

Appendix 4D

Cochlear Limited Half Yearly Report As at 31 December 2005

Results for announcement to the market

| | | Movement | | \$A'000 |
|---|-----------|------------|-----------|--------------|
| Cochlear Implant Sales (units) | up | 30% | to | 6,518 |
| Core earnings* | up | 43% | to | 47,313 |
| Total Revenue | up | 34% | to | 221,130 |
| Profit from ordinary activities after tax attributable to members | up | 33% | to | 43,759 |
| Net profit for the period attributable to members | up | 33% | to | 43,759 |
| Basic EPS (cents) | up | 32% | to | 80.4 |
| Core EPS (cents) | up | 45% | to | 86.9 |

| | | | | |
|---|----|-----|----|---------|
| Net Tangible assets per share at 31 December 2005 (cents) | up | 76% | to | (27.4) |
| Net Tangible assets per share at 31 December 2004 (cents) | | | | (113.0) |

| | | | | \$A'000 |
|----------------|------|-----|----|-----------|
| Cash | down | 2% | to | 104,431 |
| Borrowings | down | 4% | to | (194,915) |
| Net Borrowings | down | 7 % | to | (90,484) |

*Core earnings is defined as profit after tax attributable to equity holders of the parent assuming all research and development is expensed and excluding both intangible amortisation and share based compensation changes. A reconciliation of after tax profit to core earnings is found in the analysts briefing (lodged with this document).

| Dividends | Amount per security | Franked amount per security |
|---|---------------------|-----------------------------|
| Interim dividend per share (cents) | 45.0c | 45.0c |
| Previous corresponding period (cents) | 35.0c | 35.0c |
| Record date for determining entitlements to the dividend | | 24 February 2006 |
| Dividend payment date | | 14 March 2006 |
| * No dividend reinvestment plans were in operation during or since the half year. | | |

Refer to the attached directors' report for an explanation of the above movements.

Cochlear Limited and its controlled entities

ACN 002 618 073

**Financial statements and reports
for the half year ended 31 December 2005**

COCHLEAR LIMITED AND ITS CONTROLLED ENTITIES
DIRECTORS' REPORT
For the half-year ended 31 December 2005

The directors present their report, together with the consolidated financial report for Cochlear Limited and its controlled entities for the half year ended 31 December 2005, and the Auditors' review report thereon.

Directors

The directors of the Company during or since the end of the half-year are:

Mr Tommie CE Bergman, ° + *

Chairman

Age 60. DipEng, Grad Dip Marketing, FAICD, FAIM

Appointed Chairman 22 October 2002, Director since January 2002

Dr Chris Roberts, ^ #

CEO/President

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

CEO/President since February 2004

Mr Paul Bell, + ° #

Age 60. BA, MA (Hons)

Director since August 2005

Professor Edward Byrne, AO ^ ° #

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

Director since July 2002

Mr Rick Holliday-Smith, * ° +

Age 55. BA (Hons), FAICD

Director since March 2005

Mr Peter J. North, AM, # * °

Age 71. BE, MBA, FAIM, FAICD, FTSE, FIE Aust

Director since February 1997

Mr Donal O'Dwyer, # ° ^

Age 52. B Eng (Civil), MBA

Director since August 2005

Dr John L. Parker, #

Age 43. BSc (Hons), PhD, DOC

Director since March 2002

Mr Justus H. Veeneklaas, ° + #

Age 63. B. Laws

Director since March 1998

* Member of Audit Committee

+ Member of Remuneration Committee

Member of Technology & Innovation Committee

^ Member of Medical Science Committee

° Member of Nominations Committee

Professor Brian DO Anderson, AO retired as Director on 20 October 2005.

Principal Activities and Review of Operations and Results

Other than as discussed in this Report, there were no significant changes in the nature of operating activities during the half year ended 31 December 2005 and the results of those operations are set out below.

Financial overview

The consolidated results for the half year attributable to the members of the Company are:

| | 2005 | 2004 |
|---|---------------|---------------|
| | \$000 | \$000 |
| Sales revenue | 221,130 | 165,172 |
| Operating profit before tax | 62,098 | 45,956 |
| Profit after tax (PAT) attributable to members of the parent entity | <u>43,759</u> | <u>32,959</u> |
| Basic earnings per share (cents) | 80.4 | 60.9 |
| Diluted earnings per share (cents) | 79.6 | 60.8 |

Results

Regional Performance

Americas Region

Revenue in the Americas region was US\$71.8 million, up 51% on H1 F05 (US\$47.4 million). In Australian dollars, the increase was 46% over the prior year half (H1 F05).

