Cochlear Annual Report **2006**

Hear now. And always

Cochlear™

Passion. Innovation.

Changing more people's lives than ever.

Leadership carries responsibilities: for us, this means looking after our recipients for life!

1982

First Nucleus® implant

Graham Carrick implanted with the first commercially available 22 channel Nucleus cochlear implant. Featuring the only 22 channel implant in the industry, the design promotes stimulation of the nerves in the cochlea effectively and efficiently.

1985 – 1986

First two pediatric implant recipients

The first two research pediatric cochlear implant procedures take place at the Royal Victorian Eye and Ear Hospital: Scott Smith, 10 years (right) and Bryn Davies, 5 years (left).

1989

Nucleus 22 recipients upgraded to the smaller Mini Speech Processor (MSP)

MSP is much smaller and lighter than the original Wearable Speech Processor. It has the MPEAK speech coding strategy, providing improved performance; and the smaller size makes it more suitable for children.

1995

Listed on the Australian Stock Exchange

Cochlear is listed on the Australian Stock Exchange (ASX). Cochlear Ltd continues to be one of the most high profile companies in Australia.

1998

ESPrit™ – the first multi-channel BTE processor

A speech processor worn entirely behind the ear, freeing recipients from long cables and extra components. This innovation benefits the first cochlear implant recipients, giving them an option of the smaller behind-the-ear model.

Cochlear's sustained technology focus has enabled us to develop breakthrough implantable hearing innovations. We continue to build internal capability to position the Company for future growth.

Over 100,000 children and adults worldwide now have a cochlear implant or bone conduction implant.

Drive.

“The people at Cochlear are passionate about helping people to hear. It’s what inspires our engineers to develop life-changing products.”

Contents

2001
30,000 recipient mark

Cochlear celebrates its 30,000th Nucleus recipient, BJ Percy of San Antonio, Texas. Cochlear receives the prestigious 2001 Medical Design Excellence Award in New York for the Nucleus® 24 Contour™ cochlear implant.

2002
Professor Clark Scholarship introduced

The first winner in Australia is Holly McDonnell, who in 1987 at the age of 5 was the first pediatric recipient of the commercial Nucleus cochlear implant.

2005
Baha® introduced

Cochlear acquires bone anchored hearing device (Baha) company Entific. It now has 2 product platforms – bringing more hearing solutions to market.

Amy became single sided deaf following acoustic neuroma surgery and is fitted with a Baha® Compact.

2006
Following its successful launch in 2005, the 10,000th Nucleus Freedom recipient was implanted in July 2006

Freedom’s SmartSound™ technology – a unique suite of 4 intelligent input processing technologies is meeting recipients’ expectations of superior hearing performance.

One of Cochlear’s more recent initiatives is a $1.5 million donation towards the establishment of the **Cochlear Foundation**. This philanthropic entity has been designed to support various longer-term programs **promoting research in** and **awareness of treatments for significant hearing impairment**.

What makes Cochlear

As the undisputed global leader in implantable hearing solutions, Cochlear continues to discover better ways of doing things to improve quality of life for the hearing impaired.

Technological innovation

Cochlear's latest ground-breaking technological advancement is Nucleus® SmartSound™ – enabling a speech processor that mimics natural hearing.

One SmartSound™ example is SmartSound™ Beam™ which softens distracting sounds in noisy situations, while increasing the sounds you want to hear.

The effect is like shining a torch on what you want to hear.

Surrounded by sound.

SmartSound Beam for focused listening.

Hearing performance

Cochlear delivers the best technologies and highest quality products to optimise the hearing performance of our customers. Nucleus® Freedom™ is setting the new benchmark in cochlear implants. Baha Divino™ is a breakthrough sound processor which provides a flexible solution for individuals.

Nucleus® Freedom™ BTE speech processor.

Baha Divino™.

Sustainability

* **Central Institute for the Deaf (CID) open-set sentence scores for electrical stimulation alone.** Adapted from Clark G. Research Advances for Cochlear Implants. Auris Nasis Larynx 25 (1998): 73-87.

Cochlear's proven success, strong business fundamentals, and scientific rigour enable us to continue to offer sustainable solutions. **Hear now.** And always – **articulates Cochlear's lifetime commitment** to be here now and always.

different?

Reliability

As the industry pioneer, Cochlear has more than 25 years of titanium implant design experience. We have the most reliable implant on the market.

Nucleus® Freedom™ implant with
Contour Advance™ Electrode.

" Cochlear is committed to their strategic partnerships with world-leading companies to bring the best implantable hearing technology to market. "

Customer satisfaction

Cochlear provides the technology, processes and personal support to ensure each recipient receives the **best possible hearing experience.**

The Baha device is great for restoring clarity to sounds directed to the affected ear, particularly in conversational settings. The improved sound and comfort are wonderful and the added confidence it provides me is a bonus!

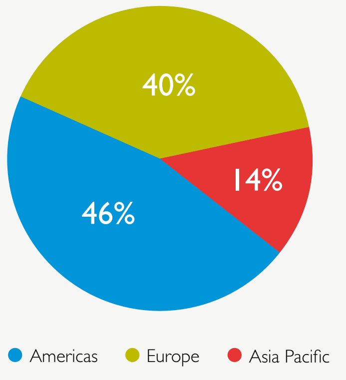
Amy

My upgrade from 3G to Nucleus Freedom has been fantastic! I am getting great benefits from the new technology in Freedom, in particular the SmartSound features. Rolling Stones never sounded so good!

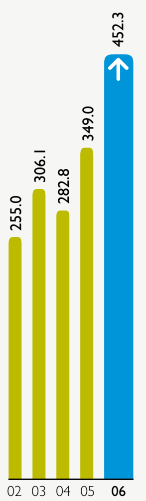
Hugh

Performance summary

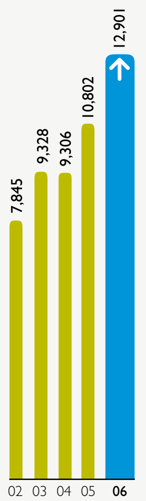
- Revenue for the year was a record $452.3 million, an increase of 30%.
- Cochlear implant unit sales growth of 19% to 12,901 drove the increase in revenue together with the Nucleus Freedom release late last year and a full year of Baha product sales following the acquisition of Entific Medical Systems in March 2005.
- Earnings before interest and taxes (EBIT) of $111.5 million increased by 35% and was 25% of revenue.
- Net profit attributable to equity holders of the parent of $80.0 million increased 34% from last financial year.
- Basic earnings per share (EPS) increased by 33% to 146.8 cents per share.
- Core earnings (expensing all development costs as incurred and excluding amortisation of acquired intangible assets and share based compensation) were at a record $86.4 million.
- Core basic EPS increased by 41% to 158.4 cents per share.
- The directors declared a final dividend of 55.0 cents per share, which will be paid on 21 September 2006. This brings the full year's dividend to $1.00 per share, fully franked, 25% up on last year.
- The Nucleus Freedom had a full year of sales in this year and is now rolled out in the major markets. There was great uptake of this market-leading product during the year. Clinical results for the Freedom system are now available and show a significant improvement in speech performance in quiet and noisy situations which has helped drive the sales of the system.
- The Entific Medical Systems business was integrated during the year and revenue growth was maintained at 30% assuming Cochlear owned the business for the entire year last year.
- Cochlear continued to roll out systems to support growth. During 2006, Oracle enterprise resource planning (ERP) system was implemented in the Americas region. It will begin to implement Oracle in Europe as well as convert manufacturing to Oracle in 2007.
- Manufacturing capability was improved through the continued implementation of "Lean Manufacturing" principles.



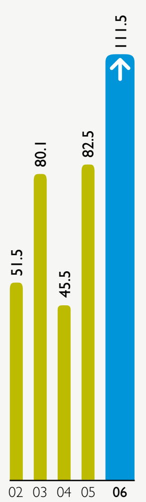
Revenue by segment



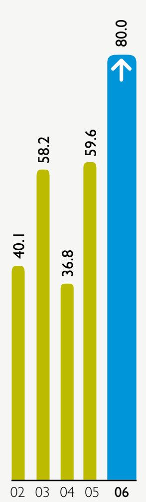
Sales revenue ($million)



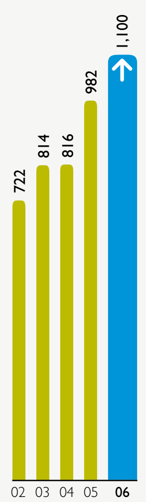
Cochlear implant system sales (units)



Earnings before interest and taxes ($million)



Net profit attributable to equity holders of the parent ($million)



Employees (number)

Financial amounts for 2005 and 2006 are in accordance with AIFRS.
Financial amounts for 2002 to 2004 are in accordance with previous GAAP.

2006 key financials

Year ended 30 June (amounts in $million unless otherwise stated) – AIFRS	2006	2005	% change
Income statement			
Revenue	452.3	349.0	30%
R&D expenditure excluding capitalisation and amortisation	56.7	44.6	27%
Earnings before interest, taxes, depreciation and amortisation (EBITDA)	127.6	94.2	35%
Earnings before interest and taxes (EBIT)	111.5	82.5	35%
Net interest expense	2.7	0.2	1,250%
Profit before tax	108.8	82.3	32%
Income tax expense	30.6	23.8	29%
Net profit attributable to equity holders of the parent (NPAT)	80.0	59.6	34%
Core earnings	86.4	60.8	42%
Balance sheet			
Total assets	545.9	502.7	9%
Total liabilities	336.1	348.0	(3%)
Inventories	76.8	49.5	55%
Intangible assets	205.2	194.3	6%
Net debt	109.0	97.0	12%
Cash flow			
Net capital and investment expenditure	14.6	208.0	(93%)
Dividends paid	49.1	42.8	15%
Cash flow from operations before changes in assets and liabilities	115.5	83.0	39%
Regional revenue			
Americas	198.2	131.2	51%
Europe	173.7	133.0	31%
Asia Pacific	59.7	58.0	3%
Key statistics			
Employees (number)	1,100	982	12%
Gross profit on revenue (%)	71%	71%	-
EBIT margin on revenue (%)	25%	24%	4%
Gearing ratio (debt/debt and equity) (%)	48%	57%	(16%)
Net debt gearing ratio (%)	34%	39%	(13%)
Basic EPS (cents)	146.8	110.1	33%
Core basic EPS (cents)	158.4	112.4	41%
Dividends per share (DPS) (cents)	100.0	80.0	25%

Passion
for success

Chairman's Report

I am delighted to report on another successful year for Cochlear with improvements in all areas of the organisation.

Financial performance

In 2006, Cochlear achieved record results with total revenue growing 30% to $452.3 million, earnings before interest and taxes growing 35% to $111.5 million and all time high cochlear implant unit sales of 12,901.

This was another excellent performance by Cochlear, building on last year's record results and providing a solid base for future growth.

Highlights for the year included the launch of the Nucleus Freedom product range and the successful integration of the Bone Anchored Solutions (Entific) business, which grew revenue by 30%. Both these initiatives added to this year's success and reinforced Cochlear's role as the world leader in implantable hearing systems. Annual market share grew during the year as Cochlear extended its reach through technology leadership and innovative global marketing programs.

Total shareholder return for the year including share price appreciation and dividends paid was a healthy 42%. Earnings per share increased by 33% to 146.8 cents.

This strong performance was achieved during a period of considerable change at Cochlear, as we broadened our product offering and implemented a wide range of productivity and efficiency enhancing programs throughout the organisation.

Dividends

The year's strong financial performance and an ongoing confidence that Cochlear will continue to grow, enabled the Board to increase the final dividend compared to last year to 55.0 cents per share, fully franked. This gives a total fully franked dividend for the year of 100.0 cents per share. Cochlear has a long-term commitment to a payout ratio of approximately 70% and this year's dividend is in line with this.

Board changes

Ongoing renewal of the Board is a vital part of the corporate governance process, especially given the dynamic industry Cochlear is in and the international nature of its operations.

The Board was pleased to welcome Mr Paul R Bell, formerly President of Asia Pacific Human Health Division of Merck & Co Inc and Mr Donal P O'Dwyer, formerly worldwide President of Cordis Cardiology (a division of Johnson & Johnson) who both joined the Board effective 1 August 2005.

Professor Brian DO Anderson, AO retired at the October 2005 Annual General Meeting (AGM) and Mr Peter J North, AM and

Mr J H Veeneklaas have announced their retirement effective from the upcoming AGM. These long-time serving non-executive directors have made significant contributions to the successful development of Cochlear and on behalf of our shareholders and the Board, I wish to thank them for their commitment to Cochlear.

Board succession planning is an ongoing process and a very important part of the Chairman's responsibilities is to ensure that Cochlear's shareholders are served by a competent Board with relevant experience and appropriate skill sets.

The Board renewal process will continue and a further appointment can be anticipated later in the year.

Corporate governance

The Board and management continue to have a strong commitment to transparency and good corporate governance. Cochlear has a rigorous corporate governance framework and we continue to refine our practices in this area each year. Our approach to corporate governance is detailed in Cochlear's Corporate Governance Report set out on pages 28 to 33 of this Annual Report.

Department of Justice

As advised in March 2004, our American subsidiary Cochlear Americas received a request for information from the United States Department of Justice (DOJ). The request sought a variety of documents including those concerning Cochlear Americas' relationships with healthcare professionals.

We are continuing to cooperate fully with the DOJ, but at the present time there is nothing further to report.

Adoption of AIFRS

Cochlear adopted the Australian equivalents of the International Financial Reporting Standards (AIFRS) from 1 July 2005, as required by all Australian companies.

While the required changes to accounting policies will affect the way Cochlear's financial results are presented, they will not impact on Cochlear's business strategy, operations, cash flow or capacity to pay fully franked dividends.

Employees

One of Cochlear's strengths is its highly educated and enthusiastic employees around the world. 2006 has been a very busy and demanding year for our employees with ongoing organisational changes, product launches, new global marketing initiatives and management of broad based improvement programs throughout the organisation.

On behalf of the Board, I thank my fellow directors, the CEO/President, Dr Chris Roberts and his management team and all employees for their outstanding contribution and dedicated efforts during the year.

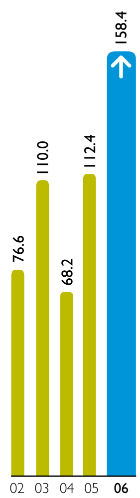
Outlook

Cochlear is exceptionally well positioned, based on its strong global market share and technology leadership.

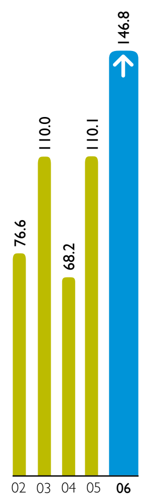
Continued commitment to R&D and an ongoing expansion of geographical market presence will underpin continued successful growth for Cochlear Limited.

MR TOMMIE CE BERGMAN

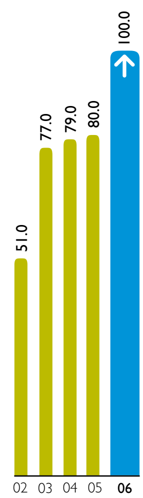
CHAIRMAN



Core basic earnings per share (cents)



Basic earnings per share (cents)



Dividends per share (cents)

Financial amounts for 2005 and 2006 are in accordance with AIFRS.
Financial amounts for 2002 to 2004 are in accordance with previous GAAP.

Passion
in leadership

CEO/President's Report

Overview: record financial results

What a great year for all the stakeholders in Cochlear! From the over 22,000 new recipients of our implants, the over 100,000 cumulative recipients through to the 1,100 employees and almost 20,000 of shareholders, F06 was a truly outstanding year.

Total revenue for the year increased 30% to a record $452.3 million (compared to $349.0 million in F05). This increase in sales was driven by both an increase in cochlear implant revenues (up 24%), and full year contribution from Baha and Vistafix product lines acquired in March 2005 ($51.7 million in F06 compared to $14.8 million in F05 which represented four months of sales). Offsetting increases in cochlear implant and Baha revenues was a 23% reduction in gains from foreign exchange contracts (used to hedge our regional net cash flow) from $26.8 million last year to $20.7 million in F06.

