purpose	To align executive KMP remuneration opportunity with shareholder value and provide retention stimulus.
Types of equity awarded	LTI up to F13 has been provided under the Cochlear Executive Long Term Incentive Plan (CELTIP). See section 5.1 for further details. Under the CELTIP, selected senior executives are offered options (being options to acquire ordinary shares of Cochlear Limited), performance shares (being fully paid ordinary shares of Cochlear Limited) or a combination of both. Effective from F14, it is intended that performance rights will replace performance shares subject to the terms of the Cochlear Executive Incentive Plan (CEIP).
Time of grant	Grants up until F13 have been made in August each year after the release of the annual financial results (excluding the CEO/President whose grant was awarded after the AGM each year). In F14, equity grants will be made after the 2013 AGM based on values determined as at 12 August 2013.
Time restrictions	Equity grants awarded to the CEO/President and other executive KMP are tested against the performance hurdles set, at the end of three years. If the performance hurdles are not met at the vesting date, performance shares are forfeited and performance options lapse. A minimum three years' service and performance requirement will continue to be imposed on all future equity grants.
Performance hurdles and vesting schedule	Equity grants to the CEO/President and other executive KMP are subject to two performance conditions. The performance conditions applying to the latest grant (F13) were as follows:

Compound annual growth in EPS (3 years)		Ranking of TSR against S&P/ASX 100 (3 years)	
Performance	% of equity to vest	Performance	% of equity to vest
< 10%	0%	< 50th percentile	0%
10% to 20%	50% to 100% pro-rata	50th to 75th percentile	50% to 100% pro-rata
> 20%	100%	> 75th percentile	100%

Options and performance shares vest if the time restrictions and relevant performance hurdles are met. The Board must approve any special provisions, in accordance with Company policies, in the event of termination of employment or a change of control.

Change in TSR hurdle for F14	After consideration of shareholder feedback, the TSR hurdle rate will be modified for future LTI grants. Effective from F14, LTI participants will now only have 40% of their award vest at the 50th percentile for the TSR portion of their award.
Dividends	Currently, dividends in respect of performance shares are paid into the Cochlear Employee Share Trust, and in turn, paid to executives during the vesting period. Once performance shares are forfeited, dividends are no longer payable. From F14, no dividends will be attached to performance rights.
Voting rights	There are no voting rights attached to options or performance rights or unvested performance shares nor vested shares unexercised.
Retesting	There is no retesting of performance hurdles under Cochlear LTI.
LTI allocation	The size of individual LTI grants for the CEO/President and other executive KMP is determined in accordance with the Board approved remuneration strategy mix. See section 4.2. F13 The target LTI dollar value for each executive once determined is then converted into a number of options and/or performance shares based on a valuation methodology determined at the grant date, as follows: • performance share allocation = LTI dollar value determined/Cochlear share value based on five day VWAP following year end results determined in accordance with estimated IFRS-2 value; and/or • performance option allocation = LTI dollar value determined/option value determined in accordance with estimated IFRS-2 value. F14 The allocation methodology for options and performance rights will be changed effective from 1 July 2013. The target LTI dollar value for each executive will be converted to options and/or performance rights according to new LTI allocation values and will be independently determined based on the gross contract value of the relevant equity instrument and based on a Black-Scholes-Merton pricing model without discounting for service or EPS and TSR performance hurdles: • performance right allocation (from 1 July 2013) = LTI dollar value/Black-Scholes-Merton value before service or EPS and TSR performance discounts; and/or • performance option allocation (from 1 July 2013) = LTI dollar value/Black-Scholes-Merton value before service or EPS and TSR performance discounts.

Table 2 – Vesting outcomes (options and performance shares granted F09 to F11)

Performance shares

Grant date	Vesting timeframe	EPS 3 year CAGR*	% vested	Relative 3 year TSR ranking percentile	% vested	Market price on vesting date
18-Aug-08	Vested August 2011	15.2%	75.0%	97th	100.0%	$74.23
17-Aug-09	Vested August 2012	-24.6%	0.0%	65th	79.3%	$64.40
16-Aug-10	Vested August 2013	-5.5%	0.0%	28th	0.0%	N/A

Options

Grant date	Vesting timeframe	Exercise price	EPS 3 year CAGR*	% vested	Relative 3 year TSR ranking percentile	% vested	Net market value at vesting
18-Aug-08	Vested August 2011	$49.91	15.2%	75.0%	97th	100.0%	$24.32
17-Aug-09	Vested August 2012	$60.04	-24.6%	0.0%	65th	79.3%	$4.36
16-Aug-10	Vested August 2013	$69.80	-5.5%	0.0%	28th	0.0%	N/A

* Compound annual growth rate.

4.5 Other remuneration elements and disclosures relevant to executive KMP

4.5.1 Clawback

Specific clawback provisions proposed under Corporations Act amendments will be automatically complied with upon proposed legislation taking effect. There have been no circumstances where the proposed legislation would have applied.

4.5.2 Hedging and margin lending prohibition

Under the Cochlear Trading Policy and in accordance with the Corporations Act, equity granted under Cochlear equity incentive schemes must remain at risk until vested, or until exercised if performance options or performance rights. It is a specific condition of grant that no schemes are entered into, by an individual or their associates that specifically protect the unvested value of performance shares, options or performance rights allocated.

Cochlear also prohibits the CEO/President or 'Designated Persons' (including other executive KMP) providing Cochlear securities in connection with a margin loan or similar financing arrangement unless that person has received a specific notice of no objection in compliance with the policy.

Cochlear, in line with good corporate governance, has a formal policy setting down how and when employees of Cochlear may deal in Cochlear securities.

Cochlear's Trading Policy is available on the Cochlear website www.cochlear.com under Investor Centre, Corporate Governance.

4.5.3 Cessation of employment provisions

The provisions that apply for STI and LTI awards in the case of cessation of employment are detailed in sections 6.1 (Service contracts) and 6.2 (Employment agreements).

4.5.4 Conditions of LTI grants

The conditions under which LTI (performance shares and performance options) are granted, and are approved by the Board in accordance with the relevant scheme rules, are as summarised in section 5.

4.5.5 Minimum shareholding guidelines

The purpose of the Cochlear NED and executive share ownership guidelines is to ensure appropriate alignment of the interests of Cochlear's executive KMP with the financial interests of Cochlear's shareholders.

The guidelines aim to create a share ownership focus and culture and to build long-term commitment to the Company by providing direction to KMP as to minimum levels of share ownership.

Each executive KMP should hold Cochlear Limited shares or vested options to an amount that is at least worth one time's his/her prior year annual TFR, or one time's base annual fees for NEDs, based on the 365 day average Cochlear Limited share price.

The guidelines were introduced in March 2007 and all executive KMP were expected to acquire the relevant number of shares over three years from implementation of the guidelines. All KMP are meeting the guideline requirements at the date of this report.

4.6 Relationship between Cochlear performance and executive KMP remuneration

4.6.1 Cochlear financial performance (F09 to F13)

	F09	F10	F11	F12	F13
Sales revenue ($million)	711.8	696.2	732.2	704.6	715.0
EBIT ($million)	183.3	220.5	242.7	76.5	178.9
NPAT ($million)	130.5	155.2	180.1	56.8	132.6
Basic EPS (cents)	233.7	275.7	318.2	100.0	233.0
Total dividend per share (cents)	175.0	200.0	225.0	245.0	252.0
Share price as at 30 June ($)	57.70	74.32	72.00	65.84	61.71
TSR ranking within the S&P/ASX 100 (at year end) (percentile)	4	18	58	52	78

For further explanation of details on Cochlear performance, see the principal activities and review of operations and results section of the Directors' Report on pages 23 to 29.

4.6.2 Cochlear current year performance and relationship to executive KMP remuneration

Over the five year period, Cochlear has experienced significant challenges due to major shifts in the global economy including the volatility of the Australian dollar. The Board has managed executive KMP remuneration with the aim of ensuring each element of remuneration was market competitive and provided appropriate incentives to drive the achievement of results important for both short and long-term success. The Board believes that Cochlear has a strong management team and that the executive KMP remuneration is appropriately balanced, all things considered.

Explaining the direct relationship between Cochlear's financial performance as summarised in the table above and executive KMP remuneration over the same period requires a detailed understanding of the nuances of our business over that period.

Following the voluntary recall of the CI500 series in September 2011 and the related provision of $138.8 million in the December 2011 half year financial statements, the Board adopted a multi-year approach to executive KMP STI, commencing from January 2012, aimed at repositioning and redirecting the Company back to sustainable growth as soon as was commercially possible.

Following the recall, Cochlear's initial focus was on care, service and support for its product recipients, clinics and healthcare professionals. Attention was then turned to also include the wellbeing of staff and the steps necessary to protect the Company.

These steps included the establishment of short-term targets to reprioritise the business to this new environment, to protect our standing as the world leader in implantable hearing solutions, to understand what had happened and how to deal with the related issues, and to establish a longer-term review and reassessment of our strategic direction that would be across the whole global business and form the basis for a longer-term coordinated initiative to support long-term sustainable growth.

The strategic plan was totally reviewed and revamped through the ensuing 12 months and was rolled out through the company commencing in F13.

In the second half of F12, the Board approved new financial and performance targets consistent with this approach and these became the new base for STI awards in the six month period to June 2012.

For F13, the Board similarly determined a challenging but balanced set of targets as part of the multi-year approach. The F13 financial targets were not wholly achieved and therefore the financial component of STI was not fully awarded. On the other hand, there was strong performance in most areas relating to the personal objectives portion of STI. Overall, the matrix of STI performance awards for executive KMP paid out between 54% and 85% of target for F13.

For F14, the Board has considered management's multi-year performance plans that are now aligned with the Board approved strategic plan that is being implemented globally across the Company. The Board has approved challenging but achievable financial targets and performance objectives focused on the final stages of the post-recall strategy with particular emphasis on getting the planned new product range though the regulatory approval phase and available in all markets. This coming year will also be focused on strong execution of new product releases, active competitive engagement, new initiatives to support overall market growth, and strong support and engagement with product recipients, clinics and healthcare professionals.

Our goal is to generate sustainable growth momentum into F15 and beyond in conjunction with the expected normalisation of foreign exchange (FX) contract related revenues and FX impacts.

4.6.3 Cochlear EPS and TSR performance (F09 to F13) and relationship to executive KMP remuneration

As explained in section 4.1, Cochlear's remuneration framework aims to incentivise executive KMP towards long-term sustainable growth of the business internationally and the creation of shareholder value in the short, medium and long term. This is developed in two ways:

- cash (and equity) short-term incentives, whether paid immediately depend on sales revenue and EBIT performance and outcomes for the completed performance year (as explained in section 4.4.1); and
- long-term incentives, in the form of options and performance shares, are linked to compound annual growth in EPS and relative TSR performance (as explained in section 4.4.2).

EPS and relative TSR are generally accepted proxies for creation of shareholder value. It is the Board's intention to review the suitability of these performance criteria and settings on a regular basis to ensure they best serve shareholders' interests.

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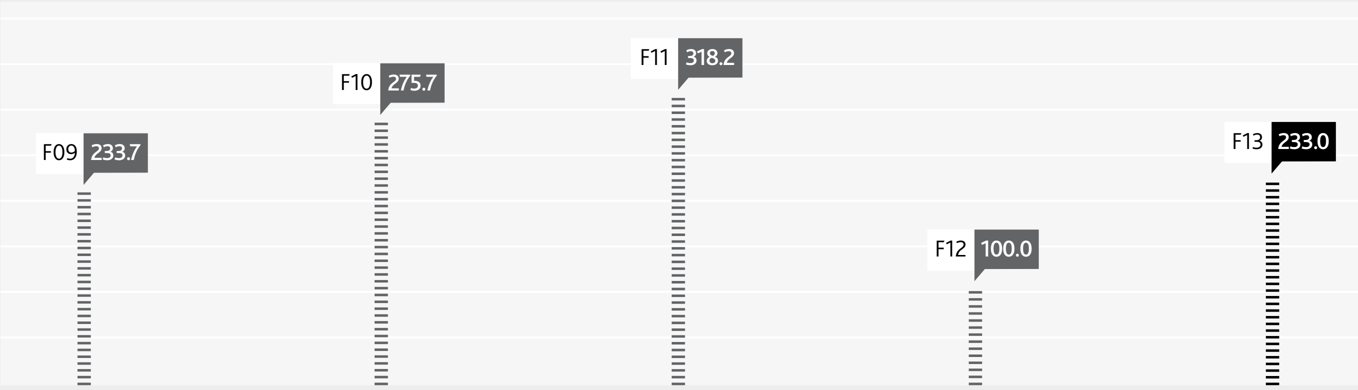
Earnings per share (EPS)

Cochlear's basic EPS over the last five years is displayed in the graph below which shows the effort to return to growth despite strong currency barriers:

Cochlear – basic earnings per share (cents)



The table below illustrates Cochlear's annual growth in basic EPS in respect of performance from F09 to F11:

Grant date	Compound EPS growth to end of financial year					EPS vesting performance
	F09	F10	F11	F12	F13	
18-Aug-08	12.3%	15.1%	15.2%			75.0%
17-Aug-09		18.0%	16.7%	-24.6%		0.0%
16-Aug-10			15.4%	-39.8%	-5.5%	0.0%

The EPS performance over the three year period reflects the prevailing difficult business conditions, and the impact of the product recall in F12. Refer to the principal activities and review of operations and results on pages 23 to 29 for details on the performance of Cochlear.

Total shareholder return (TSR) — unaudited

Cochlear's relative TSR performance over the relevant performance periods up to 30 June 2013 in respect of vested equity grants is set out below. This information is unaudited.

Grant date	Relative TSR percentile ranking	TSR vesting performance
18-Aug-08	97th	100.0%
17-Aug-09	65th	79.3%
16-Aug-10	28th	0.0%

TSR is a function of share price growth and dividends reinvested. Cochlear's performance, however, over time, is affected by a range of variables, including currency volatility, global economic and geopolitical conditions, market growth for its products and other competitive pressures.