Momentum following the Nucleus Freedom launch in June 2005 was stronger than initially anticipated and market share remained at over 70% for the full six months.

An emerging trend, particularly in the USA, is the increase in bilateral implants. That is, a recipient receiving either an implant in each ear at initial surgery (simultaneous bilateral) or a second implant some time after the initial implant (sequential bilateral). Clinical data continues to support the significant benefit from binaural hearing (where the brain can process and compare sounds from both ears) and that the longer a recipient waits for the second implant, the longer it takes and the more difficult it is to achieve binaural hearing.

With the acquisition of Entific Medical Systems, the USA customer care organisations from both Cochlear and Entific Medical Systems were integrated, which has had a positive effect on overall customer support and market coverage. This has benefited both cochlear implant and Baha customers.

European Region

European revenue for the half year (H1 F06) was Euro 51.6 million, a 45% increase on last year's half (H1 F05: Euro 35.4 million). Because the Australian dollar strengthened against the Euro during the past year, European sales were up 35% in Australian dollars terms to \$81.4 million.

Sales revenue was augmented by Baha sales (not included in the comparative), but the major markets with the exception of the UK, all grew cochlear implant sales significantly. In addition, there were tender sales of approximately 200 units in Central and Eastern Europe and the Middle East in the first half which are not expected to be repeated in the second half.

Nucleus Freedom has now been launched in all major markets in the European region. The product has been well accepted and market share increased to over 70%.

This is the first full half year that Cochlear has been direct in Italy, and with the direct operations established last year in the Netherlands, Belgium and France, Cochlear's presence in Europe has been strengthened. We have also established our direct presence in Sweden using last March's acquisition of the Swedish company Entific Medical Systems as a base.

Asia Pacific

Revenue of \$32.2 million was up 15% on last year's half (H1 F05), but up 18% in constant currency terms (restating last year's sales at F06 FX rates). Nearly all this growth came from the cochlear implant sales as the Baha product sales in Asia-Pacific are off a low base and we still require regulatory approval in many key markets. Upgrade processor revenue was approximately \$3 million less than H1 F'05.

Nucleus Freedom has now been launched in those countries where regulatory approval has been obtained and the response has been enthusiastic. Regulatory approval is still pending in certain key markets like China and Japan.

Dividends

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

| | \$'000 |
|---|---------------|
| In respect of the previous year: | |
| A final ordinary dividend of 45 cents per share, franked to 100% with Class C (30%) franking credits, in respect of the year ended 30 June 2005, paid on 22 September 2005. | <u>24,430</u> |

The interim dividend in respect of the current financial year has not been provided for in this financial report as it was not declared until after 31 December 2005. Since the end of the financial half-year, the directors declared an interim dividend of 45 cents fully franked at a tax rate of 30% amounting to a total of \$24,665,778.

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act.

The lead auditor's independence declaration is set out on page 8 and forms part of the directors' report for the half-year ended 31 December 2005.

Rounding Off

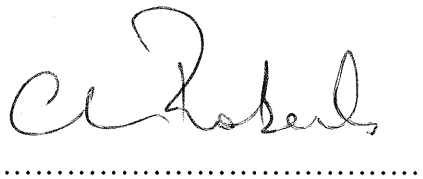
The Company is of a kind referred to in ASIC Class Order 98/ 100 dated 10 July, 1998, and in accordance with that Class Order, amounts in this Report and the accompanying financial statements have been rounded off to the nearest one thousand dollars, unless otherwise indicated.

Dated at Sydney this 14th day of February 2006.

Signed in accordance with a resolution of the directors:



Tommie CE Bergman
Director



Dr Chris G Roberts
Director



Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of Cochlear Limited

I declare that, to the best of my knowledge and belief, in relation to the review for the half-year ended 31 December 2005 there have been:

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

A handwritten signature in black ink, appearing to read 'J. Wigglesworth', written in a cursive style.

KPMG

A large, stylized handwritten signature in black ink, likely belonging to John Wigglesworth, written in a cursive style.

John Wigglesworth
Partner

Sydney

14 February 2006

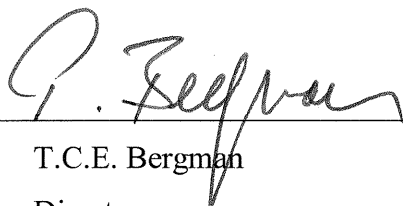
Directors' Declaration

In the opinion of the directors of Cochlear Limited:

1. The financial statements and notes set out on pages 10 to 51 are in accordance with the Corporations Act 2001, including:
 - a. giving a true and fair view of the financial position of the Consolidated Entity as at 31 December 2005, and of its performance, as represented by the results of its operations and cash flows for the half-year ended on that date; and
 - b. complying with Accounting Standards AASB 134 "Interim Financial Reporting" and the Corporations Regulations 2001; and
2. There are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Dated at Sydney this 14th day of February 2006.