NPAT of $80.0 million increased 34% over F05 reported numbers restated using AIFRS. This is the first year of reporting the financial statements to AIFRS rather than previous Australian Generally Accepted Accounting Principles (previous GAAP) and there are significant differences between the two sets of accounting standards. Importantly, a table reconciling the differences between AIFRS and previous GAAP for F05 appears at the end of the notes to the financial statements.

As discussed last year, given the change to AIFRS, one of our key management metrics is core earnings defined as NPAT assuming all research and development is expensed, and excluding both acquired intangible assets amortisation and share based compensation charges. Core earnings were $86.4 million for F06, 8% ahead of our previously stated core earnings profit guidance and up 42% on an AIFRS-restated F05. Core earnings is a better reflection of the after-tax cash earnings of the business, a fundamental driver of creating shareholder value (total shareholder return (TSR) for F06 was 42%).

All regions contributed to growth

All regions contributed to growth with the standout regions being Americas (sales revenue up 50% in constant currency (CC), that is fixed exchange rates), followed by Europe (up 35% in CC). Asia Pacific was up 7% in CC. While the Asia Pacific growth is below our long-term target, it was an outstanding year in terms of our largest market in Asia Pacific, namely China. We received an order for almost 15,000 cochlear implants for China for delivery over six years, an order worth approximately $270 million – with the first shipment in July 2006. With the first China donation shipment not being until July, F06 sales were impacted as China represents such a large proportion of Asia Pacific sales and there was a substantial slow down of sales in China ahead of the expected donation.

Nucleus Freedom Cochlear implant system: setting new performance benchmarks

The 24% increase in cochlear implant revenues was underpinned by a 19% increase in cochlear implant unit sales to a record 12,901 units for F06. A favourable country mix and the effect of increasing our direct distribution in certain European countries and Japan, drove the revenue increase at a higher rate than unit sales increase.

In the last quarter of F05, we launched the next generation Cochlear implant: Nucleus Freedom, and this rollout around the world was a major activity for F06.

There are a number of very important characteristics of this system: **first**, the clinical results our recipients are demonstrating are significantly better than any previous cochlear implant system. In a carefully designed multi-centre clinical trial involving over 50 adults, hearing performance at three months was ahead of what was previously seen at six months. Improvement continued with six months performance well ahead of three months. Importantly, substantial improvements have continued into 12 months!! In addition, the Nucleus Freedom has a powerful ASIC in the external speech processor allowing the pre-processing of the sound which helps particularly in difficult listening environments (for example, when listening to speech in noisy environments). With Nucleus Freedom, the hearing performance being demonstrated in a range of real life listening situations is truly stunning and setting new performance benchmarks.

A **second** key characteristic of the system is its reliability. Nucleus Freedom is the most reliable cochlear implant ever, and continues Cochlear's tradition that every generation of implant (now five generations) has been more reliable than the previous one. Reliability is a science, not an art. Our implant reliability is based on decades of building on previous expertise and experience. For example, our "feedthroughs", the basis of the implant being hermetic (or "airtight"), have been built in-house since the very first implant in 1982, truly a core competency and indeed a source of competitive advantage.

Third, Nucleus Freedom involves a technology platform whereby we can add various accessories and other features making the device convenient for the widest range of lifestyles and needs. For example, in F07 we are releasing a rechargeable battery option, a smaller battery pack option, as well as a backwards compatible Freedom processor for the recipients of the previous generation of Cochlear implant (N24 implant). Later, we will be able to release a version of the Nucleus Freedom speech processor for the very early implants (N22). Upgrades for existing recipients are part of our life-long commitment to our recipients as well as an important source of revenue for the business.

Baha: successful integration of the Entific Medical Systems acquisition

In March 2005, we acquired the Swedish company Entific Medical Systems for $176.3 million (enterprise value), and so F06 was the first full year of owning this business. The products include the Baha and Vistafix product lines. The Baha is a bone anchored hearing implant for conductive hearing loss or for single sided deafness and Vistafix is for anchoring certain prostheses. Importantly, Baha is complementary to cochlear implants – being indicated for different types of hearing loss. We created a new division (Bone Anchored Solutions) and integrated most of our customer support activities around the world, providing further scale in sales, marketing and clinical support for our implantable devices. Sales in F06 were $51.7 million, 30% over F05 sales (that is, assuming we had owned the business for all of F05). We have substantially increased research and development for the Baha products and remain very positive about the opportunities for bone conduction.

Research and development: our lifeblood

We remain committed to advancing the field of implantable devices for the hearing impaired and in F06 spent $56.7 million or 12% of revenues on research and development prior to capitalising and amortising development expenditure and after deducting the minority interest share. Activities cover many aspects of existing product areas as well as new product areas (for example, cochlear implants that combine electrical and acoustic stimulation for people with low frequency residual hearing) and progress on DACS (direct acoustic cochlear stimulator) – the product being developed jointly with Phonak. Technologic innovation remains a key driver as evidenced by the success of Nucleus Freedom.

Manufacturing and global supply chain upgrade

We are more than 12 months through a 30 month program to substantially upgrade manufacturing. This involves introducing "lean" concepts, training and up-skilling people and introducing major process changes in at least three areas. The process changes involve major research and development efforts to redesign the product for new manufacturing processes. This has the benefit of building scale and capacity and is critical for our future growth. Importantly, we are also completely redesigning the global supply chain. This involves everything from new warehouses in our three regions (Americas, Europe and Asia Pacific) to new people and processes that can support a growing company. We have made significant progress in building Cochlear's internal capability to match the growth potential of the business.

Outlook:

We are positioning Cochlear for sustainable growth. There is a huge unmet clinical need for our products; for example, we are implanting less than 10% of the new people we could help each year (incidence). Clinical outcomes are improving not just from better technology (for example, Nucleus Freedom) but also different ways of using the product (for example, younger age at implantation, and bilateral implantation). The clinical outcomes today are different from even a few years ago. Most importantly, our implants are very cost effective in health economic terms. All in all, we have an opportunity to continue building this business over the long term. For F07, we anticipate core earnings of $100 million.

Our people: passion abounds

The passion in Cochlear's workforce is palpable. The dedication and positive spirit of people to effect change and drive this business for the benefit of all, are outstanding. I would like to thank all our employees for their individual and team efforts in making F06 such a success. Together, we can continue to change the world.

Ch Roberts

DR CHRIS ROBERTS

CEO/PRESIDENT

Financial discussion and analysis

Revenue

Revenue grew 30% to $452.3 million.

Revenue for cochlear implants increased by 24% to $379.9 million. This was driven by a 19% growth in unit sales to 12,901units, and an improved mix of sales into higher priced countries. Bilateral implants have been discussed for many years but in 2006 we saw a marked increase in interest in this area, particularly in the US.

This year, there was a full year of revenue contribution from the Baha business of $51.7 million compared to an initial four month revenue of $14.8 million recorded last financial year. In local currency, Baha sales grew 30% compared to the same prior corresponding period.

Revenue was improved as global market share increased. Also this year, our two largest regions, Americas and Europe, both grew well above their long-term growth profiles and this more than augmented the lower growth in Asia Pacific.

AIFRS

The Company adopted AIFRS effective from 1 July 2005. A change to reporting under AIFRS does not affect the cash flow generation of Cochlear and hence has not affected commercial decisions. A detailed account of the impact of the transition to AIFRS on Cochlear's accounts is disclosed in Note 31 to the financial statements.

Core earnings

To assist with understanding of the accounts, Cochlear has also disclosed movements in core earnings to the ASX at the time of its half and full year announcements. A full reconciliation between reported and core earnings has been provided.

The three key differences between reported and core earnings are:

- all research and development is expensed as incurred in core earnings;
- there is no amortisation of acquired intangible assets in core earnings; and
- there is no expensing of share based compensation in core earnings.

There was $0.2 million of development expenditure capitalised this year, as product development had not reached the necessary AIFRS milestones in the year. Amortisation from prior years' capitalisation was $2.4 million.

Cochlear's aim is to grow core earnings by more than 20% per annum.

Research and development expense

Research and development costs expensed as incurred increased 27% to $56.7 million due to:

- additional costs of $1.3 million on the Baha product range as we ramped up research expenditure in line with our strategic intent to accelerate the technological advances possible; and
- a further $2.5 million on the joint venture DACS project. This project is important to our mid to long-term growth profile.

	2006 AIFRS	2005 AIFRS	2005 previous GAAP	2004 previous GAAP	2003 previous GAAP	2002 previous GAAP	2001 previous GAAP	2000 previous GAAP	1999 previous GAAP	1998 previous GAAP	1997 previous GAAP
Cochlear implant system sales (units)	12,901	10,802	10,802	9,306	9,328	7,845	6,482	4,941	4,128	3,507	3,128
Sales revenue ($million)	452.3	349.0	344.9	282.8	306.1	255.0	220.1	144.2	127.2	91.7	71.9
R&D expenditure ($million)	56.7	44.6	43.8	44.5	37.0	37.7(i)	27.7	20.9(ii)	13.5	11.6	10.6
EBITDA ($million)	127.6	94.2	88.5	54.9	87.9	56.2	49.0	33.0	25.8	19.3	15.9
EBIT ($million)	111.5	82.5	75.1	45.5	80.1	51.5	45.5	30.4	23.1	17.5	14.3
NPAT ($million)	80.0	59.6	54.5	36.8	58.2	40.1	31.2	20.2	16.3	13.3	10.8
Basic EPS (cents)	146.8	110.1	100.5	68.2	110.0	76.6	60.2	39.6	32.3	26.6	21.6
Core earnings ($million)	86.4	60.8	58.3	36.8	58.2	40.1	31.2	20.2	16.3	13.3	10.8
Core basic EPS (cents)	158.4	112.4	107.8	68.2	110.0	76.6	60.2	39.6	32.3	26.6	21.6
DPS (cents)	100.0	80.0	80.0	79.0	77.0	51.0	41.0	30.0	20.0	15.5	12.5
Closing share price ($)	54.63	39.20	39.20	22.72	32.30	34.05	39.00	28.76	12.00	6.27	4.30
Market capitalisation as at 30 June ($million)	2,985	2,123	2,123	1,231	1,714	1,788	2,029	1,469	606	313	215
Number of employees	1,100	982	982	816	814	722	639	543	432	376	350

Ten year performance summary

(i) Excludes $5.2 million acquisition of core technology from Implex AG Hearing Technology.

(ii) Excludes $4.4 million acquisition of core technology from Philips Hearing Implants NV.

Foreign exchange

Over 95% of our sales and more than 50% of our expenses are in foreign currency. To help manage this risk, Cochlear maintains an active hedge book in line with a Board approved Foreign Exchange Policy. Details of the forward exchange contracts totalling $389 million as at 30 June 2006 (2005: $241 million) are included in Note 30 to the financial statements.

Foreign exchange gains of $20.7 million on hedged sales were lower than 2005 ($26.8 million) as the rates secured in prior years in line with policy were lower.

Balance sheet

Cash

Cash usage for the year was $21.0 million. This usage of cash was due to increases in receivables and inventories of $56.8 million as discussed below, debt repayment of $29.8 million and dividend payments to shareholders of $49.1 million. These usages more than offset the cash generated by the growth in revenue and profit.

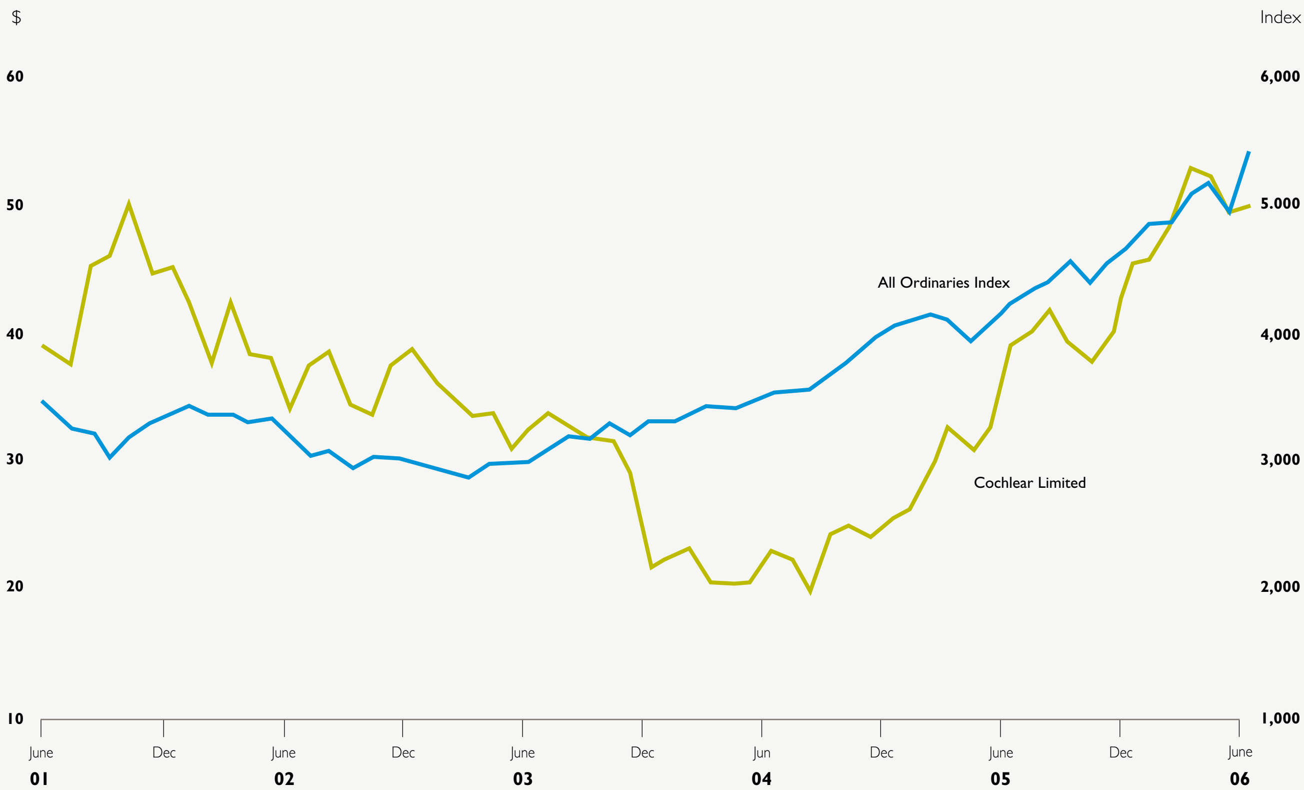
Working capital

Debtors days were higher at 74 days (2005: 65 days). This is largely a result of having a full year impact in 2006 of going direct in countries with typically longer payment terms. This is in line with our revised targets for going direct. In addition, debtors days in the Americas region increased during the Nucleus Freedom launch period as focus was directed to market penetration. The debtors days are improving but are not yet back to last year's levels.

Inventories of $76.8 million were higher than the previous year at $49.5 million. Finished goods of Cochlear implants and processors were below target levels at the end of the prior year and inventories are now at target levels of approximately two months forward sales of key products. There has also been a build of inventory for the backwards compatible Nucleus Freedom products ahead of market launch early in F07.

Intangible assets

Intangible assets of $205.2 million (2005: $194.3 million) increased predominantly due to the effect of movements in foreign exchange. Under AIFRS, all intangible assets were tested for impairment and no impairment charges were required.