4.7 Executive remuneration table – audited statutory disclosure (accounting cost to Cochlear)

	Year	Fixed remuneration					Variable remuneration				Total	Proportion of total remuneration	
		Short-term		Other employment costs		Total	Short-term[2,3]	Equity compensation[3,4,5]		Total		Performance related	Equity related
Amounts $		Salary	Non-monetary benefits[1]	Super-annuation benefits	Long service leave		Bonus	Value of options	Value of perform-ance shares			%	%
Chris Roberts[6]	**F13**	**1,349,920**	**-**	**16,470**	**36,468**	**1,402,858**	**701,125**	**538,118**	**-**	**1,239,243**	**2,642,101**	**46.9%**	**20.4%**
	F12	1,300,385	-	15,775	39,809	1,355,969	403,878	321,406	-	725,284	2,081,253	34.8%	15.4%
Richard Brook	**F13**	**461,027**	**65,909**	**77,526**	**-**	**604,462**	**166,468**	**123,627**	**-**	**290,095**	**894,557**	**32.4%**	**13.8%**
	F12	468,104	93,708	81,225	-	643,037	104,804	89,442	-	194,246	837,283	23.2%	10.7%
Jan Janssen	**F13**	**473,605**	**-**	**16,470**	**40,906**	**530,981**	**136,314**	**79,450**	**36,435**	**252,199**	**783,180**	**32.2%**	**14.8%**
	F12	453,401	-	15,775	12,390	481,566	96,412	69,133	23,340	188,885	670,451	28.2%	13.8%
Neville Mitchell	**F13**	**507,936**	**-**	**134,724**	**17,895**	**660,555**	**168,523**	**72,697**	**78,284**	**319,504**	**980,059**	**32.6%**	**15.4%**
	F12	483,915	-	119,417	28,318	631,650	113,705	110,631	-	224,336	855,986	26.2%	12.9%
Mark Salmon	**F13**	**550,889**	**-**	**16,470**	**(540)**	**566,819**	**216,151**	**50,833**	**102,536**	**369,520**	**936,339**	**39.5%**	**16.4%**
	F12	523,181	-	15,775	16,472	555,428	117,324	117,977	-	235,301	790,729	29.8%	14.9%
Chris Smith	**F13**	**540,868**	**20,708**	**12,235**	**-**	**573,811**	**132,934**	**138,301**	**11,954**	**283,189**	**857,000**	**33.0%**	**17.5%**
	F12	488,741	20,404	11,760	-	520,905	104,417	21,212	92,954	218,583	739,488	29.6%	15.4%
Total	**F13**	**3,884,245**	**86,617**	**273,895**	**94,729**	**4,339,486**	**1,521,515**	**1,003,026**	**229,209**	**2,753,750**	**7,093,236**	**38.8%**	**17.4%**
Total	F12	3,717,727	114,112	259,727	96,989	4,188,555	940,540	729,801	116,294	1,786,635	5,975,190	29.9%	14.2%

1. Benefits include the provision of pension plans, car allowances, health insurance and relocation costs which are market based payments.
2. For F12, short-term incentive (STI) payments were paid largely for second half-yearly performance only following the product recall, whereas for F13 STI payments were made for the full year (both first and second half-years) and calculated based on budgets set in a year of recovery.
3. Short-term and long-term incentive bonuses are awarded annually. The service and performance criteria are set out in this report. See section 4.4.1 Table 1 for more detail on F13 STI payments delivery. For F13, incentives paid represent 70% of target for the CEO/President and between 54% and 85% of target for other executive KMP.
4. The fair value of options is calculated at the date of grant using the Black-Scholes option-pricing model discounted for vesting probabilities of non-market performance criteria. The fair value of performance shares is calculated as the share price at the date of issue discounted for vesting probabilities of non-market performance criteria.
   The fair value of options and performance shares is allocated to each reporting period evenly over the period from grant date to vesting date. The amount expensed each reporting period includes adjustments to the life-to-date expense of grants based on the reassessed estimate of achieving non-market performance criteria and final vesting amounts for the non-market performance criteria options and performance shares.
   The value disclosed above is the portion of the fair value of the options and performance shares recognised as an expense in the financial year. The ability to exercise the options and performance shares is conditional on Cochlear achieving certain performance hurdles. Further details of options and performance shares granted during the financial year are set out in this report.
5. The total value of options and performance shares recognised in the current financial year for each executive KMP is higher than in the previous financial year due to changed assumptions on discounts used in IFRS-2 values.
6. Chris Roberts is an executive director.

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4.8 Executive remuneration table — unaudited

This table represents the value to the executive of cash paid and vested equity awards (intrinsic value) received during the year and unvested equity awards (IFRS-2 value) granted during the financial year, at risk. The LTI equity granted is a value determined under IFRS-2 which may or may not vest depending on future outcomes that are uncertain. Accordingly, this table incorporates data that could represent the accumulation of outcomes arising from multiple years.

	Year	Fixed remuneration and cash incentives received			Past at risk remuneration received during year		Actual remuneration received	Future at risk remuneration received	
Amounts $		Fixed remuneration[1]	Incentives[2]	Total cash	Intrinsic value of vested options[3]	Intrinsic value of vested performance shares[3]		Incentives (deferred as cash)[4]	LTI (equity) granted during year[5]
Chris Roberts	**F13**	**1,366,390**	**780,312**	**2,146,702**	**38,802**	**-**	**2,185,504**	**299,692**	**1,026,353**
	F12	1,316,160	445,690	1,761,850	1,413,564	-	3,175,414	378,878	986,831
Richard Brook	**F13**	**604,462**	**162,124**	**766,586**	**13,019**	**-**	**779,605**	**84,945**	**184,030**
	F12	643,037	134,555	777,592	422,129	-	1,199,721	80,600	197,122
Jan Janssen	**F13**	**490,075**	**148,124**	**638,199**	**9,507**	**-**	**647,706**	**59,602**	**196,030**
	F12	469,176	110,245	579,421	345,952	-	925,373	71,412	186,731
Neville Mitchell	**F13**	**642,660**	**183,638**	**826,298**	**13,697**	**-**	**839,995**	**73,590**	**242,593**
	F12	603,332	129,590	732,922	499,342	-	1,232,264	88,705	231,041
Mark Salmon	**F13**	**567,359**	**192,616**	**759,975**	**12,809**	**-**	**772,784**	**115,859**	**254,190**
	F12	538,956	161,239	700,195	466,191	-	1,166,386	92,324	242,126
Chris Smith	**F13**	**573,811**	**160,574**	**734,385**	**14,818**	**-**	**749,203**	**51,748**	**250,102**
	F12	520,905	130,860	651,765	414,180	99,418	1,165,363	79,388	218,384
Total	**F13**	**4,244,757**	**1,627,388**	**5,872,145**	**102,652**	**-**	**5,974,797**	**685,436**	**2,153,298**
Total	F12	4,091,566	1,112,179	5,203,745	3,561,358	99,418	8,864,521	791,307	2,062,235

1. Represents the value of base salary, non-monetary benefits and superannuation received during the year (excludes the accrued value of long service leave).
2. Represents STI payments received during the financial year. For example, F13 data includes F12 second half-year STI and F13 first-half year STI payments.
3. Reflects the intrinsic value of vested employee share scheme (ESS) benefits at the end of the financial year (refer to section 5.4).
4. Reflects STI payments related to the current financial year but paid in future years. For example, F13 data includes the F13 second half-year STI payment scheduled for payment during F14.
5. Represents the accounting value (IFRS-2) of equity grants (options and/or performance shares) awarded during the year that are unvested and will be subject to achievement of future performance hurdles.

5.0 Employee share scheme and other share information

This section provides:

1. a description of the employee share schemes (ESS) Cochlear uses to provide equity rewards to Cochlear employees;
2. disclosures required in relation to ESS grants provided to executive KMP;
3. disclosures required about ESS instruments that Cochlear has issued;
4. disclosures required in relation to Cochlear Limited shares and other ESS instruments held by executive KMP;
5. Cochlear's share ownership guidelines; and
6. Cochlear's Trading Policy.

5.1 Employee share schemes operated by Cochlear

Plan details	Type of instruments	Details	Purpose
Cochlear Employee Share Plan (CESP) Date established: 1999	Ordinary shares	Issue up to $1,000 worth of shares annually.	The purpose of the CESP is to encourage general employee equity participation through tax concessional enabling legislation. Under the 2012 grant, 1,254 employees each received an award of 13 shares under the plan. Executive KMP and other executives rewarded under the Cochlear Executive Long Term Incentive Plan or the Cochlear Executive Incentive Plan are not eligible for this program.
Cochlear Executive Long Term Incentive Plan (CELTIP) Date established: 2003 AGM	Ordinary shares (options and/or performance shares)	A long-term performance incentive scheme designed to reward participants for achieving market competitive EPS and relative TSR, as approved. Participants receive options and/or ordinary shares based on a predetermined formula.	The purpose of the CELTIP is to encourage employees and executives of Cochlear to receive performance shares or performance options. Vesting of performance shares and performance options occurs only if Cochlear achieves challenging and market competitive EPS growth and relative TSR hurdles. Target allocations are made based on seniority, the ascribed LTI remuneration value and a value formula approved by shareholders in 2003.
Cochlear Executive Incentive Plan (CEIP) Date established: July 2013	Awards consisting of ordinary shares; performance rights; options; and/or share appreciation rights.	A performance incentive scheme designed to reward participants for achieving market competitive business outcomes. Participants receive an award based on a predetermined formula, as approved by the Board from time to time based on market standards and trends.	The purpose of the CEIP is to develop the principles established with the CELTIP but to create greater flexibility in award structure to cater for Cochlear's expanding geography and to meet changing market standards and expectations. The offer terms for CEIP awards will be flexible but will meet contemporary LTI design standards. There have been no awards under the CEIP as at the date of this report. Also refer to section 4.4.2.

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5.2 Employee share scheme grants to executive KMP

5.2.1 Analysis of share based payments granted as remuneration

Details of vesting profile of the options and performance shares granted as remuneration to each executive KMP are set out below:

	Grant date	Options				Performance shares			
		Number granted	Number vested	Number forfeited	Market value of vested options ($)[1]	Number granted	Number vested	Number forfeited	Market value of vested shares ($)[1]
Chris Roberts	18-Aug-08	101,412	88,736	12,676	1,413,564	-	-	-	-
	17-Aug-09	58,599	23,235	35,364	38,802	-	-	-	-
	16-Aug-10	86,272	-	-	-	-	-	-	-
	15-Aug-11	117,620	-	-	-	-	-	-	-
	13-Aug-12	231,161	-	-	-	-	-	-	-
	Total	**595,064**	**111,971**	**48,040**	**1,452,366**	**-**	**-**	**-**	**-**
Richard Brook	18-Aug-08	30,285	26,499	3,786	422,129	-	-	-	-
	17-Aug-09	19,663	7,796	11,867	13,019	-	-	-	-
	16-Aug-10	17,674	-	-	-	-	-	-	-
	15-Aug-11	23,495	-	-	-	-	-	-	-
	13-Aug-12	41,448	-	-	-	-	-	-	-
	Total	**132,565**	**34,295**	**15,653**	**435,148**	**-**	**-**	**-**	**-**
Jan Janssen	18-Aug-08	24,819	21,717	3,102	345,952	-	-	-	-
	17-Aug-09	14,358	5,693	8,665	9,507	-	-	-	-
	16-Aug-10	17,559	-	-	-	-	-	-	-
	15-Aug-11	11,128	-	-	-	2,234	-	-	-
	13-Aug-12	26,491	-	-	-	2,473	-	-	-
	Total	**94,355**	**27,410**	**11,767**	**355,459**	**4,707**	**-**	**-**	**-**
Neville Mitchell	18-Aug-08	35,824	31,346	4,478	499,342	-	-	-	-
	17-Aug-09	20,686	8,202	12,484	13,697	-	-	-	-
	16-Aug-10	21,302	-	-	-	-	-	-	-
	15-Aug-11	27,538	-	-	-	-	-	-	-
	13-Aug-12	10,928	-	-	-	6,120	-	-	-
	Total	**116,278**	**39,548**	**16,962**	**513,039**	**6,120**	**-**	**-**	**-**
Mark Salmon	18-Aug-08	33,446	29,265	4,181	466,191	-	-	-	-
	17-Aug-09	19,344	7,670	11,674	12,809	-	-	-	-
	16-Aug-10	22,363	-	-	-	-	-	-	-
	15-Aug-11	28,859	-	-	-	-	-	-	-
	13-Aug-12	-	-	-	-	8,016	-	-	-
	Total	**104,012**	**36,935**	**15,855**	**479,000**	**8,016**	**-**	**-**	**-**
Chris Smith	18-Aug-08	29,714	26,000	3,714	414,180	1,726	1,510	216	99,418
	17-Aug-09	22,379	8,873	13,506	14,818	-	-	-	-
	16-Aug-10	-	-	-	-	5,781	-	-	-
	15-Aug-11	20,823	-	-	-	1,045	-	-	-
	13-Aug-12	45,063	-	-	-	1,577	-	-	-
	Total	**117,979**	**34,873**	**17,220**	**428,998**	**10,129**	**1,510**	**216**	**99,418**

1. The intrinsic value of vested options calculated as at the closing market price of shares of the Company on the ASX on 30 June of the year the award vests less the applicable exercise price times the number of options (negative values are treated as zero in the totals) and/or vested performance shares as at the closing market price of shares of the Company on the ASX on 30 June of the year the award vests. No value will be reflected for unvested awards, or for vested options whose exercise price was above the market price (i.e. of no value to the individual).

The options granted in F13 have an exercise price of $62.78 per share and an expiration date of 1 July 2017. The options granted during the year have a fair value (IFRS-2) of $8.56 per share at grant date for options with EPS performance based conditions and $5.70 per share at grant date for options with TSR based conditions. The performance shares granted during the financial year had a fair value (IFRS-2) at grant date of $62.78 per share for performance shares with EPS performance based conditions and $39.55 per share at grant date for performance shares with TSR based conditions.

5.2.2 Exercise of options and performance shares granted as remuneration

During F13, the following shares were acquired on the exercise of options previously granted as part of remuneration:

	Number of shares	Amount paid to exercise each option ($)	Total gross transaction value - amount paid on exercise ($)	Net market value ($)[2]
Chris Roberts[1]	-	-	-	-
Richard Brook[1]	-	-	-	-
Jan Janssen[1]	-	-	-	-
Neville Mitchell	8,202	60.04	492,448	44,737
Mark Salmon	7,670	60.04	460,507	41,835
Chris Smith	6,000	49.91	299,460	122,910

1. These executives have not exercised options or performance shares in F13.
2. Represented by taxable value during the financial year.

There are no amounts unpaid on the shares issued as a result of the exercise of the options in prior years.