Signed in accordance with a resolution of the directors:



T.C.E. Bergman
Director



Dr C. G. Roberts
Director

Cochlear Limited and its Controlled Entities
Condensed consolidated interim income statement

For the half-year ended 31 December 2005

| | | Consolidated | |
|--|-------------|--|--|
| | Note | 31 December 2005 \$'000 | 31 December 2004 \$'000 |
| Revenue | 2 | 221,130 | 165,172 |
| Cost of Sales | 2 | (59,917) | (46,376) |
| Gross profit | | 161,213 | 118,796 |
| Other operating income | | 235 | 161 |
| Distribution, marketing and field technical expenses | | (55,291) | (44,831) |
| Administrative expenses | | (17,314) | (11,243) |
| Research and development expenses | | (26,713) | (18,361) |
| Operating profit before financing costs | | 62,130 | 44,522 |
| Financial income | | 2,998 | 1,888 |
| Financial expenses | | (3,030) | (454) |
| Net financing (costs) / income | 2 | (32) | 1,434 |
| Profit before tax | | 62,098 | 45,956 |
| Income tax expense | 3 | (19,089) | (13,446) |
| Net profit | | 43,009 | 32,510 |
| Attributable to: | | | |
| Equity holders of the parent | | 43,759 | 32,959 |
| Minority interest | | (750) | (449) |
| Profit for the period | | 43,009 | 32,510 |
| Basic earnings per share (cents) | | | |
| - Ordinary shares | | 80.4 | 60.9 |
| Diluted earnings per share (cents) | | | |
| - Ordinary shares | | 79.6 | 60.8 |

The condensed consolidated interim income statement is to be read in conjunction with the notes to the half-year financial statements set out on pages 14 to 51.

Cochlear Limited and its Controlled Entities
Condensed consolidated interim statement of recognised income and expense

For the half-year ended 31 December 2005

| | | Consolidated | |
|--|-------------|--|--|
| | Note | 31 December 2005 \$'000 | 31 December 2004 \$'000 |
| Foreign exchange translation differences | | (1,231) | (402) |
| Movement in general reserves | | - | (4) |
| Cash flow hedges: | | | |
| Effective portion of changes in fair value | | (1,180) | - |
| Effect of change in accounting policy on the adoption of AASB 139 | | | |
| - hedge reserve | 14 | 27,288 | - |
| Net income recognised directly in equity | | 24,877 | (406) |
| Profit for the period | | 43,009 | 32,510 |
| Total recognised income and expense for the period | | <u>67,886</u> | <u>32,104</u> |
| Attributable to: | | | |
| Equity holders of the parent | | 68,852 | 32,951 |
| Minority interest | | (966) | (847) |
| Total recognised income and expense for the period | | <u>67,886</u> | <u>32,104</u> |

Other movements in equity arising from transactions with equity participants as equity participants are set out in note 6.

Cochlear Limited and its Controlled Entities
Condensed consolidated interim balance sheet

As at 31 December 2005

| | | Consolidated | |
|--|-------------|--|------------------------------------|
| | Note | 31 December 2005 \$'000 | 30 June 2005 \$'000 |
| Current assets | | | |
| Cash and cash equivalents | | 104,431 | 106,077 |
| Trade receivables | | 94,579 | 65,611 |
| Forward exchange contract | | 9,431 | 17,350 |
| Inventories | | 56,735 | 49,518 |
| Other | | 12,863 | 12,598 |
| Total current assets | | 278,039 | 251,154 |
| Non-current assets | | | |
| Forward exchange contract | | 4,253 | 9,938 |
| Intangibles | | 193,120 | 193,564 |
| Plant and equipment | | 25,188 | 25,389 |
| Deferred tax assets | | 26,610 | 22,464 |
| Other | | 160 | 187 |
| Total non-current assets | | 249,331 | 251,542 |
| Total assets | | 527,370 | 502,696 |
| Current liabilities | | | |
| Trade and other payables | | 48,419 | 46,539 |
| Interest bearing liabilities | | 61,818 | 64,206 |
| Income tax payable | | 21,736 | 12,455 |
| Provisions | | 23,238 | 25,617 |
| Deferred revenue | | 30,043 | 28,046 |
| Deferred foreign exchange gain | | - | 17,350 |
| Total current liabilities | | 185,254 | 194,213 |
| Non-current liabilities | | | |
| Interest bearing liabilities | | 133,097 | 138,852 |
| Provisions | | 4,330 | 5,032 |
| Deferred foreign exchange gain | | - | 9,938 |
| Total non-current liabilities | | 137,427 | 153,822 |
| Total liabilities | | 322,681 | 348,035 |
| Net assets | | 204,689 | 154,661 |
| Equity | | | |
| Issued capital | 6 | 66,663 | 49,375 |
| Reserves | 6 | 8,753 | (3,917) |
| Retained earnings | 6 | 125,498 | 104,462 |
| Total equity attributable to equity holders of the parent | | 200,914 | 149,920 |
| Minority interest | 6 | 3,775 | 4,741 |
| Total equity | | 204,689 | 154,661 |