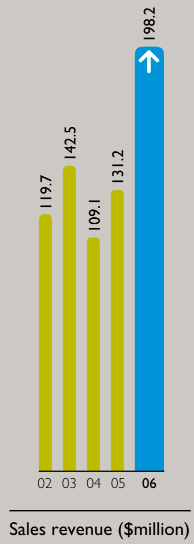
Cochlear Limited daily average share price vs All ordinaries index (accumulated total return)

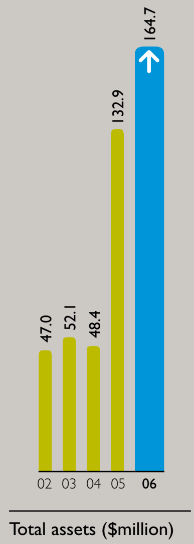
Source: Australian Stock Exchange

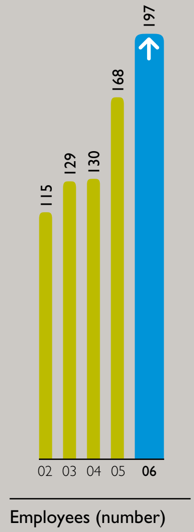

Passion
for the future

Regional review

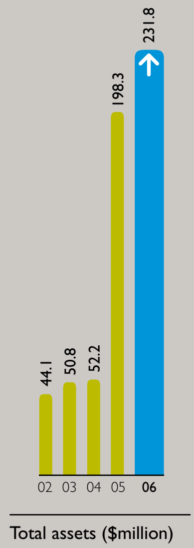
Americas

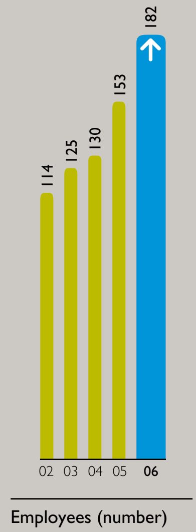




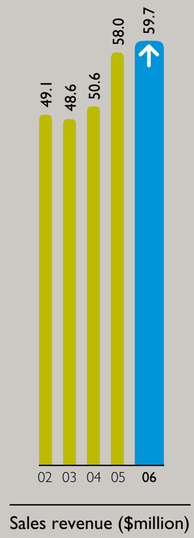


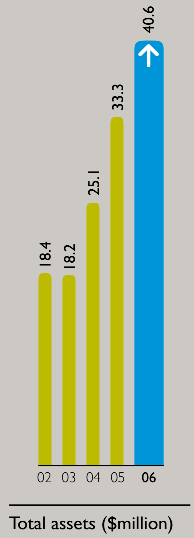
Europe

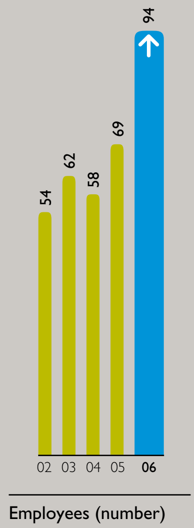




Asia Pacific







Financial amounts for 2005 and 2006 are in accordance with AIFRS. Financial amounts for 2002 to 2004 are in accordance with previous GAAP.

Achievement against goals

Growth targets
Revenue growth of 51% was well above growth targets due to improved market share, launch of a new product, the expansion of the field force and focus on market growth initiatives.

Nucleus Freedom uptake
Nucleus Freedom was launched in Latin America during the year as planned. There has been tremendous market response in the entire region for the Freedom system in the US where it was launched in April 2005.

Entific integration
By August 2005, Cochlear had relocated the Entific operations to the Denver facility and integrated the sales forces. The consolidation of the two businesses combined with focused operational efficiencies led to improved synergies in the back office and a critical mass with the sales force reflected in greater presence in the field.

Outlook

- Maintain profit growth in line with Cochlear's long-term targets.
- Launch Nucleus Freedom backwards compatible products in major markets.
- Continue promotion of the benefits of bilaterals.

Achievement against goals

Growth targets
Revenue growth of 31% was achieved through significant sales volume growth both in the core markets and the Central and Eastern European regions. This is ahead of long-term growth targets.

Launch new generation product
Nucleus Freedom was successfully rolled out throughout Europe, the Middle East and Africa during 2006 with all markets in the region now using the Freedom product.

Going direct in key markets
Cochlear's strategy of increased direct presence in key markets continued during 2006, with the first full year of direct distribution in Italy and France being successfully completed with higher growth in both countries. Sweden went direct in January 2006. The increased contact with our customers is improving our service and strengthening relationships.

Outlook

- Maintain profit growth in line with Cochlear's long-term targets.
- Recognise synergies from integrating Baha sales forces in the region.
- Implementation of Oracle ERP system by year end to gain benefits of worldwide integration of systems.
- Further define and execute on growth strategies initiated at the workshops and seminars held at IMD in Lausanne.

Achievement against goals

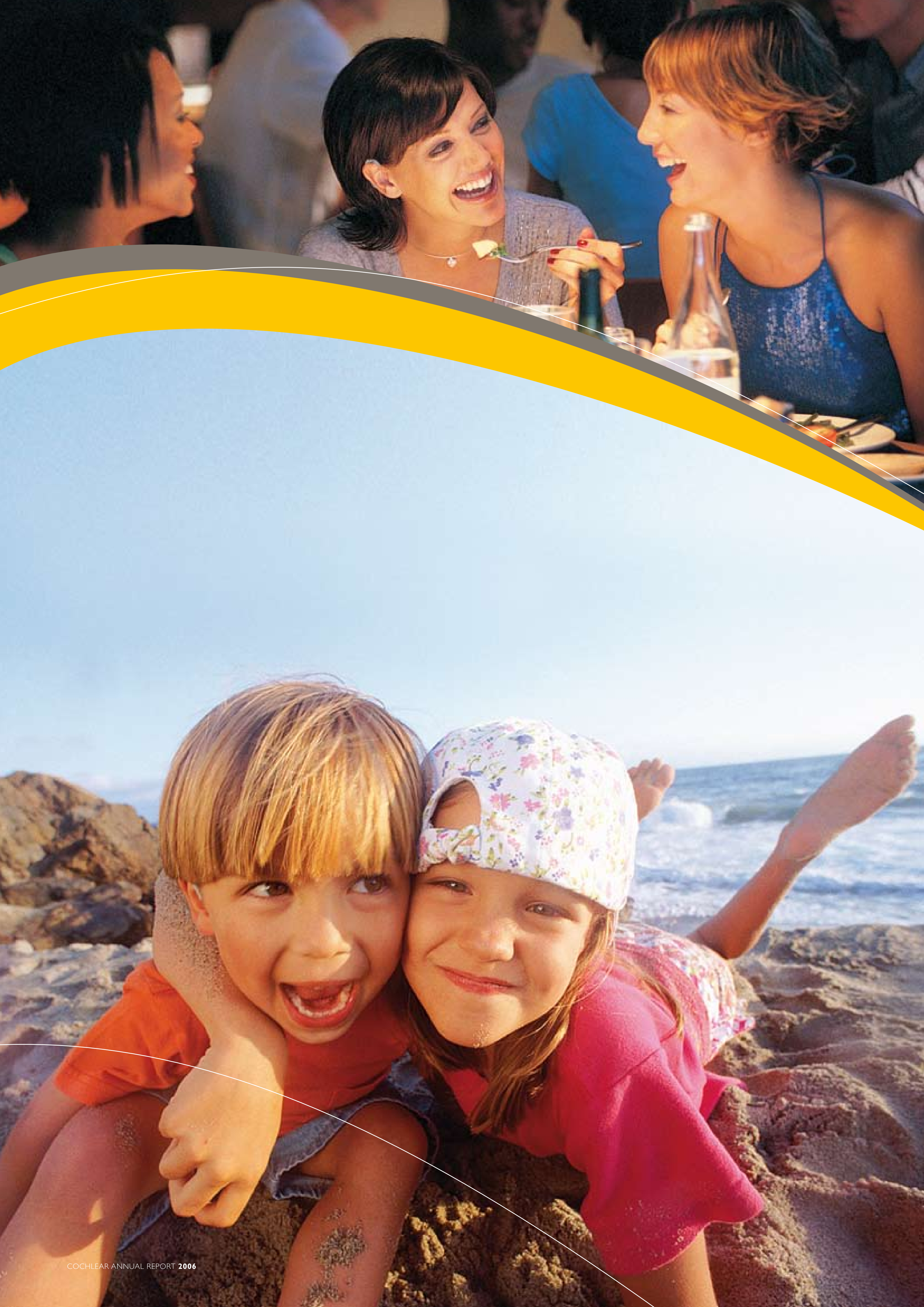
Growth targets
Revenue growth of 3% was below the target due to weaker sales in China ahead of the supply of donation units. Sales in India, Japan and Australia continued to grow at or above target levels. The level of Baha sales remained low with sales of less than $2 million. Although growth was achieved, this was not as strong as had been anticipated.

Launch new products
Nucleus Freedom was launched in Korea approximately four months behind schedule due to delays in reimbursement approval. The Nucleus Contour was approved for sale and reimbursement in Japan. The Baha Divino was launched in Australia, Singapore and Malaysia.

Improved awareness
A new Advocacy Group has been formed in Australasia, actively promoting awareness of cochlear implants throughout the community.

Outlook

- Achieve profit growth in line with Cochlear's long-term targets.
- Supply implants against the large donation order for China and Taiwan.
- Achieve Baha sales growth targets.
- Launch the backward compatible Freedom speech processor upgrade for Nucleus 24 recipients in major markets.
- Ensure the requirements of emerging regulatory regimes in India, New Zealand, Singapore, Malaysia and Hong Kong are met.



Americas

The Americas region continued its strong growth profile this year with revenue up 51% to $198.2 million largely driven by increased market share and market growth.

Significant revenue and EBIT growth

The 51% increase in revenue reinforces the growth experienced last year and reflects the market uptake of the Nucleus Freedom that was launched in April 2005. The expansion of the field force, focus on market growth initiatives and capitalisation of the synergies between the cochlear implant and Baha product lines also contributed to the overall revenue growth.

The successful integration of the Baha and cochlear implant businesses and the leverage from that revenue growth led to an EBIT increase of 110% to $52.1 million.

Freedom launch led market share growth

2006 was the first full year of the Nucleus Freedom successfully launched at the end of the previous financial year. Market share in the key US market increased more than 10 percentage points to over 70% as a result of the markets enthusiastic uptake of the new technology.

Setting the standard for implant reliability

Nucleus Freedom reinforced Cochlear's leadership position in cochlear implant reliability and continued to be a significant competitive differentiator with both professionals and consumers. This advantage was highlighted when Cochlear's two main competitors had their respective product distribution disrupted by product reliability and quality issues during the year. This further validates the importance of implant reliability and Cochlear continued to routinely reinforce the importance of reliability with professionals and consumers.

Entific integration synergies realised

This year was the first full year of operations in the Americas of the Entific business acquired in March 2005. The acquisition was strategic in that it allowed Cochlear to capitalise on the cross selling opportunities and expand account and market penetration. Early in the year, Cochlear moved the Entific operations from Columbus and consolidated the business into the Denver facility. The consolidation of the two businesses combined with focused operational efficiencies led to cost savings. Importantly, it also expanded the overall number of sales people in the field and sales revenue for Baha grew 30%.

Advocacy and awareness increasing sales

Cochlear has implemented numerous strategies to increase market share and market awareness in the Americas. The Cochlear Advocate Network further strengthened in 2006, with the number of volunteer advocates almost tripled over the last year to 225 and the number of Regional Advocate Managers more than doubled over the same period.

The advocates' strategic focus is to develop grass-roots awareness about hearing loss amongst all Americans. In addition, advocates provide a solid support network for those considering a cochlear implant for themselves or their child, and to those recipients who have received a Nucleus implant. Advocates provide an enthusiastic voice, communicating about their life-changing experiences with a Nucleus cochlear implant.

The inaugural Cochlear Celebration was held in Orlando, Florida in 2006 with over 1,200 cochlear recipients and family members attending. This energising event presented an excellent opportunity to connect Nucleus user community members. Cochlear gathered user feedback on products and programs, provided education sessions, recruited new volunteer advocates, discussed the importance of awareness development and advocacy, and created excitement about upcoming product introductions and bilateral implantation.

The Habilitation Outreach for Professionals in Education (H.O.P.E.) program continued and was expanded to focus on early intervention. Five professional workshops were conducted across the country in major cities to reinforce the significant positive impact that early intervention has on the life and prospects for the hearing impaired. H.O.P.E. is also a powerful initiative underpinning Cochlear's commitment to professional educators and the network of individuals that support Nucleus recipients in developing their language skills.

Challenging reimbursement and public policy

Adequate reimbursement for both cochlear implants and Baha products continues to be an area of focus for the Americas team.

During 2006, Baha products were placed on the government's CMS list in the US. This is an important first step in gaining public funding for patients. More work is still to be done on ensuring that this translates into adequate reimbursement levels to hospitals which admit public patients.

Strengthening organisational capability and alignment

Organisational capability was enhanced by restructuring the Regional Executive team and adding key new recruits. These new recruits reaffirm a focus to drive sustainable growth by building an organisation with the appropriate capabilities and experience. New positions in field customer care management, the Bone Anchored Solutions (BAS) business unit, marketing, clinical technical support as well as business operations were recruited in 2006. The region also more than doubled the size of the field customer care teams to drive revenue growth.

A major advancement in infrastructure was achieved with the region implementing the full suite of Oracle financial systems in July 2005. This system will provide a solid platform for the ongoing growth of the region. The Entific operations were also integrated into Oracle from September 2005 to enable the benefits of uniform systems across the region.

Heather Whitestone McCallum – former Miss America joined Cochlear Americas in a sold–out 4 city tour designed to educate and increase awareness of cochlear implants for early interventionist and other professionals who work with families of children with hearing loss.

Europe

The European region continued its strong sales growth, recording revenue of $173.7 million, up 31% from the previous year.

Continuing strong financial performance

Revenue increased 31% to $173.7 million, reflecting significant sales volume growth both in the core markets and the Central and Eastern European region and the full year impact of the Freedom product range and Baha products.

EBIT increased by 21% to $45.7 million, due to the impact of increased revenue, augmented by the full year impact of going direct in a number of countries.

Successful Nucleus Freedom rollout

Nucleus Freedom was successfully rolled out throughout Europe, the Middle East and Africa during 2006. Clinics and recipients enthusiastically embraced the new product, and all markets in the region are now using the Freedom product.

Direct distribution brings us closer to the customer

Cochlear's strategy of increased direct presence in key markets continued during 2006, with the first full year of being direct in Italy and France being successfully completed with higher growth in both countries. Cochlear also commenced direct distribution in Sweden on 1 January 2006. There has been positive customer response to this long-term investment and partnership that Cochlear has demonstrated by going direct in its key markets.

Being direct in the key markets has allowed Cochlear to get closer to the customer with increased product awareness programs resulting in increased sales and gross margins.

Showcasing Cochlear at the Vienna conference

The largest ever cochlear implant conference was held in Vienna, Austria in June 2006. Over 1,000 cochlear implant professionals attended with good representation from around the world. Cochlear reinforces its leadership in the cochlear implant market by highlighting the outstanding performance and reliability data generated on the Nucleus Freedom cochlear implant system. Cochlear had a substantial presence at the conference which enabled us to interact with a large number of professionals and customers outside the formal sessions. These forums continue to provide a useful showcase for Cochlear's implant performance data.

Continuing investment in education and training

The Cochlear Training and Education Centre in Mechelen, Belgium, has continued to play a significant role in promoting Cochlear's products in Europe. The Centre provides audiologists and surgeons from Europe and the Middle East with a professional environment for furthering their knowledge of Cochlear products. Training includes workshops for surgeons to practise insertion techniques and test new methods and surgical instruments. The Centre began training and education on the Baha products during the year.

Organisational enhancements

The new European Distribution Centre was created in Weybridge in the UK. This Centre, which houses the UK sales team and European finance and support team as well, provides vastly superior distribution capabilities. Improvements in service levels have occurred.

The integration of Baha was completed towards the end of the year and further synergies will be realised in the coming year. The European region will also begin the implementation of the Oracle ERP system during the next year as part of the worldwide rollout.

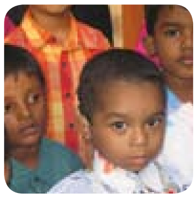
Training continues to play a key part

During 2006, the European leadership team all participated in strategic growth workshops and seminars held at IMD in Lausanne. Out of these sessions detailed growth initiatives were planned for implementation in 2007. The sessions also provided educational opportunities and training for the team.

Baha training in our Weybridge, UK facility.

European recipients enjoying life.

Asia Pacific



Revenue for the Asia Pacific region increased 3% to $59.7 million. There was strong growth in South Asia, Australasia and Japan.

Financial performance

Revenue increased 3% to $59.7 million, reflecting significant sales volume growth in South Asia, Australasia and Japan. This growth was offset by weaker sales in China ahead of the donation.

EBIT increased by 3% to $12.0 million, due to the impact of increased revenue, offset by increasing and enhancing the infrastructure and organisation to set the region up for future growth.