5.2.3 Analysis of movement in options and shares

The movement in number and value during the financial year of options over ordinary shares of Cochlear Limited acquired under the CELTIP plan held by executive KMP is detailed below:

	Opening value		Granted in year		Exercised in year		Forfeited in year		Closing value	
	Number	Value ($)[1]	Number	Value ($)[2]	Number	Value ($)[3]	Number	Value ($)[3]	Number	Intrinsic value ($)[4]
Chris Roberts	313,750	2,367,201	231,161	1,026,355	-	-	86,623	253,805	458,288	38,802
Richard Brook	60,833	549,140	41,448	184,029	-	-	11,867	34,770	90,414	13,019
Jan Janssen	43,045	489,659	26,491	117,620	-	-	8,665	25,388	60,871	9,507
Neville Mitchell	69,526	628,080	10,928	48,520	8,202	44,737	12,484	36,578	59,768	-
Mark Salmon	70,566	649,628	-	-	7,670	41,835	11,674	34,205	51,222	-
Chris Smith	49,203	674,897	45,063	200,080	6,000	122,910	13,506	39,573	74,760	14,818
Total	**606,923**	**5,358,605**	**355,091**	**1,576,604**	**21,872**	**209,482**	**144,819**	**424,319**	**795,323**	**76,146**

The movement in number and value during the financial year of performance shares acquired under the CELTIP held by executive KMP is detailed below:

	Opening value		Granted in year		Exercised in year		Forfeited in year		Closing value	
	Number	Value ($)[1]	Number	Value ($)[2]	Number	Value ($)[3]	Number	Value ($)[3]	Number	Intrinsic value ($)[4]
Chris Roberts	-	-	-	-	-	-	-	-	-	-
Richard Brook	-	-	-	-	-	-	-	-	-	-
Jan Janssen	2,234	93,359	2,473	78,419	-	-	-	-	4,707	290,469
Neville Mitchell	-	-	6,120	194,065	-	-	-	-	6,120	377,665
Mark Salmon	-	-	8,016	254,187	-	-	-	-	8,016	494,667
Chris Smith	6,826	281,848	1,577	50,007	-	-	-	-	8,403	518,549
Total	**9,060**	**375,207**	**18,186**	**576,678**	**-**	**-**	**-**	**-**	**27,246**	**1,681,350**

1. The fair value derived under IFRS-2 of remaining options and/or shares granted but not yet forfeited, lapsed or exercised during the financial year is the fair value of the options calculated at grant date using the Black-Scholes model and derived applying the valuation methodology prescribed. The total value of the options and/or shares granted is included in the table above.
2. The fair value derived under IFRS-2 of options and/or shares granted during the financial year is the fair value of the options and/or performance shares calculated at grant date using the Black-Scholes model and derived applying the valuation methodology prescribed. The total value of the options and/or shares granted is included in the table above. This amount is allocated to remuneration over the vesting period (ie in each of F13 to F15).
3. The calculated value of options exercised and forfeited during the year is calculated as the market price of shares of the Company on the ASX as at close of trading on the date the options were exercised or date of forfeiture after deducting the price paid or payable to exercise the option.
4. The intrinsic value of options calculated as at the closing market price of shares of the Company on the ASX on 28 June 2013 less the applicable exercise price times the number of options (negative values are treated as zero in the totals) and/or performance shares as at the closing market price of shares of the Company on the ASX on 28 June 2013.

5.3 Potential dilution if options vest and ordinary shares issued (unaudited)

At the date of this report, the number of ordinary shares that would be issued if all options were vested, having met the service and performance conditions, and exercised and assuming ordinary shares were issued, is as follows:

Grant date	Number of options				Exercise price per share ($)	Exercise period	Current net value as at 30-Jun-13 ($)[2]
	Issued	Exercised	Lapsed[1]	At report date			
18-Aug-08	712,331	609,100	103,231	-	49.91	Aug-11 to 1-Jul-13	-
17-Aug-09	435,606	70,995	278,937	85,674	60.04	Aug-12 to 1-Jul-14	143,076
16-Aug-10	443,498	-	43,629	399,869	69.80	Aug-13 to 1-Jul-15	-
15-Aug-11	542,948	-	25,883	517,065	68.56	Aug-14 to 1-Jul-16	-
13-Aug-12	759,828	-	24,436	735,392	62.78	Aug-15 to 1-Jul-17	-
Total	**2,894,211**	**680,095**	**476,116**	**1,738,000**			**143,076**

1. Lapsed options from unvested grants (granted in 2010, 2011 and 2012) relate to plan members who have departed Cochlear.
2. Price as at 28 June 2013 was $61.71 (30 June 2013 was a weekend day). The exercise price for options granted in 2010, 2011 and 2012 was below the market price as at 28 June 2013.

5.4 KMP equity interests (unaudited)

In accordance with the Corporations Act (section 205G(1)), Cochlear is required to notify the interests (shares and rights to shares) of directors to the ASX.

In the interests of transparency and completeness of disclosure this information is provided for each NED (as required under the Corporations Act) and all executive KMP as well.

Please refer to sections 4.5.2 (Hedging and margin lending prohibition) and 4.5.5 (Minimum shareholding guidelines).

The table below indicates Cochlear Limited shareholding including any vested but unexercised options and performance shares:

NEDs	Cochlear Limited ordinary shares	Total intrinsic value of Cochlear Limited securities as at year end ($)[3]
Rick Holliday-Smith	9,250	570,818
Yasmin Allen	2,950	182,045
Paul Bell	3,000	185,130
Edward Byrne	3,250	200,558
Andrew Denver	4,000	246,840
Donal O'Dwyer	5,000	308,550
Total NEDs	**27,450**	**1,693,941**

Executives	Cochlear Limited ordinary shares	Vested options over Cochlear Limited ordinary shares[1]	Vested performance shares over Cochlear Limited ordinary shares[2]	Total intrinsic value of Cochlear Limited securities as at year end ($)[3]
Executive director				
Chris Roberts	719,803	23,235	-	44,457,846
Other executives				
Richard Brook	7,700	7,796	-	488,186
Jan Janssen	13,328	5,693	-	831,978
Neville Mitchell	10,000	-	-	617,100
Mark Salmon	9,740	-	-	601,055
Chris Smith	10,000	8,873	-	631,918
Total executives	**770,571**	**45,597**	**-**	**47,628,083**

1. The number of vested but unexercised options.
2. The number of vested but unexercised performance shares.
3. The intrinsic value of Cochlear Limited ordinary shares and vested performance shares as at the closing Cochlear Limited share price on the ASX on 28 June 2013, plus the intrinsic value of vested options calculated as at the closing Cochlear Limited share price on the ASX on 28 June 2013 less the applicable exercise price times the number of options (negative values are treated as zero in the totals). Please note the share ownership guideline applies an average share price to NEDs' and executive KMP's holdings not intrinsic value at year end.

The table below illustrates any unvested options and performance shares issued to executive KMP but still subject to performance hurdles:

	Unvested options over Cochlear Limited ordinary shares[1]	Unvested performance shares over Cochlear Limited ordinary shares[2]	Total intrinsic value of unvested options and performance shares as at year end ($)[3]
Executive director			
Chris Roberts	435,053	-	-
Other executives			
Richard Brook	82,618	-	-
Jan Janssen	55,178	4,707	290,469
Neville Mitchell	59,768	6,120	377,665
Mark Salmon	51,222	8,016	494,667
Chris Smith	65,887	8,403	518,549
Total executives	**749,726**	**27,246**	**1,681,350**

1. The number of unvested options.
2. The number of unvested performance shares.
3. The intrinsic value of unvested performance shares as at the closing Cochlear Limited share price on the ASX on 28 June 2013 and the intrinsic value of unvested options calculated as at the closing Cochlear Limited share price on the ASX on 28 June 2013 less the applicable exercise price times the number of options (negative values are treated as zero in the totals).

6.0 Service contracts and employment agreements (audited)

6.1 Service contracts

Cochlear does not enter into service contracts for executive KMP, other than the CEO/President.

The following sets out details of the service contract terms for the current CEO/President, Dr Roberts:

Length of contract	Dr Roberts is on a permanent contract, which is an ongoing employment contract until notice is given by either party.
Notice periods	In order to terminate the employment arrangements, Dr Roberts is required to provide Cochlear with six months' written notice. Cochlear must provide Dr Roberts with 12 months' written notice.
Termination on notice by Cochlear	Cochlear may terminate employment by providing six months' written notice or payment in lieu of the notice period based on total fixed remuneration (TFR). On termination on notice by Cochlear, unless the Board determines otherwise Dr Roberts shall receive: • payment equivalent to 12 months' TFR; • pro-rated STI benefits for the months of service in the financial year to which the plan relates; and • if determined by the Board, in its sole discretion, the entitlements (if any) to LTI benefits.
Death or total and permanent disability	If Cochlear terminates employment for reasons of death or total and permanent disability, a severance payment will be made that is equal to 12 months' fixed remuneration. All STI and LTI benefits are either: • released in full or on a pro-rata basis; or • remain subject to clawback and are released at the original vesting date at the discretion of the Board with regard to the circumstances. On death or total and permanent disability, the Board has discretion to allow unvested STI and LTI benefits to vest.
Statutory entitlements	Payment of statutory entitlements of long service leave and annual leave applies in all events of separation.
Post-employment restraints	For a period of 12 months after termination date without the consent of Cochlear for engagement in business competition or to induce Cochlear NEDs or staff to terminate their employment.

6.2 Employment agreements

Other executive KMP operate under employment agreements.

The following sets out details of the employment agreements relating to other executive KMP. The terms for all other executive KMP are similar but do, on occasion, vary to suit different needs.

Length of contract	All other executive KMP are on permanent contracts, which is an ongoing employment contract until notice is given by either party.
Notice periods	In order to terminate the employment arrangements, other executive KMP are required to provide Cochlear with between 60 days' and six months' written notice.
Resignation	On resignation, unless the Board determines otherwise: • all unvested STI or LTI benefits are forfeited.
Termination on notice by Cochlear	Cochlear may terminate employment by providing between 60 days' and 12 months' written notice or payment in lieu of the notice period based on TFR. On termination on notice by Cochlear, unless the Board determines otherwise: • unvested STI or LTI benefits may be exercised or paid within 30 days of notice being given.
Redundancy	If Cochlear terminates employment for reasons of redundancy, under Cochlear policy a severance payment will be made of up to 12 months' TFR. All STI and LTI benefits are either: • released in full or on a pro-rata basis; or • remain subject to performance criteria and vesting date at the discretion of the Board with regard to the circumstances.
Death or total and permanent disability	On death or total and permanent disability, the Board has discretion to allow all unvested STI and LTI benefits to vest.
Termination for serious misconduct	Cochlear may immediately terminate employment at any time in the case of serious misconduct, and other executive KMP will only be entitled to payment of TFR up to the date of termination. On termination without notice by Cochlear in the event of serious misconduct: • all unvested STI or LTI benefits will be forfeited; and • any ESS instruments provided to the employee on vesting of STI or LTI awards that are held in trust, will be forfeited.
Statutory entitlements	Payment of statutory entitlements of long service leave and annual leave applies in all events of separation.
Other arrangements	Richard Brook - President, European Region will receive: • a maximum of Swiss francs (CHF) 30,000 for repatriation costs in the case of termination or resignation; and • redundancy benefits - refer to relevant Swiss legislation.
Post-employment restraints	All other executive KMP are subject to post-employment restraints for up to 12 months.

Indemnification of officers

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

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

Insurance premiums

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

Events subsequent to the reporting date

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

Dividends

For dividends declared after 30 June 2013, see Note 9 to the financial statements.

Lead auditor's independence declaration

The lead auditor's independence declaration is set out on page 58 and forms part of the Directors' Report for the financial year ended 30 June 2013.

Rounding off

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

Dated at Sydney this 19 day of August 2013.

Signed in accordance with a resolution of the directors:

Director

Director

Lead Auditor's Independence Declaration

Lead auditor's independence declaration under section 307C of the Corporations Act 2001
To: the directors of Cochlear Limited

I declare that, to the best of my knowledge and belief, in relation to the audit for the year ended 30 June 2013 there have been:

(i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and

(ii) no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

Sydney, 19 August 2013

Bruce Phillips, Partner

Income Statement
Cochlear Limited and its controlled entities for the year ended 30 June 2013

	Note	2013 $000	2012 $000
Revenue	5(a)	752,721	778,996
Cost of sales	5(b)	(208,072)	(203,260)
Cost of sales – product recall	29	-	(138,835)
Gross profit		**544,649**	**436,901**
Selling and general expenses		(202,781)	(197,091)
Administration expenses		(38,157)	(45,429)
Research and development expenses		(124,715)	(119,322)
Other income	5(c)	2,379	1,745
Other expenses	5(d)	(2,515)	(349)
Results from operating activities		**178,860**	**76,455**
Finance income	6	659	1,852
Finance expense	6	(6,882)	(6,150)
Net finance expense		**(6,223)**	**(4,298)**
Profit before income tax		**172,637**	**72,157**
Income tax expense	8	(40,074)	(15,354)
Net profit		**132,563**	**56,803**
Basic earnings per share (cents)	11	233.0	100.0
Diluted earnings per share (cents)	11	232.4	99.8

The notes on pages 64 to 113 are an integral part of these consolidated financial statements.

Statement of Comprehensive Income
Cochlear Limited and its controlled entities for the year ended 30 June 2013

	Note	2013 $000	2012 $000
Net profit		**132,563**	**56,803**
Other comprehensive income/(loss)			
Items that may be reclassified subsequently to the income statement:			
Foreign currency translation differences		29,179	(18,304)
Effective portion of changes in fair value of cash flow hedges, net of tax	6	(21,206)	26,639
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	6	(26,384)	(52,108)
Total items that may be reclassified subsequently to the income statement		(18,411)	(43,773)
Total other comprehensive loss		**(18,411)**	**(43,773)**
Total comprehensive income		**114,152**	**13,030**

The notes on pages 64 to 113 are an integral part of these consolidated financial statements.

Balance Sheet Cochlear Limited and its controlled entities as at 30 June 2013

	Note	2013 $000	2012 $000
Assets			
Cash and cash equivalents	23(a)	52,689	68,486
Trade and other receivables	12	203,748	189,085
Inventories	13	131,574	101,298
Current tax assets	16	6,207	5,763
Prepayments		11,004	9,249
Total current assets		**405,222**	**373,881**
Trade and other receivables	12	944	11,840
Property, plant and equipment	14	65,898	59,611
Intangible assets	15	235,774	206,715
Deferred tax assets	16	56,663	50,495
Total non-current assets		**359,279**	**328,661**
Total assets		**764,501**	**702,542**
Liabilities			
Trade and other payables	17	96,789	100,218
Loans and borrowings	18	3,309	45,744
Current tax liabilities	16	6,002	19,526
Provisions	20	63,224	78,366
Deferred revenue		22,506	18,089
Total current liabilities		**191,830**	**261,943**
Trade and other payables	17	13,242	735
Loans and borrowings	18	167,160	19,928
Provisions	20	35,356	35,056
Total non-current liabilities		**215,758**	**55,719**
Total liabilities		**407,588**	**317,662**
Net assets		**356,913**	**384,880**
Equity			
Share capital		118,788	121,136
Reserves		(32,433)	(16,762)
Retained earnings		270,558	280,506
Total equity		**356,913**	**384,880**

The notes on pages 64 to 113 are an integral part of these consolidated financial statements.