The balance sheet is to be read in conjunction with the notes to the half-year financial statements set out on pages 14 to 51.

Cochlear Limited and its Controlled Entities
Statement of Cash Flows

For the half-year ended 31 December 2005

Consolidated
31 December 31 December
2005 2004
\$'000 \$'000

Cash flows from Operating activities

| | | |
|--|---------------|---------------|
| Cash receipts from customers | 198,066 | 156,791 |
| Cash payments to suppliers & employees | (159,511) | (111,332) |
| Grants received | 235 | 161 |
| Interest received | 2,216 | 900 |
| Interest paid | (3,030) | (396) |
| Income taxes paid | (13,954) | (11,429) |
| Net cash provided by operating activities | 24,022 | 34,695 |

Cash flows from Investing activities

| | | |
|--|----------------|-----------------|
| Payment for plant and equipment | (4,102) | (3,232) |
| Payment for investments | - | (838) |
| Payment for controlled entities (net of cash acquired) | - | (15,910) |
| Net Cash used in investing activities | (4,102) | (19,980) |

Cash flows From Financing activities

| | | |
|--|-----------------|-----------------|
| Dividends paid | (24,430) | (23,831) |
| Proceeds from borrowings | 3,003 | 4,262 |
| Repayment of borrowings | (18,215) | - |
| Issue of shares | 17,288 | - |
| Net cash used in financing activities | (22,354) | (19,569) |

Net decrease in cash held **(2,434)** **(4,854)**

Cash at beginning of financial period 106,077 74,091

Effects of exchange fluctuations on the balances of cash held in foreign currencies 788 460

Cash at the end of the financial period **104,431** **69,697**

The statement of cash flows is to be read in conjunction with the notes to the half-year financial statements set out on pages 14 to 51.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

1. Significant accounting policies

Cochlear Limited (the “Company”) is a company domiciled in Australia. The condensed consolidated interim financial report of the Company for the six months ended 31 December 2005 comprise the Company and its subsidiaries (together referred to as the Consolidated Entity).

The condensed consolidated interim financial report was authorised for issue by the directors on 14th February 2006.

(a) Statement of Compliance

The condensed consolidated interim financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards, Urgent Issues Group Interpretations 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 GAAP. The interim financial report of the Consolidated Entity also complies with IFRSs and interpretations adopted by the International Accounting Standards Board.

This is the Consolidated Entity’s first AIFRS condensed consolidated interim financial report for part of the period covered by the first AIFRS annual financial report and AASB 1 *First time adoption of Australian equivalents to International Financial Reporting Standards*. The condensed consolidated interim financial report does not include all of the information required for a full annual financial report.

The interim financial report is to be read in conjunction with the most recent annual financial report, however, the basis of their preparation is different to that of the most recent annual financial report due to the first time adoption of AIFRSs. This report must also be read in conjunction with any public announcements made by Cochlear Limited during the half year in accordance with continuous disclosure obligations arising under the Corporations Act 2001.

An explanation of how the transition to AIFRSs has affected the reported financial position, financial performance and cash flows of the Consolidated Entity is provided in note 13. This note includes reconciliations of equity and profit or loss for comparative periods reported under Australian GAAP (previous GAAP) to those reported for those periods under AIFRSs.

(b) Basis of Preparation

The financial report is presented in Australian dollars.

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

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

instruments classified as available for sale.

The preparation of an interim financial report in conformity with AASB 134 *Interim Financial Reporting* requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income 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.

This condensed consolidated interim financial report has been prepared on the basis of AIFRSs in issue that are effective or available for early adoption at the Consolidated Entity's first AIFRS annual reporting date, 30 June 2006. Based on these AIFRSs, the Board of directors have made assumptions about the accounting policies expected to be adopted when the first AIFRS annual financial report is prepared for the year-ended 30 June 2006.

The entity has elected to early adopt revised accounting standard AASB 119 Employee Entitlements and AASB 2004-3 Amendments to Australian Accounting Standards in these interim financial statements.