Baha sales are not significant and have not had a material impact on the current years results.

Successful Nucleus Freedom rollout

Nucleus Freedom has now been successfully launched in the major markets except China and Japan. Local regulatory approval for the Nucleus Freedom in China is expected in F07 but Japanese approval is several years away. While regulatory approval was received earlier in the year in Korea, reimbursement approval was granted from 1 July 2006. This led to a slowing in demand during this period.

Showcasing Cochlear at industry meetings

Cochlear participated in two key industry meetings in the region this year. The International Politzer Society meeting was held in Seoul, Korea and the Asia Pacific Symposium on cochlear implants and related sciences was held in Hong Kong. These forums continue to provide a useful showcase for Cochlear's implant performance data.

Cochlear's presence at these meetings enabled us to interact with a large number of professionals and underpins our key messages and contribution to the development of implantable hearing solutions.

Large Nucleus donation order setting up growth for the future in China

An approximate $270 million order was received for Nucleus implants in China and Taiwan over the next six years. This donation represents a truly great philanthropic gesture that will impact the lives of many thousands of profoundly deaf Chinese people and their families.

The logistic arrangements for such a large order are being made. The size of the order provides the opportunity to review and test many of the industry norms. This could provide the impetus to set new industry standards suitable for higher levels of implantation worldwide.

Organisational enhancements

The Asia Pacific regional organisation was further strengthened in the year with the creation of new key roles in clinical and technical services and operations.

A new representative office has also been established in Singapore to support the South East Asian markets.

A repair service capability has been established in China to serve that market's over 3,000 recipients and support the expected high growth as a result of the recent donation.

Infrastructure was developed and enhanced in India and Japan setting the stage for continued growth in those countries.

Direct distribution in Japan, which commenced last year, has also resulted in improved growth in sales and margins.

Advocacy and awareness program implemented

A new Advocacy Group has been formed in Australasia, with 13 volunteer recipients given training by Cochlear. These advocates are now actively promoting awareness of cochlear implants throughout the community, supported by educational material provided by Cochlear together with their own personal experiences and stories.

The Habilitation Outreach for Professionals in Education (H.O.P.E.) program was launched in Japan. H.O.P.E. is a powerful initiative supporting professional educators and the network of individuals that assist Nucleus recipients in developing their language skills.

Additionally, several surgical, auditory and habilitation programs were conducted throughout the Asia Pacific region.

5th Asia Pacific Symposium on Cochlear Implant and Related Sciences, Hong Kong.

Professional Workshop on Auditory Verbal Therapy Hand Practice, India.

25th Politzer Society Meeting, Korea.

Passion for sound

Research and development

Cochlear's passion is reflected in its research and development philosophy and practice.

Medical Design Excellence Awards team.

Innovative engineering combined with scientific discipline have cemented Cochlear's position as the world's leading supplier of implantable hearing technology.

With continued high standards for quality and reliability, Cochlear remains committed to ensuring that implant recipients have access to ongoing technological advances. In 2006, the product development stream continued to conduct research into a range of implantable hearing technologies.

GLOBAL RESEARCH AND PARTNERING

Making a difference

Access to international trends and thinking is vitally important in keeping Cochlear abreast of the latest developments in the implantable hearing device field. Cochlear's in-house research and development program is spread across campuses in Sydney, Melbourne, Mechelen, Denver and Göteborg.

In addition, Cochlear works closely with leading international researchers to understand and develop ground–breaking innovations.

Today, we participate in more than 90 collaborative research programs involving 139 centres in more than 31 countries. Our focus is on clinically relevant research that will result in real improvements in the hearing performance for our recipients and candidates.

Building processes and capability for the future

An essential part of the long-term commitment to excellence is to provide the capability and structure to continue world-class research and industry leading developments.

COCHLEAR IMPLANTS

Award winning Nucleus Freedom

Cochlear has won many prestigious awards for excellence for its fourth generation cochlear implant system, the Nucleus Freedom since its successful market release last year. These awards include:

- Gold award in implant and tissue-replacement products: Medical Design Excellence Awards (New York, USA);
- Australian design award: Standards Australia;
- Excellence award for research and development: Institution of Engineers Australia (Sydney Division);
- Excellence award for manufacturing – products, facilities and processes: Institution of Engineers Australia (Sydney Division); and
- Excellence award: Institution of Engineers Australia (National Division).

Continuously improving the Nucleus Freedom

Cochlear is committed to continuous improvement of its products. In part, this involves applying knowledge learnt from existing products back into the continuous improvement loop. Lessons learnt after the commercial launch of the Freedom system have been captured and where appropriate applied back into the product during the year.

The Nucleus Freedom incorporates an advanced technology platform, providing opportunity for current and future Freedom recipients to benefit from future research outcomes.

Improved product performance

Reliability is a key characteristic of the Nucleus Freedom system – being the most reliable cochlear implant ever produced.

Clinical results for the Nucleus Freedom system show a significant improvement in speech performance in both quiet and noisy situations. Most importantly, recipients are achieving these results faster than any previous cochlear implant system.

Nucleus Freedom has a powerful chip in the external speech processor enabling advanced pre-processing schemes. Cochlear's unique SmartSound pre-processing analyses sound and is designed to enhance hearing performance in difficult listening environments.

Nucleus® Freedom™ BTE with 3 zinc air batteries and rechargeable battery.

1 Nucleus® Freedom™ BTE controller with 3 zinc air batteries.

2 Nucleus® Freedom™ BTE controller with 2 zinc air batteries.

Baha Divino™.

Studies show that 85% of our recipients chose to use SmartSound.

SmartSound also increases the flexibility of the new system and is enabled in the Freedom system via new programming software, Nucleus Custom Sound.

Further enhancements to the Freedom system and Custom Sound software have been released in selected markets with a wider release scheduled in the coming year. Improvements include rechargeable lithium ion batteries for the behind-the-ear (BTE) Freedom speech processor, the Freedom Mini BTE Controller, and an integrated FM solution. All of these modifications improve customer usability and performance.

BONE ANCHORED SOLUTIONS

Cochlear offers implantable hearing solutions for people with single sided deafness (SSD™) and conductive hearing loss that cannot be treated using conventional hearing aids.

New Divino successfully launched

The Baha technology acquired last year added a further dimension to Cochlear's implantable hearing solutions portfolio. The next generation of Baha sound processors – Baha Divino™ was released this year. This enhanced product introduced digital sound processing, combined with a built-in directional microphone to effectively meet the challenges of everyday hearing situations.

DIRECT ACOUSTIC COCHLEAR STIMULATOR (DACS) TECHNOLOGY

Cochlear Acoustics Limited

An integral element in Cochlear's vision of being the 'world leader in implantable solutions for the hearing impaired' is the continued expansion into allied markets.

Cochlear employees in clean room.

Cochlear's joint venture with Phonak AG is focusing on the development of a new type of implantable hearing device, which will broaden our market into new sectors of people with severe hearing impairment.

Good progress has been made on this long-term project. To date, four recipients have been implanted with a development device in Europe. Results have been encouraging and strongly support proof of concept. Feedback from the limited trial is currently being incorporated into the next generation product design. Clinical trials are expected to begin in F07.

ELECTRO ACOUSTIC STIMULATION (EAS)

Good progress with initial clinical trials

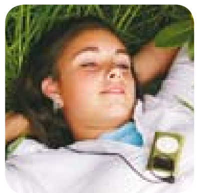
Another important area of implantable device research for Cochlear is the development of an electro acoustic system.

This addresses the market where recipients have some residual hearing (usually low frequency), but still requiring electrical stimulation for the higher frequencies. A combination device using a hearing aid and a cochlear implant is currently being developed. Clinical trials in the US have commenced with over 60 patients participating, with results being fed back into product design and concept.

Configuration of speech processor electronics.

Forming an Extra-Cochlear Electrode.

Operations



Cochlear's operations, located in Australia and Sweden, focus on delivering products of the highest quality and reliability.

Cochlear continues to strive for best practice throughout the entire process, including linking of product development to manufacturing, continuous analysis of the manufacturing process and stringent compliance with regulatory authorities and quality standards.

Improvements in manufacturing capability

Implant manufacturing is a core competency and a source of sustainable competitive advantage to Cochlear.

Cochlear has a single manufacturing site for each of its major products. The Nucleus production site is located at its Lane Cove main office in Sydney, Australia and the Baha products are manufactured in Göteborg, Sweden. All key elements are assembled for worldwide distribution at these locations, with more than 400 people employed in manufacturing and quality assurance globally.

A critical factor in successful new product introduction is the sharing and transfer of information between manufacturing and research and development. In 2006, Cochlear created a dedicated New Product Industrialisation team which includes both manufacturing staff and research and development engineers to improve the manufacturability of the next generation of products.

Cochlear's manufacturing strategy is to ensure that production methods and capacity meet the growing demand for our products. Critical processes have been identified and are in the middle of a 30 month program of re-engineering. These processes aim to improve the ease of manufacturability of our products and to ensure product supply can match anticipated demand. The first stage of "Lean Manufacturing" principles has now been implemented throughout our manufacturing facility in Lane Cove and we have commenced implementation in Göteborg. This has resulted in an increase in capacity and flexibility to respond to an increasingly complex product offering.

Quality assurance

Cochlear is committed to the highest level of quality for its products and has a worldwide quality assurance system in place to ensure the quality of its products and services.

The materials used in Nucleus and Baha implants (eg titanium, platinum and silicon) are chosen for their performance in implantable devices and superior durability. During manufacture, products undergo an extensive range of tests and quality checks that ensure the highest quality standards are maintained.

Cochlear's quality assurance system complies with the applicable regulatory requirements of the Australian TGA, the FDA in the US, the Council of the European Community and the Japanese MHLW and quality standards such as ISO 13485:2003. The regulations administered by these bodies are enforced and confirmed by inspections and audits by the independent authorities.

Regulation and compliance

Cochlear operates in a highly regulated environment with new regulatory bodies continually being created. Cochlear continues to believe in Global Harmonisation as a standard on both an efficacy and cost basis. We actively participate in the Global Harmonisation Task Force, whose aim is to encourage convergence in regulatory practices related to ensuring safety, effectiveness and quality of medical devices, to promote technological innovation, to facilitate international trade and to serve as an information exchange. Regulations encompass specific device approvals and ongoing compliance with design, manufacture, marketing and distribution requirements. As part of our overall regulatory philosophy, we place great emphasis on working closely with regulatory authorities.

Device approvals processes

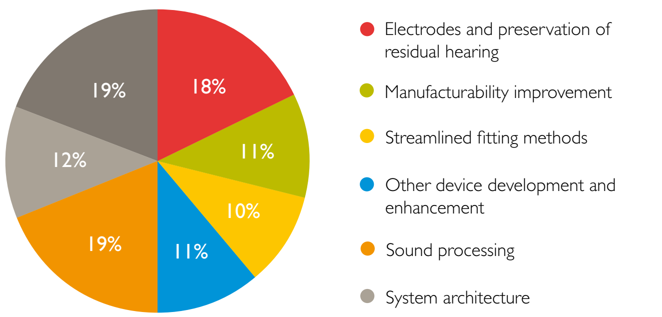
Before a medical device company can market its product, it must obtain approval from the regulatory authority of most countries in which it wishes to sell it. The approval process can typically take up to a year to obtain but may be significantly longer in some jurisdictions. It involves supplying details of the device, its design and the results of tests, such as biocompatibility tests, qualification tests and clinical trials.

At present, Cochlear has the necessary licences and approvals to enable it to conduct its business, including those for the Nucleus Freedom and Baha, in all our major markets. The Nucleus Freedom implant system has been granted CE mark certification, FDA market approval and approval in a number of other countries. Ongoing approvals are frequently being sought for new products in a variety of jurisdictions.

Intellectual property

The generation of new intellectual property and the protection of existing intellectual property are a key competitive advantage for Cochlear. While there are no "blocking" patents in the Cochlear implant field, Cochlear continues to generate key intellectual property in associated fields. In 2006, Cochlear generated 23 new patents in the cochlear implant field alone. The distribution of the cochlear implant patents by research group is shown below.

Cochlear has an internal review process, which regularly analyses the existing portfolio of patents and approves new patents for inclusion in the portfolio. External advice is sought where appropriate.



Distribution of cochlear implant patents by research group

Our people

A key attribute of a Cochlear employee is passion. Passion for: recipients and customers; our products and services; our technology; and our innovative engineering processes.

Building capability in our people, our processes and our organisation is a key driver for Cochlear's continued success.

Attracting and keeping the best people

In an increasingly competitive market for talent, positioning our unique employment value proposition remains a key priority as well as developing a more flexible and mobile workplace. This year, we have:

- enhanced our Sydney Engineering Graduate Recruitment Program to ensure our selection criteria attract the brightest and most innovative engineering talent to Cochlear;
- increased overseas recruitment for Australian positions as we continue to build our capability – positioning us well for future growth; and
- further enhanced Cochlear's international transfers program and formalised international transfer arrangements. Key positions are now advertised in all our international offices. Currently, we have 12 employees on assignment, working in offices away from their home base.

Cochlear is truly a global company with over 60 nationalities represented in the Sydney workplace alone. Cochlear continues to encourage diversity and believes there are real advantages to be gained from different cultures and viewpoints.

Keeping our employees happy, healthy and safe

A global employee survey was conducted in March 2006 using an external research organisation. Cochlear exceeded 83% of all companies in the database for employee engagement. The highest scoring response in the questionnaire was "I'm proud to tell people I work at Cochlear". This engagement in the Company is a key asset for our continued growth.

Cochlear continues to be committed to providing and maintaining a safe and healthy workplace for all employees. An occupational health and safety manager was recruited during the year to further improve Cochlear's safety procedures, standards and working practices. Total lost time injuries for the year were only 81days, down from last year when calculated on a per employee basis and there were no serious injuries or deaths. These statistics are significantly below industry standards for the manufacturing industry.

Cochlear understands the benefits of improving the health and well being of its employees. Manufacturing employees perform pause gymnastics twice a day during their shifts to improve their flexibility and assist with their well being. Other wellness programs include: an ergonomic consultant assessing workstation layout for individuals; free flu vaccinations; free eye screening; and in-house pilates classes.

Improving performance and developing capability...

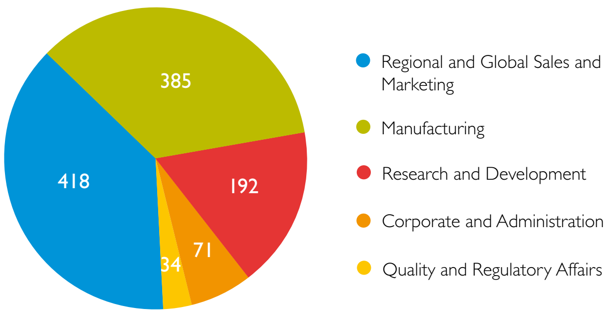
A successful orientation program for new employees is critical in integrating new employees and helping them understand our values and how their role works. The Sydney based Cochlear induction program, Get Equipped, was redeveloped during the year and has become a valuable learning tool for new employees to gain a detailed understanding of our products, organisation and values. During 2006, 75 employees attended a Get Equipped program.

A Learning and Development Calendar is run for each year based on training needs identified through team discussions and individual development plans. The training provided covered job specific and technical areas as well as general areas such as communication, time management and self-leadership. During the year, the Sydney office provided 12,773 hours of training under these programs underscoring Cochlear's commitment to training and development of its employees.

… with a special focus on manufacturing and supply

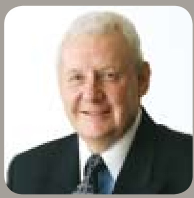
The increase in sales meant that manufacturing was expanded and reorganised along "Lean Manufacturing" principles during the year. Processes were reviewed and redesigned encouraging efficiency through increased employee participation and involvement in continuous improvements.

All Manufacturing and Supply employees participated in workshops designed to enhance teamwork – leading to greater productivity. Specially designed Team Leader training has also been rolled out. Cochlear initiated a program with the NSW Government to provide Workplace English Language and Literacy courses for our employees. These courses have been widely attended and greatly valued.