Statement of Changes in Equity

Cochlear Limited and its controlled entities for the year ended 30 June 2013

Amounts $000	Issued capital	Treasury reserve	Translation reserve	Hedging reserve	Share based payment reserve	Retained earnings	Total equity
2012							
Balance at 1 July 2011	123,226	(3,489)	(65,849)	56,379	32,827	360,189	503,283
Total comprehensive income							
Net profit	-	-	-	-	-	56,803	56,803
Other comprehensive (loss)/income							
Foreign currency translation differences	-	-	(18,304)	-	-	-	(18,304)
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	-	26,639	-	-	26,639
Net change in fair value of cash flow hedges reclassified to the income statement, net of tax	-	-	-	(52,108)	-	-	(52,108)
Total other comprehensive loss	**-**	**-**	**(18,304)**	**(25,469)**	**-**	**-**	**(43,773)**
Total comprehensive (loss)/income	**-**	**-**	**(18,304)**	**(25,469)**	**-**	**56,803**	**13,030**
Transactions with owners, recorded directly in equity							
Shares issued, net	2,639	(1,240)	-	-	-	-	1,399
Share based payment transactions	-	-	-	-	3,654	-	3,654
Dividends to shareholders	-	-	-	-	-	(136,486)	(136,486)
Balance at 30 June 2012	**125,865**	**(4,729)**	**(84,153)**	**30,910**	**36,481**	**280,506**	**384,880**
2013							
Balance at 1 July 2012	125,865	(4,729)	(84,153)	30,910	36,481	280,506	384,880
Total comprehensive income							
Net profit	-	-	-	-	-	132,563	132,563
Other comprehensive income/(loss)							
Foreign currency translation differences	-	-	29,179	-	-	-	29,179
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	-	(21,206)	-	-	(21,206)
Net change in fair value of cash flow hedges reclassified to the income statement, net of tax	-	-	-	(26,384)	-	-	(26,384)
Total other comprehensive income/(loss)	**-**	**-**	**29,179**	**(47,590)**	**-**	**-**	**(18,411)**
Total comprehensive income/(loss)	**-**	**-**	**29,179**	**(47,590)**	**-**	**132,563**	**114,152**
Transactions with owners, recorded directly in equity							
Shares repurchased, net	2,331	(4,679)	-	-	-	-	(2,348)
Share based payment transactions	-	-	-	-	2,740	-	2,740
Dividends to shareholders	-	-	-	-	-	(142,511)	(142,511)
Balance at 30 June 2013	**128,196**	**(9,408)**	**(54,974)**	**(16,680)**	**39,221**	**270,558**	**356,913**

The notes on pages 64 to 113 are an integral part of these consolidated financial statements.

Statement of Cash Flows Cochlear Limited and its controlled entities for the year ended 30 June 2013

	Note	2013 $000	2012 $000
Cash flows from operating activities			
Cash receipts from customers		669,311	724,842
Cash paid to suppliers and employees		(555,798)	(512,963)
Grant and other income received		2,379	1,745
Interest received		617	1,746
Interest paid		(6,967)	(5,972)
Income taxes paid		(39,815)	(41,118)
Net cash provided by operating activities	23(b)	**69,727**	**168,280**
Cash flows from investing activities			
Acquisition of property, plant and equipment		(21,074)	(20,843)
Acquisition of enterprise resource planning system		(14,477)	(9,972)
Acquisition of other intangible assets		(14,868)	(6,629)
Net cash used in investing activities		**(50,419)**	**(37,444)**
Cash flows from financing activities			
Repayments of borrowings		(89,000)	(141,000)
Proceeds from borrowings		195,000	143,000
Shares (repurchased)/issued, net		(2,348)	1,399
Dividends paid	9	(142,511)	(136,486)
Net cash used in financing activities		**(38,859)**	**(133,087)**
Net decrease in cash and cash equivalents		**(19,551)**	**(2,251)**
Cash and cash equivalents, net of overdrafts at 1 July		68,486	72,423
Effect of exchange rate fluctuations on cash held		3,754	(1,686)
Cash and cash equivalents, net of overdrafts at 30 June	23(a)	**52,689**	**68,486**

The notes on pages 64 to 113 are an integral part of these consolidated financial statements.

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

1. Reporting entity

Cochlear Limited (the Company) is a company domiciled in Australia. The consolidated financial statements of the Company as at and for the year ended 30 June 2013 comprise the Company and its controlled entities (together referred to as Cochlear or the Consolidated Entity). Cochlear is a for-profit entity and operates in the implantable hearing device industry.

2. Basis of preparation

(a) Statement of compliance

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

The consolidated financial statements were approved by the Board of directors on 19 August 2013.

(b) Basis of measurement

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

(c) Functional and presentation currency

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

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

(d) Use of judgements and estimates

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

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

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

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

Note 15 – Intangible assets

Note 20 – Provisions

Note 21 – Contingent liabilities

Note 26 – Employee benefits

Note 27 – Financial instruments

Note 29 – Product recall.

Notes to the Financial Statements

3. Significant accounting policies

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

(a) Basis of consolidation

Controlled entities

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

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

Transactions eliminated on consolidation

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

Special purpose entities

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

(b) Income recognition

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

Sales revenue

Sales revenue comprises revenue earned (net of returns, discounts and allowances) from the provision of products or services. Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due or if there is a risk of return of goods or there is continuing management involvement with the goods. Revenue from the sale of services is recognised when the service has been provided to the customer and where there are no continuing unfulfilled service obligations.

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

Other income

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

(c) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

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

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the relevant taxation authority are classified as operating cash flows.

(d) Foreign currency

Foreign currency transactions

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

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

Notes to the Financial Statements

Financial statements of foreign operations

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

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

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

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

(e) Financial instruments

Derivative financial instruments

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

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

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

Non-derivative financial assets

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

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

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

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

Financial assets at fair value through profit or loss

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

Loans and receivables

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

Loans and receivables comprise cash and cash equivalents, and trade and other receivables.

Non-derivative financial liabilities

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

Notes to the Financial Statements

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

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

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

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

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

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

Determination of fair values

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

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

Other

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

Cash flow hedges

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

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

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

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

Hedges of net investment in foreign operations

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

(f) Cash and cash equivalents

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

(g) Provisions

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

Notes to the Financial Statements

Warranties

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

Onerous contracts

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

Self-insurance

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

Make good lease costs

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

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

(h) Intangible assets

Goodwill

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

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

Enterprise resource planning system

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

Research and development expenditure

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

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

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

Other intangible assets

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

Subsequent expenditure

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

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

Amortisation

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

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

Acquired technology, patents and licences	4 – 15 years
Enterprise resource planning system	2.5 – 7 years
Customer relationships	4 years
Capitalised development expenditure	1 – 3 years.

(i) Impairment

Non-financial assets

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

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

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

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

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

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

Financial assets

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

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

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

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

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

(j) Property, plant and equipment

Owned assets

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

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

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

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

Leased assets

Operating leases

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

Depreciation

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

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

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

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

(k) Inventories

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

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

(l) Employee benefits

Defined contribution plans

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

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

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

Defined benefit plans

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

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

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

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

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

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

Wages, salaries and annual leave

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

Long service leave

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

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

Share based payments

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

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

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

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

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

Treasury shares

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

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

(m) Receivables

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

(n) Taxation

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

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

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

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;

- temporary differences related to investments in controlled entities to the extent that it is probable that they will not reverse in the foreseeable future; and
- taxable temporary differences arising on the initial recognition of goodwill.

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Consolidated Entity expects, at the end of the financial year, to recover or settle the carrying amount of its assets and liabilities.

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

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

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

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

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

(o) Payables

Trade and other payables are stated at amortised cost.

(p) Loans and borrowings

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

(q) Finance income and expense

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

(r) Earnings per share

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

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

(s) Segment reporting

Determination and presentation of operating segments

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

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

(t) Share capital

Ordinary shares

Ordinary shares are classified as equity.

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

Notes to the Financial Statements

Repurchase of share capital (treasury shares)

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

Dividends

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

(u) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for financial years beginning after 1 July 2012, and have not been applied in preparing these consolidated financial statements. Of the new standards, only the following are expected to have an effect on the consolidated financial statements of Cochlear:

- AASB 9 Financial Instruments, which becomes mandatory for Cochlear's 2016 consolidated financial statements;
- AASB 13 Fair Value Measurement, which becomes mandatory for Cochlear's 2014 consolidated financial statements; and
- AASB 19 Employee Benefits, which becomes mandatory for Cochlear's 2014 consolidated financial statements. This will require Cochlear to change from the corridor method for recognising actuarial gains and losses to the direct to equity method.

Cochlear is currently assessing the impact of the changes in each of the above standards and it is not expected that the changes will have a significant impact on Cochlear. As such, Cochlear does not plan to adopt these standards early.

4. Financial risk management

Overview

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

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

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

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

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

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

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

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

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

Credit risk

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

Trade and other receivables

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

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

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

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

Guarantees

Details of guarantees provided by Cochlear are provided in Note 18.

Liquidity risk

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

Cochlear monitors cash flow requirements and produces cash flow projections for the short and long term with a view to optimising return on investments. Typically, Cochlear ensures that it has sufficient funds on demand to meet expected operational net cash flows for a period of at least 30 days, including the servicing of financial obligations. This excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. In addition, Cochlear maintains lines of credit which are set out in Note 18.

Market risk

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

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

Currency risk

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

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

Interest rate risk

Cochlear is exposed to interest rate risks in Australia and Japan. See Note 27 for effective interest rates, repayment and repricing analysis of outstanding debt.

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

Operational risk

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

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

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

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

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

Capital management

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

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

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

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

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

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

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

Cochlear's net gearing ratio was as follows:

	2013 $000	2012 $000
Total loans and borrowings	170,469	65,672
Less: Cash and cash equivalents	(52,689)	(68,486)
Net debt/(cash)	**117,780**	**(2,814)**
Total equity	356,913	384,880
Net gearing ratio at 30 June	**25%**	**(1%)**

Notes to the Financial Statements

	Note	2013 $000	2012 $000
5. Revenue and expenses			
(a) Revenue			
Sale of goods before hedging		708,710	698,525
Foreign exchange gains on hedged sales		37,691	74,441
Revenue from sale of goods		**746,401**	**772,966**
Rendering of services		6,320	6,030
Total revenue		**752,721**	**778,996**
(b) Expenses			
Cost of sales			
Carrying amount of inventories recognised as an expense		206,590	198,421
Write-down in value of inventories		1,482	4,839
Total cost of sales (excluding product recall)		**208,072**	**203,260**
(c) Other income			
Grant received or due and receivable		1,401	896
Other income		978	849
Total other income		**2,379**	**1,745**
(d) Other expenses			
Net foreign exchange loss		2,515	349
Total other expenses		**2,515**	**349**
(e) Employee benefits expense			
Wages and salaries		208,585	191,025
Contributions to superannuation plans		15,846	14,379
Increase in leave liabilities		2,069	2,871
Equity settled share based payment transactions		2,740	3,654
Total employee benefits expense		**229,240**	**211,929**
(f) Profit before income tax has been arrived at after charging the following items:			
Operating lease rental expense		15,485	16,028
Loss on disposal of property, plant and equipment		1,482	1,652
Write-down in value of inventories – product recall	29	-	34,859
Impairment of property, plant and equipment – product recall	29	-	14,006
Impairment of intangible assets – product recall	29	-	13,840
Provision for warranty and other costs – product recall	29	-	76,130

Notes to the Financial Statements

	2013 $000	2012 $000
6. Net finance expense		
Recognised in the income statement		
Interest income	659	1,852
Finance income	**659**	**1,852**
Interest expense	(6,882)	(6,150)
Finance expense	**(6,882)**	**(6,150)**
Net finance expense recognised in the income statement	**(6,223)**	**(4,298)**
Recognised in other comprehensive loss		
Effective portion of changes in fair value of cash flow hedges, net of tax	(21,206)	26,639
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	(26,384)	(52,108)
Net finance expense recognised in other comprehensive loss, net of tax	**(47,590)**	**(25,469)**

	2013 $	2012 $
7. Auditors' remuneration		
Audit services		
Auditors of the Company		
KPMG:		
- audit and review of financial reports	1,336,981	1,286,910
- other regulatory compliance services	58,925	69,672
Total audit services	**1,395,906**	**1,356,582**
Non-audit services		
Auditors of the Company		
KPMG:		
- taxation compliance services	1,211,162	1,128,460
Total non-audit services	**1,211,162**	**1,128,460**

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

	Note	2013 $000	2012 $000
8. Income tax expense			
Recognised in the income statement			
Current tax expense			
Current year		31,440	45,335
Adjustment for prior years		(3,143)	(2,578)
		28,297	**42,757**
Deferred tax benefit			
Origination and reversal of temporary differences		11,777	(27,403)
	16	**11,777**	**(27,403)**
Total income tax expense		**40,074**	**15,354**

	2013 Total Reported $000	2012 Total Reported $000	2012 Total Recall $000	2012 Total Adjusted $000
Numerical reconciliation between income tax expense and profit before income tax				
Net profit/(loss)	132,563	56,803	(101,336)	158,139
Income tax expense/(benefit)	40,074	15,354	(37,499)	52,853
Profit/(loss) before income tax	**172,637**	**72,157**	**(138,835)**	**210,992**
Income tax expense/(benefit) using the Company's domestic tax rate of 30% (2012: 30%)	51,791	21,647	(41,651)	63,298
Increase in income tax expense due to:				
Non-deductible expenses	2,637	6,274	4,152	2,122
Decrease in income tax expense due to:				
Research and development allowances	(10,560)	(8,127)	-	(8,127)
Share based payment deductions	(332)	(327)	-	(327)
Effect of tax rate in foreign jurisdictions	(319)	(1,535)	-	(1,535)
	43,217	**17,932**	**(37,499)**	**55,431**
Adjustment for prior years	(3,143)	(2,578)	-	(2,578)
Income tax expense/(benefit) on profit before income tax	**40,074**	**15,354**	**(37,499)**	**52,853**

	Note	2013 $000	2012 $000
Deferred tax recognised in other comprehensive loss relating to derivative financial instruments		(20,060)	(10,545)
Total deferred tax recognised in other comprehensive loss	16	**(20,060)**	**(10,545)**
Deferred tax recognised directly in equity relating to share based payments		2,537	3,733
Total deferred tax recognised directly in equity	16	**2,537**	**3,733**

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

	Cents per share	Total amount $000	Franked/unfranked	Date of payment
9. Dividends				
Dividends recognised in the current financial year by the Company are:				
2013				
Interim 2013 ordinary	125.0	71,295	40% Franked	12 March 2013
Final 2012 ordinary	125.0	71,216	35% Franked	20 September 2012
Total amount	**250.0**	**142,511**		
2012				
Interim 2012 ordinary	120.0	68,315	60% Franked	13 March 2012
Final 2011 ordinary	120.0	68,171	70% Franked	22 September 2011
Total amount	**240.0**	**136,486**		

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

Subsequent events				
Since the end of the financial year, the directors declared the following dividends:				
Final 2013 ordinary	127.0	72,442	30% Franked	19 September 2013
Total amount	**127.0**	**72,442**		

The financial effect of the 2013 final dividend has not been brought to account in the financial statements for the year ended 30 June 2013 and will be recognised in the subsequent financial year.