The Australian Accounting Standards and UIG Interpretations that will be effective or available for voluntary early adoption in the annual financial statements for the period ended 30 June 2006 are still subject to change therefore cannot be determined with certainty. Accordingly, the accounting policies for that annual period that are relevant to this interim financial information will be determined only when the first AIFRS financial statements are prepared at 30 June 2006.

The preparation of the condensed consolidated interim financial report in accordance with AASB 134 resulted in changes to the accounting policies as compared with the most recent annual financial statements prepared under previous GAAP. Except for the change in accounting policy relating to classification and measurement of financial instruments (refer note 14), the accounting policies set out below have been applied consistently to all periods presented in these condensed consolidated interim financial statements. They also have been applied in preparing an opening AIFRS balance sheet at 1 July 2004 for the purposes of the transition to Australian Accounting Standards – AIFRSs, as required by AASB 1. The impact of the transition from previous GAAP to AIFRSs is explained in note 13. Where relevant, the accounting policies applied to the comparative period have been disclosed if they differ from the current period policy.

The accounting policies have been applied consistently throughout the Consolidated Entity for purposes of this condensed consolidated interim financial report.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

(c) Basis of consolidation

Subsidiaries

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

Investment's in subsidiaries are accounted for at cost.

Transactions eliminated on consolidation

Intragroup balances, and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the condensed consolidated interim financial statements.

Outside interests in the equity and results of the entities that are controlled by the Company are shown as a separate item in the consolidated financial statements.

(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 note 1 (h)(i).

Other revenue

Other revenue, including government grants, is recognised 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

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

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 goods and services tax (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

(i) 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 the balance sheet 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.

(ii) 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.

(iii) 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 translation reserve. They are released into the income statement upon disposal.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

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 operational, financing and investment 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 profit or loss. 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

(i) *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 forecasted transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity. When the forecasted 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 forecasted 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 profit or loss in the same period or periods during which the asset acquired or liability assumed affects profit or loss.

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 profit or loss. 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 entity 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.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

Comparative period policy

For the year ended 30 June, 2005, the following accounting treatment was applied: transactions are 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 are expected to reduce exposure to the risks being hedged, are designated prospectively so that it is clear when an anticipated transaction has or has not occurred and it is probable the anticipated transaction will 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 any other costs or gains arising at the time of entering into the hedge, are deferred and included in the measurement of the anticipated transaction when the transaction has occurred as designated. Any gains or losses on the hedged transaction after that date are included in the profit and loss statement.

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

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

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

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

(ii) 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.

(iii) 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.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

(i) Cash and cash equivalents

Cash and cash equivalents comprises 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 ten 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 its 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.

Refurbishment

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

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

do not include an element for the repairs / overhauls.

A provision for refurbishment costs is recognised over the period of the lease, measured at the expected cost of refurbishment at each reporting date. An offsetting asset of the same value is also recognised and is classified in property plant and equipment. This asset is amortised to the income statement over the life of the lease.

(k) Intangible Assets

(i) 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 profit or loss.

(ii) 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)).

(iii) 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 entity 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.

(iv) Other intangible assets

Other intangible assets, principally comprising of customer relationships, technology acquired, intellectual property are acquired individually or through business combinations

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

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 profit or loss as an expense as incurred.

(v) 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.

(vi) 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 at each annual balance sheet date. Other intangibles are amortised from the date that they are available for use. The estimated useful lives for the current and comparative periods are as follows:

- | | |
|---------------------------------------|--------------|
| • Capitalised development costs | 1-3 years |
| • Enterprise Resource Planning system | 2.5- 4 years |
| • Acquired technology | 4 years |
| • Customer relationships | 4 years |
| • Intellectual property | 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 accounting policy l(i)).

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.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

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

(i) 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 (i.e. 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.

In the year ending 30 June, 2005, the allowance for doubtful debts 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.

(ii) 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.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

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) Property, plant and equipment

(i) Owned Assets

Items of property, plant and equipment are stated at cost or deemed cost less accumulated depreciation (see below) and impairment losses (see accounting policy l). An assets 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 property, plant and equipment is 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 statements as an expense is incurred.

(ii) 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.

(iii) 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 12.0 – 20.0%
- Plant and equipment 13.0 – 33.33%

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

(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).

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 fund'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 fund 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

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

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

The exemption under AASB 1 *First time adoption of Australian Equivalents* has been applied, resulting in no adjustment being made for options granted prior to 7 November 2002 which have 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 (CELTIP) Trust.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

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 the Consolidated Entity.