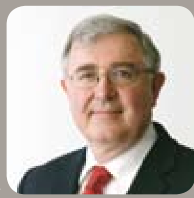


Employee numbers

Board of directors


1

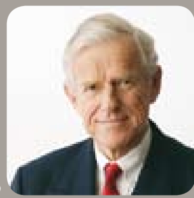
2

3

4

5

6

7

8

9

1. MR TOMMIE CE BERGMAN

Chairman

Age 61. DipEng, Grad DipMarketing, FAICD, FAIM

Appointed Chairman 22 October 2002. Appointed director and Deputy Chairman 1 January 2002.

Director of Smorgon Steel Group Limited since 1999. Member of Advisory Board of Caliburn Partnership Pty Ltd. Former Chairman (2003 – 2005) and Deputy Chairman (2001 – 2002) of WMC Resources Limited and director of Amcor Limited (1997 – 2003) and Atlas Copco Australia Pty Ltd. Former Chairman and Managing Director of Asea Brown Boveri Australasia Pty Ltd (1991 – 2002). Prior to that held CEO and Chairman positions in the ABB Group in Singapore, India, Portugal and the United States.

Chairman of the Nominations Committee. Member of the Audit Committee and Remuneration Committee.

2. DR CHRIS G ROBERTS

CEO/President

Age 52. BE (Hons), MBA, PhD, FAICD, FTSE

Appointed 1 February 2004

Chief Executive Officer of Cochlear Limited. Director of ResMed Inc since 1992 and Chairman of Research Australia. Dr Roberts has worked in the medical device industry for more than 30 years in a number of senior management positions.

Member of the Medical Science Committee and Technology and Innovation Committee.

3. MR PAUL R BELL

Age 60. BA, MA (Hons)

Appointed 1 August 2005

Director of Bio-Link Partners Limited since 2005 and GroPep Limited since 2003. Extensive executive career spanning 30 years with the international pharmaceutical company, Merck & Co Inc (Managing Director – Australia, 1988 – 1997; President of the Asia Pacific Human Health Division, 1997–2002). Member of the Global Merck Management Committee.

Chairman of the Remuneration Committee. Member of the Nominations Committee and Technology and Innovation Committee.

4. PROF EDWARD BYRNE, AO

Age 54. DSc, MD, MBA, FRCP, FRACP

Appointed 1 July 2002

Dean of Faculty of Medicine, Nursing and Health Sciences at Monash University, Melbourne, Deputy Chair of Neurosciences Victoria Limited. Director of Neurosciences Australia Limited. Board member of the Baker Medical Research Institute, Burnet Medical Research Institute, Prince Henry's Medical Research Institute, Southern Health and Mental Health Research Institute.

Chairman of the Medical Science Committee. Member of the Nominations Committee and Technology and Innovation Committee.

5. MR RICK HOLLIDAY-SMITH

Age 56. BA (Hons), FAICD

Appointed 1 March 2005

Chairman of SFE Corporation Limited since 1999 until de-listing in July 2006. Director of DCA Group Limited since 2004, MIA Group Limited (2000 – 2004) until acquired by DCA Group Limited, Servcorp Limited since 1999 and ASX Limited since July 2006. Chairman of Snowy Hydro Limited (not listed) since May 2006. Former director of Exco Resources NL (1999 – 2006). Former President of NationsBank-CRT, Chicago and Managing Director of Hong Kong Bank Limited, London.

Chairman of the Audit Committee. Member of the Nominations Committee and Remuneration Committee.

6. MR PETER J NORTH, AM

Age 72. BE, MBA, FAIM, FAICD, FTSE, FIE Aust

Appointed 1 February 1997

Chairman of the Warren Centre for Advanced Engineering and director of the Australian Academy of Technological Sciences and Engineering. A director of listed companies for more than 20 years. Former CEO in industry and management consulting.

Chairman of the Technology and Innovation Committee. Member of the Audit Committee and Nominations Committee.

7. MR DONAL P O'DWYER

Age 53. BECivil, MBA

Appointed 1 August 2005

President of Cordis Cardiology (Johnson & Johnson medical device business unit with annual turnover of over USD 2 billion) between 2000 and 2004. Chairman of Atcor Medical since 2004 and a director of Sunshine Heart Inc since 2004, Mesoblast Limited since 2004 and Angioblast Systems Inc since 2005.

Member of the Medical Science Committee, Nominations Committee and Technology and Innovation Committee.

8. DR JOHN L PARKER

Age 43. BSc (Hons), PhD, DOC

Appointed 19 March 2002

Chief Technology Officer of Cochlear Limited. Director of Premier Bionics Limited since 2004. Governor of the Warren Centre for Advanced Engineering, Board member of the Cooperative Research Centre for Cochlear Implants and Hearing Innovation. Has an academic appointment as a Visiting Fellow at the Department of Maths, Physics, Computing and Electronics at Macquarie University, NSW.

Member of the Technology and Innovation Committee.

9. MR JUSTUS H VEENEKLAAS

Age 64. BLaws

Appointed 17 March 1998

Director of PowerTel Limited since 2004. Member of the Sydney Symphony Orchestra Council since 1990. Former Chairman of Request DSL Pty Limited (2000 – 2004). Former Chairman and Chief Executive of Philips Electronics Australia (1990 – 1998). Prior to that, held CEO positions in the Philips Group in Hong Kong and the United Kingdom.

Member of the Nominations Committee, Remuneration Committee and Technology and Innovation Committee.

Senior executive team


1

2

3

4

5

6

7

8

9

10

11

12

13

1. DR CHRIS ROBERTS
CEO/President

See "Board of directors" on previous page.

2. RICHARD BROOK
BSc Management, MBA
President, European Region

Joined Cochlear in 2003 with 15 years prior experience in the medical device industry, including with Guidant Corporation. Previous roles include responsibility for direct and distributor operations in Europe, the Middle East, South Africa and Australasia in sales, marketing, customer and technical service functions.

3. DIG HOWITT
BE (Hons), MBA
Senior Vice President,
Manufacturing and Logistics

Joined Cochlear in 2000. Has more than 10 years experience in general management with Sunstate Cement Ltd and management consulting with Boston Consulting Group focusing on strategy development and operational improvement.

4. JAN JANSSEN
MScElecEng
Senior Vice President, Design and Development

Joined Cochlear in 2000 as General Manager of the Cochlear Technology Centre based in Belgium. Commenced role of Senior Vice President, Design and Development in May 2005. Has 15 years experience in research and development with involvement in fields of high technology electronics and cochlear implants.

5. MICHAEL KAVANAGH
BSc, MBA (Advanced)
Senior Vice President, Global Marketing

Joined Cochlear in 2003. Has more than 15 years experience in the healthcare industry, working in senior sales and marketing positions both locally and internationally.

6.MARG LENNON
Vice President, Human Resources and Organisation Development

Joined Cochlear in 2001. Has 16 years experience in human resources working for Merck specialising in the fields of learning and development, organisational effectiveness and organisational development.

7. NEVILLE MITCHELL
BComm, CA (SA), CA
Chief Financial Officer and Company Secretary

Joined Cochlear in 1990 as Financial Controller, became Chief Financial Officer and Company Secretary following listing in 1995. Former Senior Manager with KPMG, Johannesburg.

8. DAVID MORRIS
BBus, BAppSc
President, Bone Anchored Solutions

Joined Cochlear in 2002. Has extensive experience in strategy and operational consulting with a global technology and management consulting company working in the consumer products, pharmaceutical, financial services and utilities industries throughout Asia Pacific, the United States and Europe.

9. DR BRONWYN EVANS
BE (Hons), PhD
Vice President, Quality and Regulatory

Joined Cochlear in 2005. Has more than 20 years experience in engineering and management roles in power generation and distribution, engineering education and the medical Industry. Most recently worked as Asia Service Manager for GE Healthcare, Ultrasound based In Singapore.

10. DR JOHN PARKER
Chief Technology Officer

See "Board of directors" on previous page.

11. JIM PATRICK
MSc
Senior Vice President, Chief Scientist

One of the original Cochlear team in 1981. Deputy Director of the Cooperative Research Centre for Cochlear Implant and Hearing Aid Innovation and Associate Professor, Department of Otolaryngology, The University of Melbourne.

12. MARK SALMON
MBA
President, Asia Pacific Region

Joined Cochlear in July 2004. Has more than 20 years experience in the medical industry. Previously, President and CEO of Asia Growth Markets and Australia, New Zealand and South East Asia for GE Medical Systems.

13. CHRIS SMITH
BSc
President, Americas Region

Joined Cochlear in August 2004. Has more than 20 years experience in the medical device industry specifically, and healthcare in general in the United States including assisting Warburg Pincus, a direct equity healthcare investor in identifying market opportunities for investment. Prior to this, was Group President for Gyrus Group (ENT and Surgical Divisions).

Dr Chris Roberts reports to the Board of Directors and all other members of the senior executive team report to Dr Chris Roberts.

Corporate Governance Report

Cochlear is committed to ensuring that its policies and practices reflect good corporate governance and that there is compliance with all requirements applying to Australian listed companies. This Corporate Governance Report sets out the key governance principles and practices of Cochlear in order of the ASX Corporate Governance Council Principles.

Policies and terms of reference have been made available on the Company website **www.cochlear.com**.

ASX CORPORATE GOVERNANCE PRINCIPLE 1:

Lay solid foundations for management and oversight

The Board is responsible to Cochlear's shareholders and other stakeholders for overall business performance.

The Board operates under a Board Charter that details its functions and the matters specifically reserved to it for decision. The Charter is published on the Cochlear website.

The Board is responsible for the adoption, and overseeing of the implementation, of the strategic direction of Cochlear. It approves and reviews Company goals and performance targets; appoints and removes the CEO/President; oversees succession plans; and approves the accounts, budget, Risk Management Policy including internal control and compliance, the Code of Conduct and major capital management and expenditure decisions.

There is a clear distinction between the responsibilities of the Board and the senior executive team. The Chairman is responsible for leading the Board in those duties detailed above, while the CEO/President is responsible for the efficient and effective operation of Cochlear on a day-to-day basis. The CEO/President oversees the implementation of strategies approved by the Board and is accountable to the Board for all authority delegated to the senior executive team.

The full Board meets for at least eight regular meetings each year. Other meetings are called as deemed necessary. Meeting attendance including committee attendance for the 2006 financial year is set out in the Directors' Report. At every Board meeting, non-executive directors meet for a period without management or executive directors present.

The senior executive team meets each year to discuss in detail the strategic direction of the Company. The Board's focus is on improving shareholder returns and pursuing disciplined growth. Throughout the year, the Board has regular scheduled discussions on various aspects of the Company's strategy.

The CEO/President is responsible for bringing material matters to the Board's attention. To maintain an understanding and to monitor the results of the operations, the senior executive team briefs the Board regularly. Each month, directors receive operating reports provided by senior management, covering each region and function. Directors also personally inspect operations in Australia and overseas on a regular basis.

ASX CORPORATE GOVERNANCE PRINCIPLE 2:

Structure the Board to add value

As at 30 June 2006, the Board comprised seven non-executive directors, including the Chairman, and two executive directors, being the CEO/President and the Chief Technology Officer. The Board considers that, between them, the directors bring the necessary skills, knowledge and experience to perform the Board's duties appropriately, including international experience and scientific, medical and technical expertise. The skills, experience and expertise of each director are set out on page 26 of this Annual Report.

Two directors, Mr Paul R Bell and Mr Donal P O'Dwyer, were appointed to the Board in August 2005 following a process of appointment established by the Nominations Committee, which assesses the necessary and desirable competencies of potential candidates. The selection process included obtaining advice from an external consultant to identify suitable candidates who met the specification determined by the Board. Professor Brian Anderson, AO retired at the Company's 2005 Annual General Meeting (AGM) after having served on the Board since the Company's listing in December 1995. The composition of Cochlear's Board has otherwise remained stable during the year.

The policy for appointment of directors and the selection process are outlined in the Nominations Committee Terms of Reference, which are available on the Company website. Upon appointment of a new director, the key terms and conditions and the Company's expectations of the appointee, are set out in a letter to the new director.

New non-executive directors are provided with an induction program specifically tailored to the needs of individual appointees. That program includes product training, one-on-one meetings with members of the senior executive team and visits to key functional areas. Directors participate in continuous improvement and education programs from time to time, as considered appropriate.

The Company's Constitution requires one third of the directors to retire from office at the AGM each year. Retiring directors are eligible for re-election. The CEO/President is excluded from this requirement.

When the Board fills a vacancy during a year, the new director must stand for election at the next AGM. With the consent of the Chairman, individual directors may seek independent professional advice, at the expense of Cochlear, on any matter connected with their responsibilities. No individual directors exercised this right during the year.

Director independence

The Board has assessed the independence of the non-executive directors in light of their interests and relationships and considers all non-executive directors to be independent. Non-executive directors are deemed to be independent of management and any business or other relationship with Cochlear that could materially interfere with the exercise of objective, unfettered or independent judgement by the director or the director's ability to act in the best interests of the Company. The Nominations Committee Terms of Reference outline criteria used to apply the test.

All non-executive directors have no business relationships with Cochlear. The total number of shares owned by Cochlear non-executive directors is 31,950. This is considered immaterial.

The Board believes arbitrary limits on tenure may cause loss of experience and expertise that are important contributors to the efficient working of the Board. The Board does not currently believe that any non-executive directors have served on the Board for a period, which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the Company.

It is noted that Mr Peter J North, AM will retire at the 2006 AGM having served as a non-executive director for approximately nine years, as will Mr Justus H Veeneklaas, who has served on the Company's Board for approximately eight years.

Any loss of independence by a non-executive director will immediately be disclosed to the market.

In addition to independence, the Board assesses the time commitments of the Chairman and all other non-executive directors to ensure that adequate time is available to discharge Board duties. Directors must disclose proposed appointments on other boards prior to commitment, to the Chairman, who will assess whether the non-executive directors have adequate time to perform their duties. All directors are considered to have sufficient time available to discharge responsibilities to Cochlear.

Board committees

The Board has established five permanent committees to assist in the execution of its responsibilities. Each of the committees has Terms of Reference under which authority is delegated to them from the Board. The Terms of Reference for each committee can be viewed at the corporate governance section of the Cochlear website.

Committee meeting agendas, papers and minutes are made available to all members of the Board. Committee Chairmen are free to use whatever resources they consider necessary to discharge their responsibilities.

The number of committee meetings held during the year and the attendance at these meetings by members are set out in the Directors' Report. With the exception of the Medical Science Committee and the Technology and Innovation Committee, all members of the committees are independent non-executive directors. Executive director, Dr Chris G Roberts, is a member of the Medical Science Committee and Technology and Innovation Committee and executive director, Dr John L Parker, is a member of the Technology and Innovation Committee.

The composition and role of each committee are set out below:

Audit Committee

The Audit Committee was established at the time of listing of the Company on the ASX in 1995 and is composed entirely of non-executive directors. The members meet at least four times a year and possess sufficient technical expertise to fulfil the functions of the Committee. The assessment of technical expertise occurs on an annual basis.

Mr Rick Holliday-Smith chairs the Committee, with the other members at 30 June 2006 being Mr Tommie CE Bergman and Mr Peter J North, AM. The external and internal auditors, the CEO/President and the Chief Financial Officer (CFO) are invited to the meetings at the discretion of the Committee. At each meeting it attends of the Committee, the external auditor reports on the outcome of its audit and other work. The Committee meets with the external auditor in the absence of members of management at every meeting that it attends.

The primary role of the Committee is to advise and assist the Board in relation to the reporting of financial information.

The Committee's responsibilities include:

- ensuring the Company adopts, maintains and applies appropriate accounting and reporting processes and procedures;
- facilitating the independence of the external audit process and addressing issues arising from the audit process; and
- ensuring the Company maintains effective risk management and internal control systems.

Processes relating to financial reporting are set out under the heading "Safeguard integrity in financial reporting" and to risk management and internal control under the heading "Recognise and manage risk" herein.

Remuneration Committee

The Remuneration Committee was established at the time of listing of the Company on the ASX in 1995. It meets at least three times a year and comprises Mr Paul R Bell (Chairman), Mr Tommie CE Bergman, Mr Rick Holliday-Smith and Mr Justus H Veeneklaas. As the need arises, the CEO/President, CFO, Vice President, Human Resources and Organisation Development and other executives are invited to meetings at the discretion of the Committee.