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

	Company	
	2013	2012
	$000	$000
Dividend franking account		
30% franking credits available to shareholders of Cochlear Limited for subsequent financial years	1,807	13,042

The above amounts are based on the balance of the dividend franking account at year end.

The ability to utilise the franking account credits is dependent upon the ability to declare dividends. The impact on the dividend franking account of dividends proposed after the balance sheet date but not recorded as a liability is to reduce it by $9,313,969 (2012: $10,711,769).

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

10. Operating segments

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

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

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

Information about reportable segments

	Americas		EMEA[1]		Asia Pacific		Total	
	2013	2012	2013	2012	2013	2012	2013	2012
	$000	$000	$000	$000	$000	$000	$000	$000
Reportable segment revenue	284,394	296,948	283,023	284,691	147,613	122,916	715,030	704,555
Reportable segment profit before income tax	134,439	144,720	131,523	132,795	57,672	43,893	323,634	321,408
Reportable segment assets	111,905	91,081	176,594	143,081	70,146	72,093	358,645	306,255
Reportable segment liabilities	31,349	23,853	52,164	52,612	12,633	16,482	96,146	92,947
Other material items								
Depreciation and amortisation	720	627	1,672	1,800	1,020	948	3,412	3,375
Write-down in value of inventories excluding product recall	139	-	141	111	267	278	547	389
Acquisition of non-current assets	1,812	534	1,035	922	255	821	3,102	2,277

(1) Europe, Middle East and Africa.

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

	2013	2012
	$000	$000
Revenues		
Reportable segment revenue	715,030	704,555
Foreign exchange gains on hedged sales	37,691	74,441
Consolidated revenue	**752,721**	**778,996**
Profit or loss		
Reportable segment profit before income tax	323,634	321,408
Corporate and other net expenses	(144,774)	(106,118)
Cost of sales - product recall	-	(138,835)
Net finance expense	(6,223)	(4,298)
Consolidated profit before income tax	**172,637**	**72,157**
Assets		
Reportable segment assets	358,645	306,255
Unallocated corporate and manufacturing assets	405,856	396,287
Consolidated total assets	**764,501**	**702,542**
Liabilities		
Reportable segment liabilities	96,146	92,947
Unallocated corporate and manufacturing liabilities	311,442	224,715
Consolidated total liabilities	**407,588**	**317,662**

Notes to the Financial Statements

	Reportable segment total $000	Corporate and manufacturing total $000	Consolidated total $000
2013			
Other material items			
Depreciation and amortisation	3,412	19,592	23,004
Write-down in value of inventories excluding product recall	547	935	1,482
Acquisition of property, plant and equipment and intangible assets	3,102	34,880	37,982
2012			
Other material items			
Depreciation and amortisation	3,375	20,726	24,101
Write-down in value of inventories excluding product recall	389	4,450	4,839
Acquisition of property, plant and equipment and intangible assets	2,277	48,646	50,923

Revenue by product

	2013 $000	2012 $000
Cochlear implants	636,393	626,684
Bone anchored hearing aids (Baha)	78,637	77,871
Total	**715,030**	**704,555**

	2013	2012
11. Earnings per share		
Basic earnings per share		
The calculation of basic earnings per share for the year ended 30 June 2013 was based on net profit attributable to equity holders of the parent entity of $132,563,000 (2012: $56,803,000) and a weighted average number of ordinary shares on issue during the year ended 30 June 2013 of 56,890,261 (2012: 56,824,604) calculated as follows:		
Net profit attributable to equity holders of the parent entity	$132,563,000	$56,803,000
Weighted average number of ordinary shares (basic):		
Issued ordinary shares at 1 July (number)	56,865,878	56,680,142
Effect of options and performance shares exercised (number)	13,619	126,686
Effect of shares issued under Employee Share Plan (number)	10,764	17,776
Weighted average number of ordinary shares (basic) at 30 June	**56,890,261**	**56,824,604**
Basic earnings per share (cents)	**233.0**	**100.0**
Diluted earnings per share		
The calculation of diluted earnings per share for the year ended 30 June 2013 was based on net profit attributable to equity holders of the parent entity of $132,563,000 (2012: $56,803,000) and a weighted average number of ordinary shares on issue during the year ended 30 June 2013 of 57,047,096 (2012: 56,922,674) calculated as follows:		
Net profit attributable to equity holders of the parent entity	$132,563,000	$56,803,000
Weighted average number of ordinary shares (diluted):		
Weighted average number of shares (basic) (number)	56,890,261	56,824,604
Effect of options and performance shares (number)	156,835	98,070
Weighted average number of ordinary shares (diluted) at 30 June	**57,047,096**	**56,922,674**
Diluted earnings per share (cents)	**232.4**	**99.8**

Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2013

	2013 $000	2012 $000
12. Trade and other receivables		
Current		
Trade receivables net of allowance for impairment losses	187,593	144,727
Other receivables	12,691	11,721
Forward exchange contracts	3,464	32,637
Total current trade and other receivables	**203,748**	**189,085**
Non-current		
Other receivables	46	50
Forward exchange contracts	898	11,790
Total non-current trade and other receivables	**944**	**11,840**

Cochlear's exposure to credit and currency risks and impairment losses related to trade and other receivables is disclosed in Note 27.

	2013 $000	2012 $000
13. Inventories		
Raw materials and stores	48,653	25,300
Work in progress	15,333	13,746
Finished goods	67,588	62,252
Total inventories	**131,574**	**101,298**

	Note	2013 $000	2012 $000
14. Property, plant and equipment			
Leasehold improvements			
At cost		23,057	22,583
Accumulated amortisation		(16,613)	(17,117)
		6,444	**5,466**
Plant and equipment			
At cost		155,923	135,726
Accumulated depreciation and impairment		(96,469)	(81,581)
		59,454	**54,145**
Total property, plant and equipment, at net book value		**65,898**	**59,611**
Reconciliations			
Reconciliations of the carrying amounts of each class of property, plant and equipment are set out below:			
Leasehold improvements			
Carrying amount at beginning of financial year		5,466	6,727
Additions		2,171	1,259
Amortisation		(1,525)	(2,429)
Effect of movements in foreign exchange		332	(91)
Carrying amount at end of financial year		**6,444**	**5,466**
Plant and equipment			
Carrying amount at beginning of financial year		54,145	62,630
Additions		18,903	19,584
Impairment	29	-	(14,006)
Disposals		(1,028)	(150)
Depreciation		(13,876)	(13,397)
Effect of movements in foreign exchange		1,310	(516)
Carrying amount at end of financial year		**59,454**	**54,145**

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

	2013 $000	2012 $000
15. Intangible assets		
Intangible assets with indefinite useful lives		
Goodwill, at cost	170,959	151,066
Technology relationship, at cost	1,800	1,800
Total intangible assets with indefinite useful lives	**172,759**	**152,866**
Intangible assets with definite useful lives		
Acquired technology, patents and licences		
At cost	62,811	49,505
Accumulated amortisation and impairment	(28,733)	(25,340)
	34,078	**24,165**
Enterprise resource planning system		
At cost	60,941	47,011
Accumulated amortisation	(33,614)	(29,290)
	27,327	**17,721**
Customer relationships		
At cost	4,449	4,020
Accumulated amortisation	(4,449)	(4,020)
	-	-
Capitalised development expenditure		
At cost	7,759	7,759
Accumulated amortisation	(7,759)	(7,759)
	-	-
Other intangible assets		
At cost	4,013	13,918
Accumulated amortisation	(2,403)	(1,955)
	1,610	**11,963**
Total intangible assets with definite useful lives	**63,015**	**53,849**
Total intangible assets	**235,774**	**206,715**

Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2013

	Note	2013 $000	2012 $000
Reconciliations			
Reconciliations of the carrying amounts of each class of intangible assets are set out below:			
Goodwill			
Carrying amount at beginning of financial year		151,066	159,137
Effect of movements in foreign exchange		19,893	(8,071)
Carrying amount at end of financial year		**170,959**	**151,066**
Technology relationship			
Carrying amount at beginning of financial year		1,800	1,800
Carrying amount at end of financial year		**1,800**	**1,800**
Acquired technology, patents and licences			
Carrying amount at beginning of financial year		24,165	30,808
Acquisitions		2,431	10,174
Impairment	29	-	(13,840)
Amortisation		(2,770)	(2,823)
Reclassification from other intangible assets	(a)	9,934	-
Effect of movements in foreign exchange		318	(154)
Carrying amount at end of financial year		**34,078**	**24,165**
Enterprise resource planning system			
Carrying amount at beginning of financial year		17,721	14,296
Acquisitions		14,477	9,972
Amortisation		(4,432)	(5,047)
Disposals		(454)	(1,502)
Effect of movements in foreign exchange		15	2
Carrying amount at end of financial year		**27,327**	**17,721**
Other intangible assets			
Carrying amount at beginning of financial year		11,963	2,509
Acquisitions	(a)	-	9,934
Amortisation		(401)	(405)
Disposals		-	-
Reclassification to acquired technology, patents and licences	(a)	(9,934)	-
Effect of movements in foreign exchange		(18)	(75)
Carrying amount at end of financial year		**1,610**	**11,963**

Notes to the Financial Statements

(a) Purchase of intellectual property from Otologics LLC

As at 30 June 2012, Cochlear recorded an asset being the "Right to acquire intellectual property" of USD10.0 million to reflect its security interest in the intellectual property assets of Otologics LLC being the same value as its amount payable to Wells Fargo Bank as guarantor to Otologics LLC loan following Otologics LLC's declaration of bankruptcy.

During the year, Cochlear settled the loan and acquired intellectual property and certain other assets of Otologics LLC for a total consideration of USD14.0 million.

Amortisation charge

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

Impairment tests for CGUs

Impairment testing is performed assessing carrying amounts of goodwill, other intangible assets and property, plant and equipment at Cochlear's CGUs.

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

The aggregate carrying amounts of goodwill allocated to each CGU are as follows:

	2013 $000	2012 $000
Americas	86,438	76,224
EMEA	74,709	66,012
Asia Pacific	9,812	8,830
	170,959	**151,066**

The recoverable amount of each CGU is based on value-in-use calculations. Those calculations use cash flow projections based on actual operating results and the three year business plan. Cash flows for subsequent years are extrapolated using a conservative growth rate of 3% (2012: 3.0%) per annum which is consistent with long-term economic growth rates. A pre-tax discount rate of 13.5% (2012: 13.5%) per annum has been used in discounting the projected pre-tax cash flows.

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

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

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

	Assets		Liabilities		Net	
	2013	2012	2013	2012	2013	2012
	$000	$000	$000	$000	$000	$000
16. Deferred tax assets and liabilities						
Recognised deferred tax assets and liabilities						
Property, plant and equipment	4,395	5,294	(729)	(345)	3,666	4,949
Intangible assets	55	57	(1,809)	(55)	(1,754)	2
Inventories	16,063	24,327	-	-	16,063	24,327
Provisions	25,567	30,186	-	-	25,567	30,186
Deferred revenue	3,382	1,428	-	-	3,382	1,428
Forward exchange contracts	6,407	-	-	(13,636)	6,407	(13,636)
Other	4,713	11,268	(2,678)	(8,029)	2,035	3,239
Tax losses carried forward	1,297	-	-	-	1,297	-
Deferred tax assets/(liabilities)	**61,879**	**72,560**	**(5,216)**	**(22,065)**	**56,663**	**50,495**
Set off of tax	(5,216)	(22,065)	5,216	22,065	-	-
Net deferred tax assets	**56,663**	**50,495**	**-**	**-**	**56,663**	**50,495**

Unrecognised deferred tax liabilities

At 30 June 2013, a deferred tax liability of $23.3 million (2012: $24.5 million) relating to investments in subsidiaries has not been recognised because the Company controls whether the asset will be recovered or the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future.

Current tax assets and liabilities

The current tax assets for the Consolidated Entity of $6.2 million (2012: $5.8 million) represent the amount of income taxes recoverable in respect of current and prior years and arise from the payment of tax in excess of the amounts due to the relevant taxation authority. The current tax liabilities for the Consolidated Entity of $6.0 million (2012: $19.5 million) represent the amount of income taxes payable in respect of current and prior financial years.

Movement in temporary differences during the year

	Note	2013 $000	2012 $000
Carrying amount at beginning of financial year		50,495	16,072
Recognised in the income statement	8	(11,777)	27,403
Recognised in other comprehensive loss	8	20,060	10,545
Recognised directly in equity	8	(2,537)	(3,733)
Effects of movements in foreign exchange		422	208
Carrying amount at end of financial year		**56,663**	**50,495**

Notes to the Financial Statements

	2013 $000	2012 $000
17. Trade and other payables		
Current		
Trade payables and accruals	80,632	98,404
Other payables	1,242	1,713
Forward exchange contracts	14,915	101
Total current trade and other payables	**96,789**	**100,218**
Non-current		
Other payables	-	695
Forward exchange contracts	13,242	40
Total non-current trade and other payables	**13,242**	**735**

	2013 $000	2012 $000
18. Loans and borrowings		
Current		
Secured bank loans	3,309	45,744
Total current loans and borrowings	**3,309**	**45,744**
Non-current		
Secured bank loans[i]	167,160	19,928
Total non-current loans and borrowings	**167,160**	**19,928**
Financing arrangements		
Cochlear had access to the following lines of credit at the reporting date:		
Multi-option credit facilities		
Secured bank loan	295,000	170,000
Standby letters of credit	19,736	44,345
Bank guarantees	264	655
Other credit facilities		
Unsecured bank overdrafts	352	508
Secured bank loan	4,963	3,744
Standby letters of credit	-	329
Bank guarantees	1,198	3,655
	321,513	223,236

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

	2013 $000	2012 $000
Facilities utilised at the reporting date		
Multi-option credit facilities		
Secured bank loan	168,000	62,000
Standby letters of credit	1,924	16,030
Bank guarantees	264	655
Other credit facilities		
Secured bank loan	3,309	3,744
Standby letters of credit	-	145
Bank guarantees	1,193	323
	174,690	**82,897**
Facilities not utilised at the reporting date		
Multi-option credit facilities		
Secured bank loan	127,000	108,000
Standby letters of credit	17,812	28,315
Other credit facilities		
Unsecured bank overdrafts	352	508
Secured bank loan	1,654	-
Standby letters of credit	-	184
Bank guarantees	5	3,332
	146,823	**140,339**

(i) Included within secured bank loans is an amount of $840,028 (2012: $71,875) in relation to unamortised loan establishment fees.