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

(p) Trade and other 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 the balance sheet 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 the balance sheet 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) Trade and other payables

Trade and other payables are stated at cost.

(s) Interest bearing borrowings

Effective 1 July, 2005, interest-bearing borrowings are recognised initially at fair value less attributable transactions costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

value being recognised in the income statement over the period of the borrowings on an effective interest basis.

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

(t) Net financing costs

Borrowing costs include interest, finance charges in respect of finance leases and foreign exchange differences net of the effect of hedges on borrowings. Debt establishment costs are capitalised and recognised as a reduction in borrowings. 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 entity when they are declared by the subsidiary.

(u) Earnings per share

Basic earnings per share (EPS) is calculated by dividing the net profit 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 (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

| | Consolidated | |
|---|---------------------|--------------------|
| | 31 December | 31 December |
| | 2005 | 2004 |
| | \$'000 | \$'000 |
| 2. Revenue and expenses from ordinary activities | | |
| (a) Revenue | | |
| Revenue from sale of goods before hedging | 207,609 | 151,692 |
| Foreign exchange gains on hedged sales | 12,424 | 11,854 |
| Revenue from the sale of goods | 220,033 | 163,546 |
| | | |
| Revenue from rendering of services | 1,097 | 1,626 |
| | 221,130 | 165,172 |
| | | |
| (b) Expenses | | |
| Cost of sales | | |
| - Cost of goods sold | 53,486 | 41,189 |
| - Warranty and policy | 5,819 | 2,955 |
| - Write down in value of inventories | 612 | 2,232 |
| | 59,917 | 46,376 |
| | | |
| (c) Net financing costs | | |
| Interest income | (2,170) | (1,040) |
| Net foreign exchange gain | (828) | (848) |
| Financial income | (2,998) | (1,888) |
| | | |
| Interest expense | 3,030 | 454 |
| Financial expense | 3,030 | 454 |
| Net financing costs /(income) | 32 | (1,434) |

Cochlear Limited and its Controlled Entities**Notes to the condensed consolidated interim financial statements****For the half-year ended 31 December 2005**

| | Consolidated | |
|--|-------------------------|-------------------------|
| | 31 December 2005 | 31 December 2004 |
| | \$'000 | \$'000 |
| 3. Income tax expense | | |
| Recognised in the income statement | | |
| Current tax expense | | |
| Current year | 14,895 | 14,639 |
| Adjustment for prior years | 48 | (113) |
| | <u>14,943</u> | <u>14,526</u> |
| Deferred tax expense | | |
| Origination and reversal of temporary differences | <u>4,146</u> | <u>(1,080)</u> |
| Total income tax expense in income statement | <u>19,089</u> | <u>13,446</u> |
| Numerical reconciliation between tax expense and pre-tax net profit | | |
| Income tax using the domestic corporation tax rate of 30% (2004: 30%) | 18,629 | 13,787 |
| Increase in income tax expense due to: | | |
| Net higher overseas tax rate | 551 | 205 |
| Equity settled transactions | 426 | 585 |
| Amortisation of intangibles | 317 | - |
| Other non-deductible differences | 479 | 461 |
| Decrease in income tax expense due to: | | |
| Research and development allowance | (1,139) | (1,124) |
| Employee share distribution | (164) | (198) |
| Other non-assessable differences | (58) | (157) |
| | <u>19,041</u> | <u>13,559</u> |
| Income tax under / (over) provided in prior years | 48 | (113) |
| Total income tax expense attributable to operating profit | <u>19,089</u> | <u>13,446</u> |

Cochlear Limited and its Controlled Entities
Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

| | Asia Pacific | | Europe | | Americas | | Eliminations | | Consolidated | |
|---|--------------|---------|---------|---------|----------|---------|--------------|----------|----------------|----------------|
| | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 |
| | A\$'000 | A\$'000 | A\$'000 | A\$'000 | A\$'000 | A\$'000 | A\$'000 | A\$'000 | A\$'000 | A\$'000 |
| 4. Segment reporting | | | | | | | | | | |
| Revenue | | | | | | | | | | |
| Revenue outside the Consolidated Entity | 32,229 | 27,959 | 81,387 | 60,304 | 95,090 | 65,055 | - | - | 208,706 | 153,318 |
| Intersegment revenue | 119,655 | 87,374 | - | - | - | - | -(119,655) | (87,374) | - | - |
| Foreign exchange gains on hedged sales | | | | | | | | | 12,424 | 11,854 |
| Total revenue | | | | | | | | | 221,130 | 165,172 |
| Segment result | 9,494 | 5,409 | 26,033 | 23,287 | 28,982 | 14,201 | - | - | 64,509 | 42,897 |
| Unallocated expenses | | | | | | | | | (2,379) | 1,625 |
| Net financing (costs) / income | | | | | | | | | (32) | 1,434 |
| Profit before tax | | | | | | | | | 62,098 | 45,956 |
| Income tax expense | | | | | | | | | (19,089) | (13,446) |
| Profit after tax | | | | | | | | | 43,009 | 32,510 |
| Industry segment | | | | | | | | | | |
| The Consolidated Entity operates in the medical devices industry. | | | | | | | | | | |