The Committee is responsible for recommendations to the Board in determining Remuneration Policy and the remuneration of executive directors and the senior executive team. This includes long-term performance requirements and incentives.

Remuneration levels are competitively set to attract and retain qualified and experienced staff and independent advice is taken on the appropriateness of remuneration packages.

The Committee's role also includes the responsibility for the remuneration and incentive policies (including the Performance Appraisal Policy) for Cochlear generally. It also approves the recruitment, retention and termination policies and practices as well as superannuation arrangements and makes recommendations to the Board in accordance with the Cochlear Executive Long Term Incentive Plan.

Nominations Committee

The Nominations Committee is chaired by the Company Chairman and is comprised entirely of non-executive directors. In addition to the Chairman, the members of the Committee are Prof Edward Byrne, AO, Mr Rick Holliday-Smith, Mr Peter J North, AM and

Mr Justus H Veeneklaas, with Mr Paul R Bell and Mr Donal P O'Dwyer joining the Committee on 1 August 2005.

The Committee was established in July 2003. The Committee's role is to assist the Board in ensuring that the Board is comprised of individuals who are best able to discharge the responsibilities of a director, having regard to the law and the highest standards of governance, by:

- assessing the skills, knowledge, experience and diversity required on the Board and the extent to which each is represented;
- establishing processes for the review of the performance of individual directors and the Board as a whole;
- establishing processes for the identification of suitable candidates for appointment to the Board;
- reviewing skills required to be maintained by existing directors; and
- overseeing succession planning for the Board.

A copy of the Nominations Committee Terms of Reference is available on the Company's website. This includes a description of the procedure for the selection and appointment of new directors to the Board and factors used to determine director independence.

Medical Science Committee

The Medical Science Committee was established in the 2003 financial year and meets at least bi-annually. The Committee comprises Prof Edward Byrne, AO (Chairman) and Dr Chris G Roberts, with Mr Donal P O'Dwyer joining the Committee on 1 August 2005. The Committee may invite any executive to its meetings at its discretion.

The Committee considers any matters relating to medical aspects of the Cochlear implant program and allied technologies. This includes a watching brief on medical developments in these fields and the findings of independent medical experts.

Technology and Innovation Committee

The Technology and Innovation Committee was established in the 2003 financial year and comprises Mr Peter J North, AM (Chairman), Prof Edward Byrne, AO, Dr John L Parker, Dr Chris G Roberts and Mr Justus H Veeneklaas with Mr Paul R Bell and Mr Donal P O'Dwyer joining the Committee on 1 August 2005. Executives of the Company are invited to meetings at the discretion of the Committee.

The Committee oversees the strategic direction of the Company's technology research and product development programs with an emphasis on priority and resource allocation in line with the Company's agreed corporate strategy.

ASX CORPORATE GOVERNANCE PRINCIPLE 3:

Promote ethical and responsible decision making

Directors and the senior executive team are expected to act with the utmost integrity and objectivity, striving at all times to enhance the reputation and performance of Cochlear. Cochlear's values are enunciated in the Code of Conduct and are reflected in Cochlear's mission statement and strategic plan. The Code of Conduct guides the directors and the senior executive team as to the practices necessary to maintain confidence in the Company's integrity and as to the responsibility and accountability of individuals for reporting and investigating reports of unethical practices. The Code also guides compliance with legal and other obligations to legitimate stakeholders.

Directors and the senior executive team are encouraged to own shares in the Company purchased in accordance with Cochlear's Policy for Dealing in Securities. Under this Policy, directors are required to obtain the consent of the Chairman before dealing in Cochlear securities. Directors and the senior executive team are also prohibited from dealing in securities of Cochlear during designated periods and at any time at which the individual is in possession of inside information.

Share dealings by directors are promptly notified to the ASX.

Executives are granted shares under the Cochlear Executive Long Term Incentive Plan and are provided with recommended share trading periods and guidelines on what constitutes insider trading.

The Cochlear Dealing in Securities Policy can be viewed at the Cochlear website.

ASX CORPORATE GOVERNANCE PRINCIPLE 4:

Safeguard integrity in financial reporting

The directors are committed to the preparation of financial statements that present a balanced and clear assessment of the Company's financial position and prospects.

Accounting and financial control policies and procedures have been established and are monitored by the Audit Committee. The Committee approves any new accounting policies. Compliance with these procedures and policies is subject to review by the external and internal auditors. The Committee provides a link between the external auditor and the Board, and monitors compliance with statutory responsibilities. The Committee is responsible for making recommendations on the appointment, evaluation and dismissal of the external auditor, setting fees and ensuring that the external auditor reports to the Committee and the Board. The Committee reviews the performance, independence and objectives of the external auditor on an annual basis.

Cochlear is committed to auditor independence. The Cochlear audit engagement partners must rotate every five years, with the last rotation occurring in 2002. To enhance auditor independence, the Committee must approve all non-audit services provided by its external auditor firm.

Cochlear has a highly structured six monthly reporting process, culminating in Board sign-off and release of financial results to the market. The CEO/President and the CFO provide a written statement to the Board that to the best of their knowledge and belief, the Company's published financial reports present a true and fair view, in all material respects, of the Company's financial condition and that the operational results are in accordance with relevant accounting standards.

ASX CORPORATE GOVERNANCE PRINCIPLE 5:

Make timely and balanced disclosure

Cochlear is committed to effective communication with its investors so as to give them ready access to balanced and understandable communication.

Cochlear's Continuous Disclosure Policy and Procedures set out the requirements aimed to ensure full and timely disclosure to the market of material issues relating to Cochlear, to ensure all stakeholders have an equal opportunity to access information. The Policy reflects the continuous disclosure requirements set out in the ASX Listing Rules and Corporations Act 2001 and is reviewed regularly.

The Continuous Disclosure Policy and Procedures are provided on the Company website.

ASX CORPORATE GOVERNANCE PRINCIPLE 6:

Respect the rights of shareholders

The shareholders of Cochlear play a key role in the governance of the Company by electing directors. The directors recognise that shareholders must receive high quality, relevant, and useful information in a timely manner to play their role effectively.

The principal communication channels are through the provision of the annual and half yearly reports, periodic analyst and media briefings, the distribution of specific material covering major transactions and events, Company announcements and the AGM.

The Board's philosophy is to encourage full participation of shareholders at the AGM to ensure a high level of accountability and identification with Cochlear's strategy and goals.

The external auditor attends the AGM and is available to answer questions about the conduct of the audit and the preparation and content of the Audit Report. Shareholders can gain access to information about Cochlear, including the Annual Report, key policies and the Terms of Reference of its Board committees through the Company website. A Shareholder Communications Policy is included on the Company website.

ASX CORPORATE GOVERNANCE PRINCIPLE 7:

Recognise and manage risk

The objectives of Cochlear, in relation to risk management, are to improve business performance through management of exposures in a cost effective manner. To do this, Cochlear maintains a comprehensive risk management process, aimed at identifying, assessing and appropriately managing Cochlear's material risks. Major business risks arise from such matters as actions by competitors, technological developments, government policy changes and exchange rate movements.

The Board, Audit Committee and senior executive team are accountable for this process. The Board oversees the establishment and implementation of the risk management system, reviewing the effectiveness of the Company's operation of that system and ensuring investors are informed of material changes to the Company's risk profile.

The Audit Committee advises the Board and reports on the status of business risks through integrated risk management programs aimed at ensuring risks are identified, assessed and appropriately managed. The senior executive team, through a Risk Management Committee, reports to the Audit Committee at least twice a year. The Risk Management Committee, through regular reviews and updates of the risk profile, is responsible for identification of areas of risk, prioritisation of these risks and adoption of cost effective strategies to manage Cochlear's exposure. Senior executives charged with the responsibility for identifying and managing these risks are required to sign off on them on a quarterly basis.

The Audit Committee advises on the establishment and maintenance of internal compliance and control systems within the risk management framework. This includes the scope of the internal audit function. The Audit Committee is responsible for the appointment and removal of the internal auditor and for ensuring that the internal auditor is independent from the external auditor.

The internal and external audit functions are separate and independent of each other. Particular internal audit programs are outsourced. The Audit Committee approves the internal audit program for each year and the effectiveness of the function is kept under review. The CEO/President and the CFO are required to state to the Board in writing that to the best of their knowledge, the integrity of the financial statements is founded on a sound system of risk management and internal compliance and control which operates efficiently in all material respects. The Risk Management Policy can be found on the Company website.

ASX CORPORATE GOVERNANCE PRINCIPLE 8:

Encourage enhanced performance

The Board, its committees, individual directors, the senior executive team and employees are assessed on their performance.

A review of the performance of the Board, its committees and individual directors is performed annually with the most recent being undertaken in the second half of 2006. The Chairman, in agreement with the Nominations Committee, undertook individual interviews, questionnaires and subsequent agreement with each individual director as to their performance over the past year.

Employees, including key executives, participate in bi-annual performance reviews with their manager, where achievement of key goals is discussed and assessed and future goals are agreed upon.

The Policy for Performance Evaluation of the Board, its committees, individual directors and key executives is published on the Company website.

ASX CORPORATE GOVERNANCE PRINCIPLE 9:

Remunerate fairly and responsibly

Cochlear's Remuneration Policy and practices are designed to attract, motivate and retain high quality people.

The Policy is built around principles that:

- remuneration be linked to Cochlear's performance and the creation of shareholder value;
- directors' remuneration be competitive and reflect good corporate governance;
- executive and employee rewards be competitive in the markets in which Cochlear operates;
- executive and relevant employee remuneration be an appropriate balance of fixed and variable reward;
- variable remuneration for senior management have short and long-term components; and
- a significant proportion of executive and employee reward be dependent upon performance assessed against key business measures, both financial and non-financial.

Non-executive directors' remuneration policy

Fees for non-executive directors are based on the nature of their work and their responsibilities. In determining the level of fees, survey data on comparable companies has been considered. Non-executive directors' fees are recommended by the Remuneration Committee and determined by the Board within the aggregate amount approved by shareholders at the 2004 AGM of $1,000,000 a year.

Non-executive directors do not receive any options, performance shares or other performance related remuneration. Non-executive directors appointed after July 2003 are not entitled to a retirement allowance and their fees are market based. Only those non-executive directors appointed prior to this date are entitled to a retirement allowance in line with that set out in the Corporations Act 2001.

Senior executives' remuneration policy

Remuneration for Cochlear executives includes both fixed and variable incentive components. Details of the 2006 remuneration of the directors, including retirement benefits, the five highest paid executive officers of the Consolidated Entity and Company and specified executives are included in the Remuneration Report on page 38 of this Annual Report. The remuneration philosophy and details are also included in the Remuneration Report.

ASX CORPORATE GOVERNANCE PRINCIPLE 10:

Recognise the legitimate interests of stakeholders

The Company provides a forum to address individual shareholder's questions at each AGM. The Board and senior executive team are committed to formulating and implementing Company strategy in a manner that continually increases value for shareholders.

As well as its responsibility to shareholders, the Company is aware of its responsibilities to employees, customers and the community.

The Company has documented policies on equal opportunity, occupational health and safety and standards of workplace behaviour, which are communicated to employees at the time of employment and reinforced by continuous performance management employee training programs. For further information regarding the Company's employees, refer to page 25 of this Annual Report.

The Company's substantial marketing, design and development and regional teams are focused on meeting and exceeding the needs and expectations of Cochlear's customers and sustaining excellence in customer service.

The Company requires all employees, consultants and agents performing work for Cochlear to comply with the Code of Conduct. This Code requires strict compliance with high standards of honesty, integrity, fairness and equity in all conduct relating to Cochlear and its products. Code policies outline formal procedures regarding privacy, anti-corruption, confidentiality, trade practices, documentation management, workplace and other compliance issues for the purpose of ensuring that the Company meets best practice in these areas. The Code also provides for clear and confidential reporting mechanisms concerning any potential breach. In 2006, the Company introduced a whistleblower policy to ensure that the confidentiality, investigation and reporting of any allegations relating to improper conduct are properly maintained.

Cochlear engages across the world in philanthropic and educational activities which benefit its implant recipients, the advance of medical treatment and the wider community. In 2006, the Cochlear Foundation was formed primarily to provide assistance in research, education and community activities for the benefit of the hearing-impaired.

For further information regarding Cochlear's community involvement, please refer to the website.

Financial Report

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

Contents

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

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

Directors

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

Directors' meetings

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

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

(i) Number of meetings held while in office.
(ii) Number of meetings attended.
(iii) Prof BDO Anderson, AO retired on 20 October 2005.
(iv) Mr PR Bell and Mr DP O'Dwyer were appointed on 1 August 2005.

Principal activities and review of operations and results

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

Other than as discussed in the CEO/President's Report and the Financial discussion and analysis, there were no significant changes in the nature of those activities during the year ended 30 June 2006 and the results of those operations are set out in the above-mentioned reports.

Consolidated results

The consolidated results for the financial year are:

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

Dividends

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

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

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

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

Environmental regulations

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

Non-audit services

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

- all non-audit services were subject to the corporate governance procedures adopted by the Company and have been reviewed by the Audit Committee to ensure that they do not impact the integrity and objectivity of the auditor; and
- the non-audit services provided do not undermine the general principles relating to auditor independence.

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

State of affairs

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

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

Likely developments

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

Remuneration Report

Remuneration Committee

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

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

Remuneration policies – audited

The Board recognises that Cochlear's performance is dependent on the quality of its people. To successfully achieve its financial and operating objectives in a complex and global environment, Cochlear must be able to attract, motivate and retain highly skilled senior executives who are dedicated to the interests of shareholders. Cochlear adopts a total remuneration approach for senior executives. The key principles that underpin Cochlear's Remuneration Policy include:

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

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

Remuneration structure

Senior executives – audited

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

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

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

Service contracts – audited

Cochlear does not enter into service contracts for senior executives, other than the CEO/President. Senior executives operate under standard termination and redundancy conditions with the following exceptions. The President, Asia Pacific Region has a notice period of three months and the President, European Region has a notice period of six months. The President, European Region will receive a maximum of CHF 30,000 for repatriation costs in the case of termination or resignation.

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

Base salary and benefits – audited

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

In addition to base salary, selected overseas based executives receive additional benefits including health insurance, a car allowance and a relocation allowance. In Australia, retirement benefits are paid in line with the statutory Superannuation Guarantee legislation levels. In July 2005, members of the legacy defined benefit plan (Plan) were given the opportunity to transfer to the accumulation fund with ongoing contributions based on the estimated required Company contributions under the Plan actuarial assessments to ensure that employees are not adversely prejudiced by the move. The transfer of all members was completed in the first half of the 2006 financial year.

Globally, retirement benefits are paid in line with local legislation and practice.

Variable remuneration – unaudited

The Board believes that well designed and managed short-term and long-term incentive plans are important elements of employee remuneration, providing tangible incentives for senior executives to achieve Cochlear's short-term and long-term performance goals. Participation in these plans encourages greater involvement by senior executives to share in the future growth, prosperity and profitability of Cochlear in a way that gives them a community of interest with shareholders.

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

Cochlear Management Short Term Incentive Plan – audited

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

The percentage of total remuneration that is allocated to short-term incentives varies according to the senior executive's position and the range is 30% – 50% of total fixed remuneration for achieving all budgeted targets. In years of exceptional performance, the short-term incentives could increase to 100% of total fixed remuneration.

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

- at the beginning of the financial year, the Remuneration Committee recommends to the Board the targets for the CEO/President and the other senior executives. These are dependent on financial objectives and agreement between the CEO/President and the senior executive on individual performance goals; and
- the CEO/President and the other senior executives and then the CEO/President and Chairman assess progress towards the financial and individual performance goals. The Remuneration Committee reviews, and the Board approves, these assessments prior to any payment.

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

Once approved by the Board, the short-term incentive awards are paid to participants. This occurs on a half and full year basis.