Secured bank loan – multi-option credit facilities

Cochlear's existing corporate loan facility was amended and extended in June 2013 for a period of three years. The facility is for a total commitment limit of AUD200.0 million, with an option to allocate a letter of credit sub-facility limit of up to AUD30.0 million for the purpose of drawing either bank guarantees or letters of credit. This letter of credit sub-limit currently sits at AUD5.0 million.

In June 2013, Cochlear negotiated a further loan facility for a period of five years. The facility has a total commitment limit of AUD115.0 million made up of an AUD100.0 million loan sub-facility limit and incorporates an existing AUD15.0 million letter of credit facility that was negotiated in August 2011.

Both facilities are secured by interlocking guarantees provided by certain controlled entities. Interest on the facilities is variable and charged at prevailing market rates.

Unsecured bank overdrafts

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

Secured bank loan

In September 2012, Cochlear's JPY300.0 million bank facility was increased to JPY450.0 million. It is secured by a letter of guarantee and reviewed annually. Interest is charged at prevailing market rates.

Bank guarantees

At 30 June 2013, Cochlear has other bank guarantee facilities denominated in USD, EUR, GBP, Indian rupees and New Zealand dollars (NZD) totalling $1.2 million (2012: $3.7 million).

	2013 $000	2012 $000
19. Commitments		
Operating lease commitments		
Future non-cancellable operating lease rentals not provided for in the financial statements are payable as follows:		
Not later than one year	21,763	20,702
Later than one year but not later than five years	62,709	67,018
Later than five years	100,059	109,857
Total operating lease commitments	**184,531**	**197,577**
Capital expenditure commitments		
Contracted but not provided for and payable:		
Not later than one year	1,553	3,410
Total capital expenditure commitments	**1,553**	**3,410**

Cochlear leases property under non-cancellable operating leases expiring from one to 15 years. Leases generally provide Cochlear with a right of renewal at which time all terms are renegotiated. Lease payments comprise a base amount plus an incremental contingent rental. Contingent rentals are based on movements in the Consumer Price Index.

Notes to the Financial Statements
Cochlear Limited and its controlled entities for the year ended 30 June 2013

	Note	2013 $000	2012 $000
20. Provisions			
Current			
Employee benefits	26	30,450	30,068
Warranties		13,231	11,053
Legal and other		7,487	7,523
Make good lease costs		-	312
Product recall	29	12,056	29,410
Total current provisions		**63,224**	**78,366**
Non-current			
Employee benefits	26	3,589	4,447
Warranties		4,683	2,938
Directors' retirement scheme	26	411	399
Make good lease costs		2,143	3,712
Product recall	29	24,530	23,560
Total non-current provisions		**35,356**	**35,056**
Reconciliations			
Reconciliations of the carrying amounts of each class of provision, except for the employee benefits provision, are set out below:			
Warranties			
Carrying amount at beginning of financial year		13,991	11,818
Provisions made		29,152	21,874
Provisions used		(25,229)	(19,701)
Carrying amount at end of financial year		**17,914**	**13,991**
Legal and other			
Carrying amount at beginning of financial year		7,523	5,294
Provisions made		5,218	3,547
Provisions used		(5,294)	(1,316)
Effects of movements in foreign exchange		40	(2)
Carrying amount at end of financial year		**7,487**	**7,523**
Make good lease costs			
Carrying amount at beginning of financial year		4,024	4,840
Provisions made		400	-
Provisions used		(416)	(818)
Provisions released		(1,857)	-
Effects of movements in foreign exchange		(8)	2
Carrying amount at end of financial year		**2,143**	**4,024**

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

	Note	2013 $000	2012 $000
Directors' retirement scheme			
Carrying amount at beginning of financial year		399	382
Provisions made		12	17
Carrying amount at end of financial year		**411**	**399**
Product recall			
Carrying amount at beginning of financial year		52,970	-
Provisions made	29	-	76,130
Provisions used		(16,384)	(23,160)
Carrying amount at end of financial year	29	**36,586**	**52,970**

Employee benefits
Employee benefits include entitlements measured at the present value of future amounts expected to be paid, based on a 3% per annum projected weighted average increase in remuneration rates over an average period of eight years. The present value is calculated using a weighted average discount rate of 3% per annum based on national government securities with similar maturity terms.

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

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

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

Directors' retirement scheme
Non-executive directors appointed prior to 2003 were entitled to retirement benefits of up to three times their annual remuneration over the previous three years once they had more than five years' service. The ongoing accrual of benefits under the directors' retirement scheme ceased from 30 June 2007. The benefits accrued to that date are indexed by reference to the bank bill rate. As at 30 June 2013, Prof E Byrne, AO is the only non-executive director entitled to this benefit.

Product recall
See Note 29 for details of how the provision balance is determined.

21. Contingent liabilities
The details of contingent liabilities are set out below. The directors are of the opinion that provisions are either adequate or are not required in respect of these matters, as it is either not probable that a future sacrifice of economic benefits will be required, or the amount is not capable of reliable measurement.

Product liability claims
Cochlear is currently and is likely from time to time to be involved in claims and law suits incidental to the ordinary course of business, including claims for damages relating to its products and services.

In addition, Cochlear has received legal claims in various countries and law suits in the United States by recipients who have had Cochlear implant CI500 series devices stop functioning for the reason that led to the September 2011 voluntary recall of unimplanted CI500 series devices. The claims are being negotiated and the law suits defended by Cochlear.

Cochlear carries product liability insurance and has made claims under the policies. The insurers have agreed to indemnify Cochlear in accordance with the terms and conditions of the policies including deductibles and exclusions. In the opinion of the directors, the details of the product liability insurance policies are commercially sensitive and any disclosure of these details may be prejudicial to the interests of Cochlear.

Patent infringement complaints

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

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

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

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

22. Capital and reserves

Share capital

	Number of issued shares in market circulation		Number of shares held in Trust under CELTIP		Total number of issued shares	
	2013	2012	2013	2012	2013	2012
On issue 1 July – fully paid	56,865,878	56,680,142	63,554	64,881	56,929,432	56,745,023
Issued for nil consideration under Employee Share Plan	16,302	25,023	-	-	16,302	25,023
Shares purchased from the market	(68,872)	(17,021)	68,872	17,021	-	-
Issued from the exercise of options	95,198	159,386	-	-	95,198	159,386
Performance shares vesting from Trust	6,783	18,348	(6,783)	(18,348)	-	-
On issue 30 June – fully paid	**56,915,289**	**56,865,878**	**125,643**	**63,554**	**57,040,932**	**56,929,432**

Cochlear has also issued options (see Note 26(b)).

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

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings.

Treasury reserve

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

Translation reserve

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

Hedging reserve

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

Share based payment reserve

The share based payment reserve comprises the cost of shares distributed to eligible executives under the CELTIP, as detailed in Note 26(b).

23. Notes to the statement of cash flows

Cash assets

The operating account received an average interest rate of 0.82% (2012: 1.66%) per annum.

Cash held on deposit for periods not exceeding 90 days received an average interest rate of 3.27% (2012: 2.94%) per annum.

(a) Reconciliation of cash and cash equivalents

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

	2013 $000	2012 $000
Cash on hand	31,455	56,905
Cash on deposit	21,234	11,581
Cash and cash equivalents	**52,689**	**68,486**
(b) Reconciliation of net profit to net cash provided by operating activities		
Net profit	132,563	56,803
Add items classified as investing activities		
Loss on disposal of property, plant and equipment	1,482	1,652
Add non-cash items		
Amounts set aside to provisions	60,870	128,363
Depreciation and amortisation	23,004	24,101
Impairment of property, plant and equipment and intangible assets	-	27,846
Equity settled share based payment transactions	2,740	3,654
Net cash provided by operating activities before changes in assets and liabilities	**220,659**	**242,419**
Changes in assets and liabilities		
Change in trade and other receivables	(43,677)	19,866
Change in inventories	(30,276)	4,828
Change in prepayments	(2,596)	300
Change in deferred tax assets	(6,168)	(34,423)
Change in trade and other payables	(6,618)	1,517
Change in current tax liabilities	6,485	411
Change in provisions	(75,712)	(68,597)
Change in deferred revenue	4,417	(643)
Effects of movements in foreign exchange	3,213	2,602
Net cash provided by operating activities	**69,727**	**168,280**

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

		Interest held		Country of incorporation/formation
		2013 %	2012 %	
24. Controlled entities				
Particulars in relation to controlled entities				
Company				
Cochlear Limited				Australia
Controlled entities				
Acoustic Implants Limited		100	-	UK
Cochlear AG		100	100	Switzerland
Cochlear Americas		100	100	USA
Cochlear Benelux NV		100	100	Belgium
Cochlear Bone Anchored Solutions AB		100	100	Sweden
Cochlear Boulder LLC		100	-	USA
Cochlear Canada Inc		100	100	Canada
Cochlear Clinical Services LLC		100	-	USA
Cochlear Deutschland GmbH & Co KG		100	100	Germany
Cochlear Employee Share Trust		100	100	Australia
Cochlear Europe Finance GmbH		100	100	Germany
Cochlear Europe Limited		100	100	UK
Cochlear Executive Long Term Incentive Plan (Performance Shares) Trust		100	100	Australia
Cochlear Finance Pty Limited		100	100	Australia
Cochlear France SAS		100	100	France
Cochlear German Holdings Pty Limited		100	100	Australia
Cochlear Holdings NV		100	100	Belgium
Cochlear Incentive Plan Pty Limited		100	100	Australia
Cochlear Investments Pty Ltd		100	100	Australia
Cochlear Italia SRL		100	100	Italy
Cochlear Korea Limited		100	100	Korea
Cochlear Latinoamerica S.A.		100	100	Panama
Cochlear Malaysia Sdn. Bhd.		100	100	Malaysia
Cochlear Manufacturing Corporation		100	100	USA
Cochlear Medical Device (Beijing) Co., Ltd		100	100	China
Cochlear Medical Device Company India Private Limited		100	100	India
Cochlear Nordic AB		100	100	Sweden
Cochlear NZ Limited		100	100	New Zealand
Cochlear Research and Development Limited		100	100	UK
Cochlear Sweden Holdings AB		100	100	Sweden
Cochlear Technologies Pty Limited	(i)	100	100	Australia
Cochlear Tibbi Cihazlar ve Saglik Hizmetleri Limited Sirketi		100	100	Turkey
Cochlear Verwaltungs GmbH		100	100	Germany
Cochlear (HK) Limited		100	100	Hong Kong
Cochlear (UK) Limited	(i)	100	100	UK
Isitme Implantlari Tibbi Cihazlar ve Saglik Hizmetleri Ltd Sti		100	-	Turkey
Lachlan Project Development Pty Ltd		100	100	Australia
Lachlan Project Holdings Pty Ltd		100	100	Australia
Lachlan Project Security Holdings Pty Ltd		100	100	Australia

Notes to the Financial Statements

		Interest held		Country of incorporation/formation
		2013 %	2012 %	
Medical Insurance Pte Limited		100	100	Singapore
Miaki NV		100	100	Belgium
Neopraxis Pty Limited	(i)	100	100	Australia
Nihon Cochlear Co Limited		100	100	Japan
Percutis AB		100	100	Sweden

(i) Dormant.

25. Related parties

Key management personnel

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

Non-executive directors

Mr R Holliday-Smith (Chairman)

Mrs YA Allen

Mr PR Bell

Prof E Byrne, AO

Mr A Denver

Mr DP O'Dwyer

Executive director

Dr CG Roberts

Executives

Mr R Brook

Mr J Janssen

Mr NJ Mitchell

Mr MD Salmon

Mr CM Smith.

Key management personnel disclosures

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

	2013 $	2012 $
Short-term employee benefits	6,824,569	6,090,379
Post-employment benefits	368,245	350,940
Other long-term benefits	94,729	96,989
Directors' retirement benefits	12,293	16,485
Share based payments	1,232,235	846,095
	8,532,071	**7,400,888**

Information regarding individual directors' and executives' remuneration and some equity instruments disclosures as permitted by section 300A of the Corporations Act 2001 is provided in the Remuneration Report in the Directors' Report on pages 30 to 55.

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

Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2013

Options and performance shares granted as compensation

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

	Held at 1 July 2012	Granted as remuneration	Vested and exercised	Forfeited	Held at 30 June 2013	Vested and exercisable at 30 June 2013
Option holdings						
Executive director						
Dr CG Roberts	313,750	231,161	-	(86,623)	458,288	23,235
Executives						
Mr R Brook	60,833	41,448	-	(11,867)	90,414	7,796
Mr J Janssen	43,045	26,491	-	(8,665)	60,871	5,693
Mr NJ Mitchell	69,526	10,928	(8,202)	(12,484)	59,768	-
Mr MD Salmon	70,566	-	(7,670)	(11,674)	51,222	-
Mr CM Smith	49,203	45,063	(6,000)	(13,506)	74,760	8,873
Performance share holdings						
Executive director						
Dr CG Roberts	-	-	-	-	-	-
Executives						
Mr R Brook	-	-	-	-	-	-
Mr J Janssen	2,234	2,473	-	-	4,707	-
Mr NJ Mitchell	-	6,120	-	-	6,120	-
Mr MD Salmon	-	8,016	-	-	8,016	-
Mr CM Smith	6,826	1,577	-	-	8,403	-

Notes to the Financial Statements

	Held at 1 July 2011	Granted as remuneration	Vested and exercised	Forfeited	Held at 30 June 2012	Vested and exercisable at 30 June 2012
Option holdings						
Executive director						
Dr CG Roberts	297,542	117,620	(88,736)	(12,676)	313,750	-
Executives						
Mr R Brook	67,623	23,495	(26,499)	(3,786)	60,833	-
Mr J Janssen	56,736	11,128	(21,717)	(3,102)	43,045	-
Mr NJ Mitchell	77,812	27,538	(31,346)	(4,478)	69,526	-
Mr MD Salmon	88,071	28,859	(42,183)	(4,181)	70,566	-
Mr CM Smith	58,004	20,823	(25,910)	(3,714)	49,203	6,000
Performance share holdings						
Executive director						
Dr CG Roberts	-	-	-	-	-	-
Executives						
Mr R Brook	-	-	-	-	-	-
Mr J Janssen	-	2,234	-	-	2,234	-
Mr NJ Mitchell	-	-	-	-	-	-
Mr MD Salmon	-	-	-	-	-	-
Mr CM Smith	7,507	1,045	(1,510)	(216)	6,826	-

No options held by key management personnel were vested but not exercisable at 30 June 2013 or 2012.

The options and performance shares granted in the 2013 financial year were granted on 13 August 2012 and vest in August 2015. The options have an exercise price of $62.78 per share and an expiration date of 1 July 2017. No options or performance shares have been granted since the end of the financial year. The options and performance shares were provided at no cost to the recipients.

The options granted during the year have a fair value of $8.56 per share at grant date for options with EPS performance based conditions and $5.70 per share at grant date for options with TSR based conditions. The performance shares granted during the financial year had a fair value at grant date of $62.78 per share for performance shares with EPS performance based conditions and $39.55 per share at grant date for performance shares with TSR based conditions.

Notes to the Financial Statements

Movement in shares

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

	Held at 1 July 2012	Purchases	Received on exercise of options and performance shares	Sales	Held at 30 June 2013
Directors					
Non-executive					
Mr R Holliday-Smith	7,020	2,230	-	-	9,250
Mrs YA Allen	2,500	450	-	-	2,950
Mr PR Bell	2,500	500	-	-	3,000
Prof E Byrne, AO	3,250	-	-	-	3,250
Mr A Denver	2,500	1,500	-	-	4,000
Mr DP O'Dwyer	4,000	1,000	-	-	5,000
Executive					
Dr CG Roberts	715,803	4,000	-	-	719,803
Executives					
Mr R Brook	10,000	200	-	(2,500)	7,700
Mr J Janssen	31,248	2,398	-	(20,318)	13,328
Mr NJ Mitchell	36,346	2,500	8,202	(37,048)	10,000
Mr MD Salmon	9,740	-	7,670	(7,670)	9,740
Mr CM Smith	10,000	-	6,000	(6,000)	10,000

	Held at 1 July 2011	Purchases	Received on exercise of options and performance shares	Sales	Held at 30 June 2012
Directors					
Non-executive					
Mr R Holliday-Smith	5,500	1,520	-	-	7,020
Mrs YA Allen	2,500	-	-	-	2,500
Mr PR Bell	2,500	-	-	-	2,500
Prof E Byrne, AO	2,000	1,250	-	-	3,250
Mr A Denver	2,500	-	-	-	2,500
Mr DP O'Dwyer	3,350	650	-	-	4,000
Executive					
Dr CG Roberts	725,310	-	88,736	(98,243)	715,803
Executives					
Mr R Brook	8,806	1,194	26,499	(26,499)	10,000
Mr J Janssen	32,921	-	21,717	(23,390)	31,248
Mr NJ Mitchell	33,571	-	31,346	(28,571)	36,346
Mr MD Salmon	9,740	-	42,183	(42,183)	9,740
Mr CM Smith	10,000	-	27,420	(27,420)	10,000

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

	Note	2013 $000	2012 $000
26. Employee benefits			
Current			
Provision for long service leave		7,325	6,317
Provision for annual leave		16,850	14,930
Provision for short-term incentives		6,275	8,821
	20	30,450	30,068
Wages and salaries accrued		515	409
Total current employee benefits		**30,965**	**30,477**
Non-current			
Provision for long service leave		3,589	4,447
Provision for directors' retirement scheme		411	399
Total non-current employee benefits	20	**4,000**	**4,846**
Total employee benefits		**34,965**	**35,323**

Cochlear has benefit plans that provide pension benefits to employees upon retirement. These defined benefit plans cover, in aggregate, 75 employees. Cochlear contributed cash of $0.9 million (2012: $0.8 million) to defined benefit plans in the year ended 30 June 2013 and expects to contribute $1.0 million in the year ending 30 June 2014.

(a) Defined contribution superannuation plans

Cochlear makes contributions to defined contribution plans. The amount recognised as expense was $14.9 million for the year ended 30 June 2013 (2012: $14.4 million).

(b) Share based payments

Cochlear's Employee Share Plan (Plan) was approved by special resolution at the AGM held on 19 October 1999. Under the Plan, the directors can at their discretion, allocate at nil consideration up to a maximum of $2,000 worth of shares per eligible employee in any one year. The fair value of shares issued during the financial year is the market price of the Company's shares on the ASX as at the start of trading on the issue date. Shares under the Plan vest with the employee immediately but are non-transferable for a period of up to three years. For the year ended 30 June 2013, the Company issued 16,302 shares under the Plan.

Notes to the Financial Statements

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

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

Grant date	Number of instruments	Conditions for minimum vesting	Contractual life of options
Option grant in August 2009	42,837	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	42,837	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Option grant in August 2010	199,934	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	199,935	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Option grant in August and October 2011	258,532	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	258,533	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Option grant in August 2012	367,696	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	367,696	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Total options(1)	**1,738,000**		

(1) No options granted in August 2008 were outstanding as at 30 June 2013.

Notes to the Financial Statements

Issue date	Number of instruments	Conditions for minimum vesting	Contractual life of shares in the Trust
Performance shares issued in August 2008	185	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	186	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Performance shares issued in August 2009	385	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	386	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Performance shares issued in August 2010	9,734	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	9,734	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Performance shares issued in August 2011	11,211	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	11,211	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Performance shares issued in August 2012	38,299	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	38,300	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Total performance shares	119,631		

Notes to the Financial Statements

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

	Weighted average exercise price $	Number of options	Weighted average exercise price $	Number of options
	2013	2013	2012	2012
Outstanding at 1 July	64.33	1,635,440	58.72	1,719,451
Forfeited	61.62	(402,069)	56.59	(149,571)
Exercised	52.73	(255,199)	51.37	(477,388)
Granted	62.78	759,828	68.56	542,948
Outstanding at 30 June	**65.98**	**1,738,000**	**64.33**	**1,635,440**
Exercisable at 30 June	60.04	85,674	54.99	298,462

The weighted average share price at date of exercise was $69.77 (2012: $69.41).

The estimated value of options for the current financial year is calculated at the date of grant using the Black-Scholes model.

For options outstanding at 30 June 2013, 85,674 options have an exercise price of $60.04, 399,869 options have an exercise price of $69.80, 517,065 options have an exercise price of $68.56 and 735,392 options have an exercise price of $62.78 (2012: 114,258 options at $63.18, 184,204 options at $49.91, 396,679 options at $60.04, 409,737 options at $69.80 and 530,562 options at $68.56). The weighted average remaining contractual life of options outstanding at the end of the year is three years (2012: three years).

Inputs for measurement of grant date fair values

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

	13 August 2012	15 August 2011	24 October 2011
Fair value of options at grant date with:			
- EPS performance based conditions	$8.56	$13.45	$4.71
- TSR based conditions	$5.70	$8.95	$3.14
Fair value of performance shares at grant date with:			
- EPS performance based conditions	$62.78	$68.56	N/A(1)
- TSR based conditions	$39.55	$43.19	N/A(1)
Share price at grant date	$62.97	$73.75	$56.61
Option exercise price	$62.78	$68.56	$68.56
Expected volatility (weighted average volatility)	23.99%	22.0%	23.8%
Option life	3 – 5 years	3 – 5 years	3 – 5 years
Expected dividends	3.80%	2.84%	3.90%
Risk free interest rate (based on government bonds)	2.71%	3.89%	3.90%

(1) No performance shares were issued.

27. Financial instruments

Credit risk

Exposure to credit risk

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

	2013 $000	2012 $000
Cash and cash equivalents	52,689	68,486
Trade receivables and other receivables	200,330	156,498
Forward exchange contracts	4,362	44,427
	257,381	**269,411**

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

	2013 $000	2012 $000
Americas	59,110	51,548
EMEA	84,173	66,364
Asia Pacific	44,310	26,815
	187,593	**144,727**

Impairment losses

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

	2013 $000	2012 $000
Gross receivables		
Not past due	138,570	101,827
Past due 0 – 30 days	18,651	20,666
Past due 31 – 120 days	15,680	12,510
Past due 121 – 270 days	5,877	6,147
Past due 271 days and over	12,379	6,347
	191,157	**147,497**
Impairment losses	(3,564)	(2,770)
Trade receivables net of allowance for impairment losses	**187,593**	**144,727**

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

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

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

	2013 $000	2012 $000
Balance at 1 July	(2,770)	(4,899)
Net impairment losses (recognised)/utilised	(562)	2,261
Effect of movements in foreign exchange	(232)	(132)
Balance at 30 June	**(3,564)**	**(2,770)**

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

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

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

Liquidity risk

Non-derivative assets and liabilities

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

	Effective interest rate Per annum	Carrying amount $000	Contractual cash flows $000	6 months or less $000	6 – 12 months $000	1 – 2 years $000	2 – 5 years $000	More than 5 years $000
Non-derivative financial liabilities 30 June 2013								
AUD floating rate loan	4.63%	167,160	190,151	3,917	3,853	7,770	174,611	-
JPY floating rate loan	0.67%	3,309	3,324	12	3,312	-	-	-
Trade and other payables	-	81,874	81,874	81,874	-	-	-	-
Total		**252,343**	**275,349**	**85,803**	**7,165**	**7,770**	**174,611**	**-**

	Effective interest rate Per annum	Carrying amount $000	Contractual cash flows $000	6 months or less $000	6 – 12 months $000	1 – 2 years $000	2 – 5 years $000	More than 5 years $000
Non-derivative financial liabilities 30 June 2012								
AUD floating rate loan	5.93%	42,000	44,491	1,256	43,235	-	-	-
	5.92%	19,928	22,139	597	588	20,954	-	-
JPY floating rate loan	0.68%	3,744	3,750	3,750	-	-	-	-
Trade and other payables	-	100,953	100,953	100,218	-	735	-	-
Total		**166,625**	**171,333**	**105,821**	**43,823**	**21,689**	**-**	**-**

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

Notes to the Financial Statements

Derivative assets and liabilities designated as cash flow hedges

In the year ended 30 June 2013, Cochlear designated some sales and purchases of various currencies as cash flow hedges to hedge the amount converted into AUD for forecast future transactions. These are hedges of forecast future transactions to manage the currency risk arising from exchange rate fluctuations. The hedged items were highly probable foreign currency transactions.

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

All material hedges were effective at the reporting date.

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

30 June 2013						
Amounts $000	Carrying amount	Expected cash flows	6 months or less	6 – 12 months	1 – 2 years	2 – 5 years
Forward exchange contracts						
Assets	4,362	4,454	1,821	1,697	936	-
Liabilities	(28,134)	(29,081)	(7,097)	(7,999)	(9,980)	(4,005)
Total	**(23,772)**	**(24,627)**	**(5,276)**	**(6,302)**	**(9,044)**	**(4,005)**

30 June 2012						
Amounts $000	Carrying amount	Expected cash flows	6 months or less	6 – 12 months	1 – 2 years	2 – 5 years
Forward exchange contracts						
Assets	44,427	44,602	19,768	12,935	9,435	2,464
Liabilities	(141)	(141)	(53)	(48)	(23)	(17)
Total	**44,286**	**44,461**	**19,715**	**12,887**	**9,412**	**2,447**

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

Market risk

Currency risk

Exposure to currency risk

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

Amounts local currency thousands	USD	EUR	GBP	SEK	JPY
30 June 2013					
Trade receivables	62,627	38,978	3,211	6,100	669,529
Secured bank loans	-	-	-	-	(300,000)
Trade payables	(14,820)	(4,931)	(6,844)	(47,429)	(65,556)
Gross balance sheet exposure	**47,807**	**34,047**	**(3,633)**	**(41,329)**	**303,973**

Amounts local currency thousands	USD	EUR	GBP	SEK	JPY
30 June 2012					
Trade receivables	55,311	35,053	2,368	6,039	539,297
Secured bank loans	-	-	-	-	(300,000)
Trade payables	(12,797)	(4,267)	(8,129)	(49,531)	(70,009)
Gross balance sheet exposure	**42,514**	**30,786**	**(5,761)**	**(43,492)**	**169,288**

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

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

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

	Foreign exchange rates		Gross value	
	2013	2012	2013 $000	2012 $000
Sell USD				
Not later than one year			142,467	159,957
Later than one year but not later than two years			71,113	77,290
Later than two years but not later than five years			20,256	23,768
Weighted average exchange rates contracted	0.97	0.93		
Sell EUR				
Not later than one year			113,740	132,671
Later than one year but not later than two years			59,473	72,903
Later than two years but not later than five years			15,111	28,689
Weighted average exchange rates contracted	0.72	0.69		
Sell JPY				
Not later than one year			9,246	7,540
Later than one year but not later than two years			4,960	4,317
Later than two years but not later than five years			1,259	1,821
Weighted average exchange rates contracted	83.72	75.98		

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

	Average rate		Reporting date spot rate	
AUD1 =	2013	2012	2013	2012
USD	1.022	1.030	0.928	1.007
EUR	0.794	0.766	0.711	0.806
GBP	0.654	0.649	0.603	0.645
SEK	6.796	6.897	6.239	7.113
JPY	89.349	81.109	90.666	80.118

Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2013

Interest rate risk

Profile

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

	2013 $000	2012 $000
Carrying amount		
Variable rate instruments		
Financial assets	52,689	68,486
Financial liabilities	170,469	65,672

At 30 June 2013, no interest rate hedging had been entered into.

Sensitivity analysis

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

For the year ended 30 June 2013, it is estimated that a general increase of one percent in interest rates would have decreased Cochlear's profit after income tax and equity by approximately $0.6 million (2012: $0.1 million). A one percent general decrease in interest rates would have had the equal but opposite effect on Cochlear's profit and equity.

It is estimated that a general increase of 10 percent in the value of the AUD against other foreign currencies would have decreased Cochlear's profit for the year ended 30 June 2013, including hedging results and after income tax, by approximately $6.1 million (2012: $2.3 million) and decreased Cochlear's equity by $14.5 million (2012: $2.3 million). A 10 percent general decrease in the value of the AUD against other foreign currencies would have increased Cochlear's profit by $7.2 million (2012: $5.6 million) and increased equity by $14.2 million (2012: $4.4 million).