Cochlear Executive Long Term Incentive Plan – audited

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

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

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

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

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

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

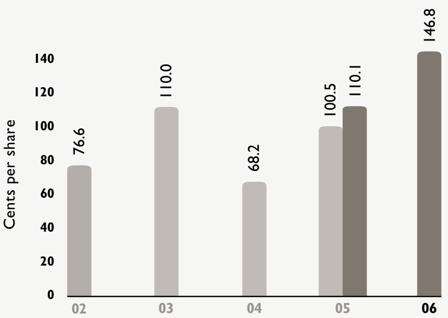
Compound annual growth rate of EPS over a three year period		Ranking of TSR growth rate against S&P/ASX 100 comparator group over a three year period	
Performance	% of options and performance shares vesting	Performance	% of options and performance shares vesting
<10%	0%	<50th percentile	0%
10% to 20%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

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

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

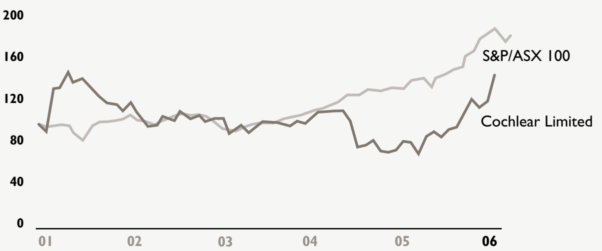
Performance of Cochlear in current CELTIP cycle – unaudited

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



Comparison of Cochlear Limited's basic EPS performance for financial years 2002 to 2006

Previous GAAP AIFRS



Comparison of Cochlear Limited's TSR performance against the S&P/ASX 100 for financial years 2002 to 2006
Total return basis index: June 2001 = 100

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

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

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

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

Executive Share Option Plan – audited

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

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

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

Executive directors – audited

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

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

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

Dr CG Roberts

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

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

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

Dr JL Parker

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

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

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

Non-executive directors – audited

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

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

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

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

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

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

Directors' and senior executives' remuneration details – audited

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

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

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

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

(i) Short-term and long-term incentive bonuses are granted annually. The grant date is tied to the performance appraisal, which, for the current year was completed by 30 June 2006. The service and performance criteria are set out in this report.

(ii) Benefits include the provision of car allowances, health insurance and relocation costs.

(iii) Amounts accrued during the financial year to the directors' retirement scheme. Refer to Note 28 to the financial statements for further information.

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

(v) Executive is included as one of the five named Company executives or Consolidated Entity executives who received the highest remuneration in the current financial year in accordance with section 300A of the Corporations Act 2001.

(vi) Executive is included as a key management person in accordance with AASB 124 *Related Party Disclosures*.

(vii) Denotes overseas based executive.

(viii) Denotes Consolidated Entity and Company executives.

(ix) Not included in Company top five executives in 2005.

(x) Not included in Company top five executives in 2006.

Exercise of options granted as remuneration – audited

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

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

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

Analysis of bonuses included in remuneration – unaudited

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

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

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

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

Analysis of share based payments granted as remuneration – unaudited

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

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

(i) The percentage forfeited in the financial year represents the reduction from the maximum number of options and performance shares available to vest due to the highest level performance criteria not being achieved.

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

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

Analysis of movements in options – unaudited

The movement of values during the reporting period of options over ordinary shares of Cochlear Limited held by each Company director and each of the five named Company executives and relevant Consolidated Entity executives is detailed below:

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

(i) The value of options granted in the year is the fair value of options calculated at grant date using a Black-Scholes model. The total value of the options granted is included in the table above. This amount is allocated to remuneration over the vesting period (i.e. in years 30 June 2006 to 30 June 2009).

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

Other items – unaudited

Unissued shares under option

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

Number of options	Plan	Exercise price per share	Exercise period
192,761	CELTIP	$34.19	August 2006 – September 2008
715,540	CELTIP	$18.97	August 2007 – September 2009
725,903	CELTIP	$39.93	August 2008 – September 2010

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

During the financial year, the Company granted 725,903 options over ordinary shares to employees under the CELTIP. The options are exercisable in the two years following lodgement with the ASX of the Company's preliminary financial report for the year ending 30 June 2008. The number of options which will be exercisable is dependent on the performance measures and retention requirements set out in this Remuneration Report.

During the year, 513,500 options granted by the Company were forfeited.

Directors' interests

The relevant interest of each director in the share capital of the Company, as notified by the directors to the ASX in accordance with section 205G(1) of the Corporations Act 2001, at the date of this report is as follows:

	Cochlear Limited ordinary shares	Options over ordinary shares
Mr PR Bell	1,500	-
Mr TCE Bergman	12,000	-
Prof E Byrne, AO	1,000	-
Mr R Holliday-Smith	1,000	-
Mr PJ North, AM	13,000	-
Mr DP O'Dwyer	2,450	-
Dr JL Parker	25,000	91,180
Dr CG Roberts	237,000	243,789
Mr JH Veeneklaas	1,000	-

Indemnification of officers

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

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

Insurance for directors and officers

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

Events subsequent to reporting date

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

Dividends

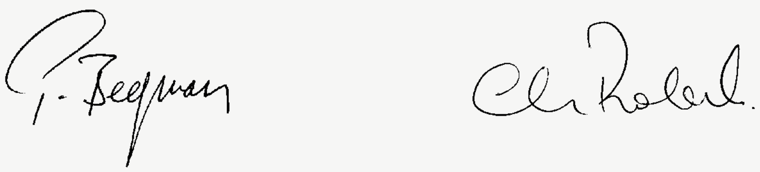
For dividends declared after 30 June 2006, see Note 7 of the financial statements.

Rounding off

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

Dated at Sydney this 15th day of August 2006.

Signed in accordance with a resolution of the directors:



Director

Director

Auditor's Independence Declaration

Lead Auditor's Independence Declaration under section 307C of the Corporation Act 2001

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

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

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

KPMG

Sydney, 15 August 2006

John Wigglesworth, Partner

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

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

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

Statements of recognised income and expense

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

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

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

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

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

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

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

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

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

1. Statement of significant accounting policies

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

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

(a) Statement of compliance

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

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

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

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

(b) Basis of preparation

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

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

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

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

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

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

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

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

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

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

(c) Basis of consolidation

Controlled entities

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

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

Associates

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

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

Transactions eliminated on consolidation

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

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

(d) Revenue recognition

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

Sales revenue

Sales revenue comprises revenue earned (net of returns, discounts and allowances) from the provision of products or services. Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due, the costs incurred or to be incurred cannot be measured reliably, there is a risk of return of goods or there is continuing management involvement with the goods. Revenue from the sale of services is recognised when the service has been provided to the customer and where there are no continuing unfulfilled service obligations.

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

Other income

Other revenue, including government grants, is recognised on a systematic basis as income over the periods necessary to match it with the related costs for which it is intended to compensate or if the costs have already been incurred in the period in which it becomes receivable which is when the entitlement is confirmed.

Sales of non-current assets

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

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

(e) Goods and services tax

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

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

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

(f) Foreign currency

Foreign currency transactions

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

Financial statements of foreign operations

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

Net investment in foreign operations

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

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

(g) Derivative financial instruments

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

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

(h) Hedges

Cash flow hedges

Current period policy

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity. When the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated cumulative gain or loss is removed from equity and included in the initial cost or other carrying amount of the non-financial asset or liability. If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, then the associated gains and losses that were recognised directly in equity are reclassified into the income statement in the same period or periods during which the asset acquired or liability assumed affects the income statement.

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

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

Comparative period policy

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

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

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

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

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

Hedge of monetary assets and liabilities

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

Hedge of net investment in foreign operations

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

(i) Cash and cash equivalents

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

(j) Provisions

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

Warranties

Provisions for warranty claims are made for claims in relation to sales made prior to the reporting date, based on historical claim rates and respective product populations. The provision is determined on a discounted cash flow basis. Warranty periods on hardware products extend for three to 10 years. The Consolidated Entity is expected to incur the majority of the liability over the next three to 10 years.

Dividends

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

Restructuring, employee termination benefits and surplus lease space

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

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

Self-insurance

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

Make good lease costs

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

A provision for make good lease costs is recognised at the time it is determined that it is probable that such costs will be incurred in a future period, measured at the expected cost of returning the asset to the lessor in its original condition. The Consolidated Entity is expected to incur the liability within the next 12 years. An offsetting asset of the same value is also recognised and is classified in plant and equipment. This asset is amortised to the income statement over the life of the lease.

(k) Intangible assets

Goodwill

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

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash generating units and is no longer amortised but is tested annually for impairment (see accounting policy (l)).

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

Enterprise resource planning system

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

Research and development expenditure

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

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

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

Other intangible assets

Other intangible assets, principally comprising of technology acquired, customer relationships and intellectual property, are acquired individually or through business combinations and are stated at cost less accumulated amortisation (see below) and impairment losses (see accounting policy (l)).

Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

Subsequent expenditure

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

Amortisation

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

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

(l) Impairment

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

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

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

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

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

Calculation of recoverable amount

Receivables

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

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

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

Other assets

The recoverable amount of other assets is the greater of their fair value less costs to sell, and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs.

Reversals of impairment

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

An impairment loss in respect of goodwill is not reversed.

In respect of other assets, an impairment loss is reversed when there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(m) Plant and equipment

Owned assets

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

The cost of self-constructed assets includes the cost of material and direct labour, an appropriate proportion of fixed and variable overheads, and capitalised interest.

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

Leased assets

Operating leases

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

Depreciation

Items of plant and equipment, including leasehold assets, are depreciated using the straight-line method over their estimated useful lives, taking into account estimated residual values. Assets are depreciated from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and held ready for use.

Depreciation rates and methods and residual values are reviewed annually for appropriateness. When changes are made, adjustments are reflected prospectively in current and future financial periods only.

The estimated useful lives in the current and comparative periods are as follows:

Leasehold improvements	5 – 9 years
Plant and equipment	3 – 8 years.

(n) Inventories

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

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

(o) Employee benefits

Defined contribution plans

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

Defined benefit plans

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

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

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

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

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

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

The full amount of actuarial gains and losses that arise subsequent to transition date will be recognised directly in retained earnings.

Wages, salaries and annual leave

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

Long service leave

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

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

Share based payment transactions

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

The fair value of options and shares granted is recognised as an employee benefits expense with a corresponding increase in equity. The fair value is measured at the date the options or shares are granted taking into account market and non-market based criteria and expensed over the vesting period after which the employees become unconditionally entitled to the options and shares. The fair value of the options granted is measured using the Black-Scholes method, taking into account the terms and conditions attached to the options. The fair value of the performance shares granted is measured using the weighted average share price of ordinary shares in the Company, taking into account the terms and conditions attached to the shares. The amount recognised as an expense is adjusted to reflect the actual number of options and shares that vest except where forfeiture is due to market related conditions.

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

Treasury shares

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

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

(p) Receivables

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

(q) Taxation

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

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

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

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

(r) Payables

Trade and other payables are stated at amortised cost.

(s) Interest bearing liabilities

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

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

(t) Net financing income

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

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

(u) Earnings per share

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

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

(v) Segment reporting

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

(w) Accounting estimates and judgements

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

Key sources of estimation uncertainty

US Department of Justice Inquiry

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

2. Changes in accounting policies

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The above amounts are based on the balance of the dividend franking account at year end adjusted for:

- franking credits that will arise from the payment of the current tax liability;
- franking debits that will arise from the payment of dividends recognised as a liability at the year end; and
- franking credits that the Company may be prevented from distributing in subsequent financial years.

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

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

8. Segment reporting

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

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

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

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

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

Secondary reporting

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

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

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

	Note	Consolidated 2006 $000	Consolidated 2005 $000	Company 2006 $000	Company 2005 $000

14. Plant and equipment

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

		Consolidated		Company	
		2006	2005	2006	2005
	Note	$000	$000	$000	$000
15. Intangible assets					
Goodwill at cost		**185,352**	**168,002**	**-**	**-**
Acquired technology					
At cost		3,702	3,334	-	-
Accumulated amortisation		(1,234)	(278)	-	-
		2,468	**3,056**	**-**	**-**
Enterprise resource planning system					
At cost		13,091	12,217	9,179	9,179
Accumulated amortisation		(10,545)	(7,178)	(9,093)	(7,179)
		2,546	**5,039**	**86**	**2,000**
Customer relationships					
At cost		5,433	5,002	-	-
Accumulated amortisation		(1,826)	(417)	-	-
		3,607	**4,585**	**-**	**-**
Intellectual property capitalised, at cost(i)		**6,788**	**6,825**	**-**	**-**
Capitalised development expenditure					
At cost		7,385	7,524	7,385	7,524
Accumulated amortisation		(3,345)	(1,261)	(3,345)	(1,261)
		4,040	**6,263**	**4,040**	**6,263**
Other intangible assets					
At cost		583	590	-	-
Accumulated amortisation		(146)	(31)	-	-
		437	**559**	**-**	**-**
Total intangible assets		**205,238**	**194,329**	**4,126**	**8,263**

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

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

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

Amortisation charge

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

Impairment tests for cash generating units containing goodwill

The following units have significant carrying amounts of goodwill:

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

The recoverable amount of each cash generating unit is based on value-in-use calculations. Those calculations use cash flow projections based on actual operating results and the three year business plan. Cash flows for a further two year period are extrapolated using a 3.5% per annum growth rate and are appropriate because the related acquisitions are long-term businesses. This growth rate is consistent with the long-term average growth rate for the industry. A post-tax discount rate of 9.5% per annum has been used in discounting the projected cash flows.

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

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

The recoverable amount of each cash generating unit including unallocated corporate assets is in excess of their carrying amounts and therefore no impairment charge was required. Any adverse change in assumptions could reduce the recoverable amount below the carrying amount.

16. Deferred tax assets and liabilities

Recognised deferred tax assets and liabilities

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

At 30 June 2006, a deferred tax liability of $14,282,667 (2005: $5,151,203) relating to an investment in a subsidiary has not been recognised because the Company controls whether the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future.

Movement in temporary differences during the year

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

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

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

Bank overdrafts

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

Bank loans

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

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

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

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

Employee benefits

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

Warranties

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

Other and legal

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

Directors' retirement scheme

Refer to Note 28.

Make good lease costs

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

22. Contingent liabilities

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

US Department of Justice Inquiry

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

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

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

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

Guarantees

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

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

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

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

		Consolidated		Company	
		2006	2005	2006	2005
	Note	$000	$000	$000	$000

23. Issued capital

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

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

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

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

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

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

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

Company

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

Treasury reserve

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

Foreign currency translation reserve

The foreign currency translation reserve records the foreign currency differences arising from the translation of the financial statements of foreign operations where their functional currency is different to the presentation currency of the reporting entity. Refer to Note 1(f) for further details.

Hedging reserve

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

25. Notes to the statements of cash flows

Cash assets

The operating account received an average interest rate of:

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

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

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

(a) Reconciliation of cash and cash equivalents

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

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

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

(i) These entities are audited by other member firms of KPMG.
(ii) Dormant.
(iii) Name changed from Entific Canada Inc on 29 August 2005.
(iv) Name changed from Entific Medical Systems SAS on 21 March 2006.
(v) Name changed from Entific Harbour AB on 22 November 2005.

(b) Acquisition of controlled entities

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

(i) three distribution businesses were acquired, being:

- on 1 July 2004, Nihon Cochlear Co Limited, a wholly-owned subsidiary of the Company, acquired the cochlear implant distribution business from its distributor for cash;
- on 1 July 2004, the Consolidated Entity purchased 100% of the voting shares of Miaki NV, a distributor of Cochlear Limited products, incorporated in Belgium. At the time of acquisition, Miaki NV owned 100% of the voting shares of Newmedic NV, which was subsequently renamed to Cochlear Benelux NV;
- on 1 November 2004, the Consolidated Entity purchased 100% of the voting shares of Newmedic International SAS, a distributor of Cochlear Limited products, incorporated in France. Newmedic International SAS was subsequently renamed to Cochlear France SAS; and

(ii) on 8 March 2005, the Consolidated Entity purchased 100% of the shares of Entific Medical Systems AB, a company incorporated in Sweden. The company designs, manufactures and distributes bone anchored hearing implants.

Details of each acquisition are as follows:

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

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

27. Key management personnel disclosures

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

Non-executive directors

Mr TCE Bergman (Chairman)

Prof BDO Anderson, AO (resigned 20 October 2005)

Mr PR Bell (appointed 1 August 2005)

Prof E Byrne, AO

Mr R Holliday-Smith

Mr PJ North, AM

Mr DP O'Dwyer (appointed 1 August 2005)

Mr J H Veeneklaas

Executive directors

Dr CG Roberts

Dr JL Parker

Executives

Mr R Brook

Mr NJ Mitchell

Mr MD Salmon

Mr CM Smith.