Fair values

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

		2013		2012	
	Note	Carrying amount $000	Fair value $000	Carrying amount $000	Fair value $000
Cash and cash equivalents	23(a)	52,689	52,689	68,486	68,486
Trade and other receivables – current	12	203,748	203,748	189,085	189,085
Trade and other receivables – non-current	12	944	944	11,840	11,840
Trade and other payables – current	17	(96,789)	(96,789)	(100,218)	(100,218)
Trade and other payables – non-current	17	(13,242)	(13,242)	(735)	(735)
Secured bank loans – current	18	(3,309)	(3,309)	(45,744)	(45,744)
Secured bank loans – non-current(i)	18	(167,160)	(168,000)	(19,928)	(20,000)
Total		**(23,119)**	**(23,959)**	**102,786**	**102,714**

(i) Included within the carrying amount of secured bank loans is an amount of $840,028 (2012: $71,875) in relation to unamortised loan establishment fees.

Basis for determining fair values

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

Notes to the Financial Statements

Derivatives

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

Non-derivative financial assets and liabilities

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

The directors consider the carrying amount of long-term borrowings recorded in the financial statements approximates their fair value as interest rates on loans and borrowings are variable.

Fair value hierarchy

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

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

	Level 2 $000	Total $000
30 June 2013		
Derivative financial assets		
Forward exchange contracts used for hedging	4,362	4,362
Total assets	**4,362**	**4,362**
Derivative financial liabilities		
Forward exchange contracts used for hedging	(28,134)	(28,134)
Other forward exchange contracts	(23)	(23)
Total liabilities	**(28,157)**	**(28,157)**
30 June 2012		
Derivative financial assets		
Forward exchange contracts used for hedging	44,427	44,427
Total assets	**44,427**	**44,427**
Derivative financial liabilities		
Forward exchange contracts used for hedging	(141)	(141)
Other forward exchange contracts	(768)	(768)
Total liabilities	**(909)**	**(909)**

There have been no transfers between levels during the year. There are no other financial instruments carried at fair value or valued using a Level 1 or Level 3 valuation method.

28. Events subsequent to the reporting date

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

Dividends

For dividends declared after 30 June 2013, see Note 9.

29. Product recall

On 11 September 2011, the Company initiated a worldwide voluntary recall of its unimplanted Nucleus CI500 cochlear implant range. The Company had identified a recent increase in the number of Nucleus CI512 implant failures. In the event of a Nucleus CI500 series implant failure, recipients may be re-implanted with the Nucleus CI24RE implant range which remains available and continues to be sold with Nucleus 5 externals.

Relevant healthcare professionals and regulatory authorities were advised of this action and management continued to work with these authorities.

On 20 December 2011, the Company announced to healthcare professionals and the ASX that it had identified the root cause of the failures and continued to work on resolving the problem.

For the year ended 30 June 2012, $138.8 million was recognised as a charge to cost of sales in the income statement, representing management's best estimate of probable costs based on current available data. This takes into account inventory write-downs, property, plant and equipment and intangible asset impairments, and warranty and other costs which include factors such as estimated return rates for the affected units, unit replacement costs, and consulting, logistical and administration expenses directly associated with the recall.

Management has made judgements, estimates and assumptions related to probable costs arising from the recall which affect the reported amounts of assets, liabilities, income and expenses. Actual outcomes may differ from these estimates as further information is identified.

No further amount has been recognised as a charge in the year ended 30 June 2013.

A provision of $36.6 million (2012: $53.0 million) is included in current and non-current provisions related to the costs associated with the recall that are still to be incurred as at 30 June 2013.

Net profit includes the following items whose disclosure is relevant in explaining the financial performance of the Consolidated Entity:

Product recall

	2013 $000	2012 $000
Write-down in value of inventories	-	34,859
Impairment of property, plant and equipment	-	14,006
Impairment of intangible assets	-	13,840
Provision for warranty and other costs	-	76,130
Total cost of sales – product recall	-	138,835
Income tax benefit	-	(37,499)
Total product recall cost after tax	-	**101,336**

30. Parent entity disclosures

At, and throughout the financial year ended, 30 June 2013, the parent company of Cochlear was Cochlear Limited.

	Company	
	2013	2012
	$000	$000
Result of the parent entity		
Net profit	158,414	28,445
Other comprehensive loss	(47,449)	(21,905)
Total comprehensive income	**110,965**	**6,540**
Financial position of the parent entity at year end		
Current assets	197,014	195,340
Total assets	636,642	606,049
Current liabilities	110,457	181,887
Total liabilities	382,022	320,353
Total equity of the parent entity comprising of:		
Issued capital	128,196	125,865
Treasury reserve	(9,408)	(4,729)
Hedging reserve	(16,557)	30,892
Share based payment reserve	35,838	35,837
Retained earnings	116,551	97,831
Total equity	**254,620**	**285,696**

Parent entity contingencies

The details of all contingent liabilities in respect to Cochlear Limited are disclosed in Note 21.

Parent entity capital commitments for acquisition of plant and equipment

	Company	
	2013	2012
	$000	$000
Plant and equipment		
Contracted but not yet provided for and payable:		
Within one year	1,553	3,089
Total parent entity capital commitments for acquisition of plant and equipment	**1,553**	**3,089**

Directors' Declaration

Cochlear Limited and its controlled entities for the year ended 30 June 2013

1. In the opinion of the directors of Cochlear Limited (the Company):
   (a) the consolidated financial statements and notes and the Remuneration Report in the Directors' Report set out on pages 30 to 113, are in accordance with the Corporations Act 2001, including:
      (i) giving a true and fair view of the Consolidated Entity's financial position as at 30 June 2013 and of its performance for the financial year ended on that date; and
      (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
   (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
2. The directors have been given the declarations required by section 295A of the Corporations Act 2001 from the CEO/President and Chief Financial Officer for the financial year ended 30 June 2013.
3. The directors draw attention to Note 2(a) to the consolidated financial statements, which includes a statement of compliance with International Financial Reporting Standards.

Signed in accordance with a resolution of the directors:

Dated at Sydney this 19 day of August 2013.

Director

Director

Independent Audit Report to the Members of Cochlear Limited

Report on the financial report

We have audited the accompanying financial report of Cochlear Limited (the Company), which comprises the consolidated balance sheet as at 30 June 2013, and consolidated income statement and consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year ended on that date, notes 1 to 30 comprising a summary of significant accounting policies and other explanatory information and the directors' declaration of the Consolidated Entity comprising the Company and the entities it controlled at year's end or from the time during the financial year.

Directors' responsibility for the financial report

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

Auditor's responsibility

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

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

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

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

Independence

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

Auditor's opinion

In our opinion:

(a) the financial report of Cochlear Limited is in accordance with the Corporations Act 2001, including:

- (i) giving a true and fair view of the Consolidated Entity's financial position as at 30 June 2013 and of its performance for the year ended on that date; and
- (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.

(b) the financial report also complies with International Financial Reporting Standards as disclosed in note 2(a).

Report on the remuneration report

We have audited the remuneration report included in the directors' report for the year ended 30 June 2013. The directors of the Company are responsible for the preparation and presentation of the remuneration report in accordance with Section 300A of the Corporations Act 2001. Our responsibility is to express an opinion on the remuneration report, based on our audit conducted in accordance with auditing standards.

Auditor's opinion

In our opinion, the remuneration report of Cochlear Limited for the year ended 30 June 2013, complies with Section 300A of the Corporations Act 2001.

KPMG
Sydney, 19 August 2013

Bruce Phillips, Partner

Additional Information

Additional information required by Australian Securities Exchange Listing Rules and not disclosed elsewhere in this report – the information presented is as at 31 July 2013:

Shareholdings

Substantial shareholders

Shareholder	Number of ordinary shares held	%
Baillie Gifford & Co	6,478,080	11.36
Wilson HTM Group Limited	3,534,289	6.20
Harding Loevner LP	3,185,723	5.58
Total	**13,198,092**	**23.14**

Distribution of shareholders

Number of shares held	Number of ordinary shareholders
1 – 1,000	31,880
1,001 – 5,000	3,491
5,001 – 10,000	208
10,001 – 100,000	100
100,001 and over	23
Total	**35,702**

Non-marketable parcels – 245 shareholders held less than a marketable parcel of ordinary shares

Twenty largest shareholders

Shareholder	Number of ordinary shares held	%
HSBC Custody Nominees (Australia) Limited	10,611,481	18.60
National Nominees Limited	9,725,353	17.05
JP Morgan Nominees Australia Limited	9,445,762	16.56
Citicorp Nominees Pty Limited	1,455,571	2.55
JP Morgan Nominees Australia Limited (Cash income a/c)	842,132	1.48
BNP Paribas Noms Pty Ltd (DRP)	813,312	1.43
Dr Christopher Graham Roberts	703,803	1.23
HSBC Custody Nominees (Australia) Limited – a/c 2	512,817	0.90
HSBC Custody Nominees (Australia) Limited (NT-Comnwlth Super Corp a/c)	424,129	0.74
Citicorp Nominees Pty Limited (Colonial First State Inv a/c)	375,117	0.66
BNP Paribas Nominees Pty Ltd (Agency Lending Collateral)	320,000	0.56
HSBC Custody Nominees (Australia) Limited – GSCO ECA	315,903	0.55
Citicorp Nominees Pty Limited (BHP Billiton ADR Holders a/c)	257,507	0.45
UBS Nominees Pty Limited	254,506	0.45
RBC Investor Services Australia Nominees Pty Limited (Bkcust a/c)	254,343	0.45
BNP Paribas Nominees Pty Ltd (Agency Lending DRP a/c)	180,511	0.32
AMP Life Limited	144,768	0.25
Merrill Lynch (Australia) Nominees Pty Limited	138,994	0.24
Argo Investments Limited	128,000	0.22
Cochlear Incentive Plan Pty Limited	125,643	0.22
		64.91

The 20 largest shareholders held 64.91% of the ordinary shares of the Company.

On market buy-back

There is no current on market buy-back.

Glossary, Company ASX Announcement Record and Company Information

Glossary

AGM Annual General Meeting.
ASIC Australian Securities and Investments Commission.
ASX Australian Securities Exchange.
DPS Dividends per share.
EBIT Earnings before interest and tax.
EBITDA Earnings before interest, tax, depreciation and amortisation.
EMEA Europe, Middle East and Africa.
EPS Earnings per share.
F11 Financial Year 2011: 1 July 2010 to 30 June 2011.
F12 Financial Year 2012: 1 July 2011 to 30 June 2012.
F13 Financial Year 2013: 1 July 2012 to 30 June 2013.
F14 Financial Year 2014: 1 July 2013 to 30 June 2014.
FDA United States Food and Drug Administration.
FX Foreign exchange.
IFRS International Financial Reporting Standards.
KMP Key management personnel.
NPAT Net profit after tax.
Previous GAAP Previous Australian Generally Accepted Accounting Principles.
Processor/sound processor The externally worn part of the cochlear implant.
R&D Research and development.
TGA Therapeutic Goods Administration.
TSR Total shareholder return.
TUV Technical Überwachungs-Verein.

Company ASX Announcement Record

17 June 2013

UBS Australian Healthcare Conference 2013 presentation

Cochlear Limited CEO/President, Dr Chris Roberts, gave a presentation at the UBS Australian Healthcare Conference in Sydney on 17 June 2013. It was an update on Cochlear technologies and the product pipeline.

3 June 2013

Market update

Cochlear Limited updated the market on its next generation cochlear implant sound processor, Nucleus 6, and provided a trading update, which anticipated a lower than expected net profit after tax for F13.

12 March 2013

Half year report 2013

Cochlear Limited provided an F13 half year report to shareholders listing half year revenues and sales.

5 February 2013

First half revenue announcement

Cochlear Limited announced revenue up 1% to $391.7 million, with sales up 9% in constant currency for the six months ended 31 December 2012. There was a net profit after tax of $77.7 million. The interim dividend of $1.25 per share was up 4%.

16 October 2012

Chairman's address

Cochlear Limited Chairman, Mr Rick Holliday-Smith, addressed shareholders at the Annual General Meeting.

7 August 2012

Full year results for year ended 30 June 2012

Cochlear Limited announced revenue down 4% to $779 million, with sales up 1% in constant currency. Net profit after tax was $56.8 million, including $101.3 million after-tax recall costs. The final dividend was $1.25 per share (35% franked), up 4%.

7 August 2012

Update on voluntary recall

Cochlear Limited provided an update to shareholders on actions taken following the voluntary recall of the unimplanted Nucleus CI500 series implants.

Non-IFRS financial measures

Given the significance of the product recall and FX movements the directors believe the presentation of non-IFRS financial measures is useful for the users of this document as they reflect the underlying financial performance of the business.

The non-IFRS financial measures included in this document have been calculated on the following basis:

- Excluding recall costs: IFRS measures adjusted for the costs of the product recall
- Constant currency: restatement of IFRS financial measures in comparative years using F13 FX rates
- Free cash flow: IFRS cash flow from operating and investing activities excluding interest and tax paid related to non-operating activities.

The above non-IFRS financial measures have not been subject to review or audit. However, KPMG have separately undertaken a set of procedures to agree the non-IFRS financial measures disclosed to the books and records of the consolidated entity.

Company Information

Stock exchange listing

Australian Securities Exchange
ASX code COH

Solicitors

Clayton Utz

Share registrar

Computershare Investor Services Pty Limited

Level 4, 60 Carrington Street
Sydney NSW 2000, Australia
Tel: 61 3 9415 4000

Auditor

KPMG

Bankers

Australia Westpac Banking Corporation and HSBC Bank Australia Limited
Japan The Bank of Tokyo-Mitsubishi UFJ, Limited
Sweden Skandinaviska Enskilda Banken AB (publ)
United Kingdom HSBC Bank plc
United States Wells Fargo Bank West, NA

Annual General Meeting

The Annual General Meeting will be held at 10am on Tuesday 15 October 2013 at Australian Securities Exchange, Exchange Square Auditorium, 20 Bridge Street, Sydney. A Notice of Meeting and Proxy Form are enclosed with this Annual Report.

Financial calendar

2013

Final dividend record date 29 August
Payment of final dividend 19 September
Annual General Meeting 15 October

2014

Interim profit announcement 11 February*
Interim dividend record date 6 March*
Payment of interim dividend 27 March*
Final profit announcement 5 August*
Annual General Meeting 14 October*

* Indicative dates only.

Design

Cross Media Communications Pty Ltd

Hear now. And always

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