Key management personnel disclosures

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

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

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

Options and performance shares granted as compensation

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

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

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

All options and performance shares granted in the 2006 financial year were granted on 22 August 2005 and vest in August 2008. Options have an expiration date of 30 September 2010. No options or performance shares have been granted since the end of the financial year. The options and performance shares were provided at no cost to the recipients.

All options granted during the financial year have an exercise price of $39.93 per share and a fair value of $4.63 per share at grant date for options with performance based conditions and $3.48 per share at grant date for options with market based conditions. The performance shares granted during the financial year had a fair value at grant date of $21.36 per share for performance shares with performance based conditions and $16.02 per share at grant date for performance shares with market based conditions.

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

Movement in shares

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

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

	Held at 1 July 2004	Purchases	Received on exercise of options	Sales	Held at 30 June 2005
Directors					
Non-executive					
Mr TCE Bergman	12,000	-	-	-	12,000
Mr PR Bell(i)	n/a	n/a	n/a	n/a	n/a
Prof E Byrne, AO	1,000	-	-	-	1,000
Mr R Holliday-Smith	-	1,000	-	-	1,000
Mr PJ North, AM	13,000	-	-	-	13,000
Mr DP O'Dwyer(i)	n/a	n/a	n/a	n/a	n/a
Mr JH Veeneklaas	1,000	-	-	-	1,000
Non-executive					
Dr CG Roberts	162,000	75,000	-	-	237,000
Dr JL Parker	25,000	-	-	-	25,000
Executives					
Mr R Brook	-	-	-	-	-
Mr NJ Mitchell	15,000	20,000	-	-	35,000
Mr MD Salmon	-	1,457	-	-	1,457
Mr CM Smith	-	-	-	-	-

(i) Appointed director on 1 August 2005.

		Consolidated		Company	
		2006	2005	2006	2005
	Note	$000	$000	$000	$000

28. Employee benefits

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

(i) Recognised in other assets.

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

(a) Liability for defined benefit obligation

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

		Consolidated		Company	
		2006	2005	2006	2005
	Note	$000	$000	$000	$000
Movement in the net asset for defined benefit obligation recognised directly in retained earnings					
Net asset for defined benefit obligation at 1 July		324	603	324	603
Contributions by employer		167	197	167	197
Expense recognised in the income statement		(167)	(336)	(167)	(336)
Actuarial losses recognised in the statement of recognised income and expense		-	(140)	-	(140)
Net asset for defined benefit obligation at 30 June		**324**	**324**	**324**	**324**
Defined benefit pension plans					
Amounts in the balance sheet:					
Assets		324	324	324	324
Liabilities		-	-	-	-
Net asset		**324**	**324**	**324**	**324**
Amounts for the current and previous four years are as follows:					
Defined benefit obligation		(3,293)	(4,089)	(3,293)	(4,089)
Plan assets		3,647	4,891	3,647	4,891
Surplus		354	802	354	802
Experience adjustments on plan liabilities		(647)	64	(647)	64
Experience adjustments on plan assets		266	4	266	4

The Consolidated Entity and Company have used the exemption in AASB 1 and disclosed amounts above for each annual reporting period prospectively from the transition date to AIFRS.

Changes in the present value of defined benefit obligation are as follows:				
Opening defined benefit obligation	4,089	3,600	4,089	3,600
Service cost	275	264	275	264
Interest cost	234	170	234	170
Actuarial losses	647	262	647	262
Contributions by plan participants	50	92	50	92
Benefits paid	(2,002)	(299)	(2,002)	(299)
Closing defined benefit obligation	**3,293**	**4,089**	**3,293**	**4,089**
Changes in fair values of plan assets are as follows:				
Opening fair value of plan assets	4,891	4,551	4,891	4,551
Expected return	275	346	275	346
Actuarial gains	266	4	266	4
Contributions by employer	167	197	167	197
Contributions by plan participants	50	92	50	92
Benefits paid	(2,002)	(299)	(2,002)	(299)
Closing fair value of plan assets	**3,647**	**4,891**	**3,647**	**4,891**

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

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

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

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

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

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

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

Principal actuarial assumptions

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

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

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

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

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

(i) Plan assets at net market value, and accrued benefits have been calculated at 30 June 2006, being the date of the most recent financial statements of the plans.

(ii) Plan assets at net market value and accrued benefits were calculated at 30 June 2005, being the date of the most recent financial statements of the plans.

(iii) Accrued benefits are benefits which the plans are presently obliged to pay at some future date, as a result of membership of the plans and calculated in accordance with AAS 25 *Financial Reporting by Superannuation Plans*. Accordingly, the surplus does not always equal the defined benefit obligation. The Consolidated Entity has a legal liability to make up a deficit in the funds but no legal right to benefit from any surplus in the funds other than by way of contribution holiday.

(iv) Contribution recommendations are based on a funding methodology that will result in adequate funding for payments expected to be made over the next five years. The levels of the contributions to the plans are reassessed annually.

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

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

(c) Defined contribution superannuation plan

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

(d) Share based payments

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

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

To achieve a 100% allocation of options and shares, compound annual growth rate in earnings per share of 20% must be achieved and the TSR of the Consolidated Entity must be in at least the 75th percentile against the S&P/ASX 100.

At the date of this report, unissued ordinary shares of the Company under option and issued shares held in the Trust are:

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

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

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

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

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

29. Related parties

Non-director related parties

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

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

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

30. Financial instruments

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

Credit risk

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

Foreign exchange risk

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

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

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

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

	Foreign exchange rates		Consolidated	
	2006	2005	2006	2005
Note			$000	$000
Sell United States dollar				
Not later than one year			95,937	67,346
Later than one year but not later than two years			45,802	37,842
Later than two years but not later than three years			5,956	4,052
Weighted average exchange rates contracted	0.72	0.67		
Sell euro				
Not later than one year			104,656	62,031
Later than one year but not later than two years			56,251	37,496
Later than two years but not later than three years			6,070	3,479
Weighted average exchange rates contracted	0.57	0.56		
Sell Japanese yen				
Not later than one year			8,962	9,204
Later than one year but not later than two years			3,893	4,536
Later than two years but not later than three years			503	-
Weighted average exchange rates contracted	68.43	50.03		
Sell Hong Kong dollar				
Not later than one year			-	10,160
Later than one year but not later than two years			-	5,107
Later than two years but not later than three years			-	-
Weighted average exchange rates contracted	-	4.87		
Buy Sweden kroner				
Not later than one year			24,986	-
Later than one year but not later than two years			36,056	-
Later than two years but not later than three years			-	-
Weighted average exchange rates contracted	5.29	-		

Forecast transactions

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

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

Interest rate risk

Effective interest rates, repayment and repricing analysis

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

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

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

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

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

Impact of transition to AIFRS

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

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

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

(a) Reclassifications

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

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

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

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

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

(b) Business combinations

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

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

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

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

(c) Intangible assets

Goodwill

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

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

Research and development expenditure

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

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

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

Other intangible assets

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

Amortisation

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

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

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

(d) Impairment

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

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

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

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

(e) Employee benefits

Defined benefit plans

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

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

Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currency that match the estimated future cash flows. The full amount of actuarial gains and losses that arise subsequent to transition date are recognised directly in retained earnings in accordance with AASB 119 which was early adopted.

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

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

Share based payments

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

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

The fair value of the options granted has been measured using the Black-Scholes method, taking into account the terms and conditions attached to the options. The fair value of the performance shares granted is measured using the weighted average share price of ordinary shares in the Company, taking into account the terms and conditions attached to the shares. The amount recognised as an expense is adjusted to reflect the actual number of options and shares that vest except where forfeiture is due to market related conditions.

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

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

(f) Leased assets – make good provisions

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

Under previous GAAP, the costs of returning the asset to the lessor in its original condition were not recognised until the expenditure was incurred, whereas under AIFRS a provision for make good lease costs is recognised at the time it is determined that it is probable that such costs will be incurred in a future period, measured at the expected cost of returning the asset to the lessor in its original condition. The Consolidated Entity is expected to incur the liability within the next 12 years. An offsetting asset of the same value is also recognised and it classified in plant and equipment. This asset is amortised to the income statement over the life of the lease.

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

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

(g) Foreign operations

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

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

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

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

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

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

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

(h) Financial instruments

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

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

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

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

(i) Revenue recognition

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

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

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

(j) Treasury shares

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

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

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

(k) Taxation

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

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

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

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

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

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

Summary of transitional adjustments

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

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

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

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

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

Summary of impact of transition to AIFRS on retained earnings

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

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

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

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

32. Events subsequent to reporting date

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

Dividends

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

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

In the opinion of the directors of Cochlear Limited:

(a) the financial statements, notes, and the remuneration disclosures contained in the Remuneration Report in the Directors' Report, as set out on pages 38 to 103, are in accordance with the Corporations Act 2001, including:

   (i) giving a true and fair view of the financial position of the Company and Consolidated Entity as at 30 June 2006 and of their performance, as represented by the results of their operations and their cash flows, for the financial year ended on that date; and

   (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001;

(b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable;

(c) the remuneration disclosures that are contained in sections of the Remuneration Report in the Directors' Report comply with AASB 124 Related Party Disclosures; and

(d) the directors have been given the declarations required by section 295A of the Corporations Act 2001 from the Chief Executive Officer and the Chief Financial Officer for the year ended 30 June 2006.

Dated at Sydney this 15th day of August 2006.

Signed in accordance with a resolution of the directors:

Director

Director

Independent Audit Report to the members of Cochlear Limited

Scope

The Financial Report, Remuneration disclosures and directors' responsibility

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

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

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

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

Audit approach

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

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

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

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

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

Audit opinion

In our opinion:

(1) the Financial Report of Cochlear Limited is in accordance with:

(a) the Corporations Act 2001, including:

(i) giving a true and fair view of the Company's and Consolidated Entity's financial position as at 30 June 2006 and of their performance for the financial year ended on that date; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and

(b) other mandatory financial reporting requirements in Australia; and

(2) the Remuneration disclosures that are labelled as audited and contained in the Remuneration Report in the Directors' Report comply with AASB 124 *Related Party Disclosures*.

KPMG

KPMG

Sydney, 15 August 2006

John Wigglesworth, Partner

Additional information

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

Shareholdings

Substantial shareholders

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

Distribution of shareholders

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

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

Twenty largest shareholders

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

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

On market buy-back

There is no current on market buy-back.

Other information

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

Glossary

AIFRS Australian equivalents to International Financial Reporting Standards.

AGM Annual General Meeting.

ASIC Application Specific Integrated Circuit.

ASX Australian Stock Exchange.

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

BTE Behind-the-ear speech processor.

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

DACS Direct Acoustic Cochlear Stimulator.

ERP Enterprise resource planning.

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

FDA United States Food and Drug Administration.

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

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

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

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

MHLW Ministry of Health, Labour and Welfare, Japan.

Previous GAAP Previous Australian Generally Accepted Accounting Principles.

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

R&D Research and development.

SmartSound Set of sound processing algorithms which enhance hearing performance.

TGA Therapeutic Goods Administration, Australia.

Company ASX announcement record

8 JUNE 2006 **Gold award**
Cochlear Limited announces that the previous night it was awarded Gold for the Nucleus Freedom cochlear implant system at the International Medical Design Excellence Awards held in New York.

5 MAY 2006 **$270 million order for China**
Cochlear Limited announces the receipt of an approximately $270 million order for cochlear implants to supply Nucleus cochlear implants in Taiwan and China over approximately six years.

10 MARCH 2006 **Share price increase**
Cochlear Limited notes that the strong increase in share price that day appears to be in response to the recall of a competitor product.

14 FEBRUARY 2006 **Record financial results for half year ended 31 December 2005**
Cochlear Limited announces record revenue for the six months of $221.1 million, a 34% increase over the previous corresponding period, and core earnings of $47.3 million, an increase of 43% over the 31 December 2004 half year.

14 DECEMBER 2005 **Full year earnings upgrade**
Cochlear Limited announces an increase in its full year F06 guidance of core earnings to approximately $80 million, an increase of 37% over the prior year.

20 OCTOBER 2005 **Chairman's address**
Cochlear Limited Chairman Tommie CE Bergman addresses shareholders at the Annual General Meeting.

16 AUGUST 2005 **2005 full year financial results**
Cochlear Limited announces total revenue for the year of $348.5 million, a 22% increase over the prior financial year, and core earnings of $58.3 million, an increase of 58% over the prior financial year. The final dividend was 45 cents per share fully franked.

Company information

Stock exchange listing
Australian Stock Exchange Limited
ASX code COH

Share registrar
Computershare Investor Services Pty Limited
60 Carrington Street
Sydney NSW 2000, Australia
Tel: +61 2 8234 5000

Solicitors
Clayton Utz

Auditors
KPMG Chartered Accountants

Bankers
Australia Westpac Banking Corporation
Japan The Bank of Tokyo-Mitsubishi UFJ, Limited
Sweden Skandinaviska Enskilda Banken AB
United Kingdom NatWest Bank
United States Wells Fargo Bank West, NA

Annual General Meeting
The Annual General Meeting will be held at 2pm on Tuesday 24 October 2006 at the Four Seasons Hotel,
199 George Street, Sydney
A Notice of Meeting and Proxy Form are enclosed with this Annual Report.

Financial calendar

2006

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

2007

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

* Indicative dates only.

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

Design
Cross Media Communications Pty Ltd

Cochlear™

Cochlear Ltd (ABN 96 002 618 073) 14 Mars Road, Lane Cove NSW 2066, Australia Tel: 61 2 9428 6555 Fax: 61 2 9428 6352
Entific Medical Systems AB Mölndalsvägen 91, PO Box 16024, SE-412 21 Göteborg, Sweden Tel: 46 31 733 37 00 Fax: 46 31 335 88 60
Cochlear Americas 400 Inverness Parkway, Suite 400, Englewood CO 80112, USA Tel: 1 303 790 9010 Fax: 1 303 792 9025
Cochlear AG European Headquarters, Margarethenstrasse 47, CH - 4053 Basel, Switzerland Tel: 41 61 205 0404 Fax: 41 61 205 0405
Cochlear GmbH Karl-Wiechert-Allee 76A, D-30625 Hannover, Germany Tel: 49 511 542 770 Fax: 49 511 542 7770
Cochlear Europe Ltd 9 Weybridge Business Park, Addlestone Road, Addlestone, Surrey KT15 2UF, United Kingdom Tel: 44 1932 87 1500 Fax: 44 1932 87 1526
Cochlear (HK) Ltd Rm 2106, 21/F Wing On Centre, 111 Connaught Rd, Central, Hong Kong Tel: 852 2530 5773 Fax: 852 2530 5183
Nihon Cochlear Co Ltd Ochanomizu-Motomachi Bldg, 2-3-7 Hongo, Bunkyo-Ku, Tokyo 113-0033, Japan Tel: 81 3 3817 0241 Fax: 81 3 3817 0245
Cochlear Benelux NV Schaliënhoevedreef 20 I, B - 2800 Mechelen, Belgium Tel: 32 15 36 28 77 Fax: 32 15 36 28 70
Cochlear Bone Anchored Solutions France S.A.S. Route de l'Orme aux Merisiers, Z.I. Les Algorithmes - Bât Homère, F - 91190 St Aubin, France Tel: 33 1 69 35 19 93 Fax: 33 1 60 19 64 99
Cochlear France S.A.S. 3 impasse Marcel Chalard, 31100 Toulouse, France Tel: 33 534 63 85 85 Fax: 33 534 63 85 80
Cochlear Italia SRL Via Augusto Murri, 43, I-40137 Bologna, Italy Tel: 39 051 343578 Fax: 39 051 392062
Cochlear Nordic AB Mölndalsvägen 91, SE - 412 63 Göteborg, Sweden Tel: 46 31 335 14 61/62 Fax: 46 31 335 14 60
Cochlear Canada Inc 2500-120 Adelaide Street West, Toronto, ON M5H 1T1 Canada Tel: 1 416 972 5082 Fax: 1 416 972 5083
www.cochlear.com

N32016 ISS1 AUG06