Cochlear Limited and its Controlled Entities
Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

| | Consolidated | |
|--|---------------------|----------------|
| | 31 December | 30 June |
| | 2005 | 2005 |
| | \$'000 | \$'000 |
| 5. Issued capital | | |
| Issued and paid-up capital | | |
| 54,812,840 (June 2005: 54,289,477) ordinary shares, fully paid | 68,034 | 50,746 |
| Movements in ordinary share capital | | |
| Balance at beginning of financial period | 50,746 | 50,746 |
| Shares issued: | | |
| 14,170 (2004: 72,870) shares issued on 30 September 2005 for nil consideration under the Employee Share Plan | - | - |
| 453,500 (2004: nil) shares issued from the exercise of options on 21 September 2005 for \$38.12 per share | 17,288 | - |
| 55,693 (2004: 54,917) shares issued on 16 December 2005 for nil consideration under the Cochlear Executive Long Term Incentive Plan (CELTIP) | - | - |
| Balance at end of financial period | 68,034 | 50,746 |

Options and performance shares

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

| | Exercise Price Per Option | Exercise Period | Number of Options | Number of Performance Shares |
|---|--------------------------------------|----------------------------|------------------------------|---|
| Options & performance shares issued in November 2003 (i) | \$34.19 | Aug 2006-08 | 192,761 | 54,244 |
| Options & performance shares issued in September 2004 (i) | \$18.97 | Aug 2007-09 | 715,540 | 58,429 |
| Options & performance shares Issued in September 2005 (i) | \$39.93 | Aug 2008 -10 | 729,494 | 63,172 |

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

The Cochlear Executive Long Term Incentive Plan (CELTIP) was approved and adopted at the annual general meeting on 20 October 2003 and replaced the ESOP Plan. The CELTIP offers a mixture of options over unissued shares and performance shares. Both the options and the performance shares are subject to a three-year vesting period. The number of options and 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 growth rate in earnings per share of 10% is not achieved and the Consolidated Entity is below the 50th percentile against the S&P ASX 100 over three years, no shares will be issued. To achieve a 100% allocation, an annual compound growth rate in earnings per share of 20% must be achieved and the Consolidated Entity must be in at least the 75th percentile against the S&P ASX 100. During the financial period 22,950 options and 7,479 performance shares were forfeited.

The accounting policy that applied in relation to this program is set out in note 1(o).

Cochlear Limited and its Controlled Entities
Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

6. Capital and reserves

Reconciliation of movement in capital and reserves
 Attributable to equity holders of the parent

| Consolidated A\$000s | Share capital | Treasury Reserve | Translation Reserve | General Reserve | Hedging Reserve | Retained earnings | Total | Minority interest | Total equity |
|--|--------------------------|-----------------------------|--------------------------------|----------------------------|----------------------------|------------------------------|----------------|------------------------------|-------------------------|
| Balance as at 1 July 2005 | 50,746 | (1,371) | (3,991) | 74 | - | 104,462 | 149,920 | 4,741 | 154,661 |
| Total recognised income and expense | - | - | (1,014) | - | 26,108 | 43,759 | 68,853 | (966) | 67,887 |
| Shares Issued* | 17,288 | - | - | - | - | - | 17,288 | - | 17,288 |
| Equity settled transactions | - | - | - | - | - | 1,707 | 1,707 | - | 1,707 |
| Net hedge gains recognised in income statement | - | - | - | - | (12,424) | - | (12,424) | - | (12,424) |
| Dividends to shareholders | - | - | - | - | - | (24,430) | (24,430) | - | (24,430) |
| Balance at 31 December 2005 | 68,034 | (1,371) | (5,005) | 74 | 13,684 | 125,498 | 200,914 | 3,775 | 204,689 |

* Shares issued due to the exercise of employee options in September 2005.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

7. Earnings per share

Basic earnings per share

The calculation of basic earnings per share for the six months ended 31 December 2005 was based on the profit attributable to ordinary shareholders of \$43,759,000 (six months ended 31 December 2004: \$32,959,000) and a weighted average number of ordinary shares outstanding during the six months ended 31 December 2005 of 54,427,884 (six months ended 31 December 2004: 54,135,266) calculated as follows:

Profit attributable to ordinary shareholders for the six months ended 31 December 2005

In A\$000s

| | 2005 | 2004 |
|--|---------------|---------------|
| | \$'000 | \$'000 |
| Profit for the period | 43,759 | 32,959 |
| Profit attributable to ordinary shareholders | <u>43,759</u> | <u>32,959</u> |

Weighted average number of ordinary shares

For the six months ended 31 December 2005

| | 31 Dec 05 | 31 Dec 04 |
|--|-------------------|-------------------|
| Issued ordinary shares at 1 July | 54,289,477 | 54,161,690 |
| Less treasury shares included in opening balance | (120,152) | (65,235) |
| Effect of shares issued on 24 September 2004 | - | 38,811 |
| Effect of shares issued on 21 September 2005 | 251,397 | - |
| Effect of shares issued on 30 September 2005 | 7,162 | - |
| Weighted average number of ordinary shares at 31 December | <u>54,427,884</u> | <u>54,135,266</u> |

Diluted earnings per share

The calculation of diluted earnings per share for the six months ended 31 December 2005 was based on the profit attributable to ordinary shareholders of \$43,759,000 (six months ended 31 December 2004: \$32,959,000) and a weighted average number of ordinary shares outstanding during the six months ended 31 December 2005 of 54,955,498 (six months ended 31 December 2004: 54,224,076) calculated as follows:

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

Profit attributable to ordinary shareholders for the six months ended 31 December 2005

In A\$000s

| | 2005 | 2004 |
|--|---------------|---------------|
| | \$'000 | \$'000 |
| Profit for the period | 43,759 | 32,959 |
| Profit attributable to ordinary shareholders | 43,759 | 32,959 |

**Weighted average number of ordinary shares
(diluted)**

For the six months ended 31 December 2005

| | 31 Dec 05 | 31 Dec 04 |
|--|-------------------|-------------------|
| Weighted average number of ordinary shares at 31 December | 54,427,884 | 54,135,266 |
| Effect of share options and performance shares | 527,614 | 88,810 |
| Weighted average number of ordinary shares (diluted) at 31 December | 54,955,498 | 54,224,076 |

Cochlear Limited and its Controlled Entities
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For the half-year ended 31 December 2005

8. Dividends

Dividends recognised in the current financial period by Cochlear Limited are:

| | Cents per share | Total amount \$'000 | Franked/ unfranked | Date of payment |
|-------------------------|----------------------------|--------------------------------|-------------------------------|----------------------------|
| 31 December 2005 | | | | |
| Final - ordinary | 45.0 | 24,430 | Franked | 22 September 2005 |
| 31 December 2004 | | | | |
| Final - ordinary | 44.0 | 23,831 | Franked | 23 September 2004 |

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

Subsequent events

Since the end of the reporting period, the directors declared the following dividend:

| | Cents per share | Total amount \$'000 | Franked/ Unfranked | Date of payment |
|--------------------|----------------------------|--------------------------------|-------------------------------|----------------------------|
| Interim – ordinary | 45.0 | 24,666 | Franked | 14 March 2006 |

The financial effect of these dividends has not been brought to account in the Consolidated Entity financial statements for the half-year ended 31 December 2005 and will be recognised in subsequent financial reports.

Dividend Franking Account

| | Company | |
|---|-----------------------------|-----------------------------|
| | 31 December 2005 | 31 December 2004 |
| | \$'000 | \$'000 |
| 30% franking credits available to shareholders of Cochlear Limited for subsequent financial periods | 15,030 | 3,576 |

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

| | Interest Held | | Country of Incorporation |
|--|---------------|---------|--------------------------|
| | 31 December | 30 June | |
| | 2005 | 2005 | |
| | % | % | |
| 10. Particulars in relation to controlled entities | | | |
| The Company | | | |
| Cochlear Limited | | | Australia |
| Controlled entities | | | |
| Cochlear Europe Limited | 100 | 100 | United Kingdom |
| Cochlear Acoustics Limited | 75 | 75 | United Kingdom |
| Cochlear AG | 100 | 100 | Switzerland |
| Cochlear (UK) Limited | 100 | 100 | United Kingdom |
| Cochlear GmbH | 100 | 100 | Germany |
| Cochlear Americas | 100 | 100 | United States of America |
| Cochlear (HK) Limited | 100 | 100 | Hong Kong |
| Nihon Cochlear Co Limited | 100 | 100 | Japan |
| Neopraxis Pty Limited | 100 | 100 | Australia |
| Cochlear Technologies Pty Limited | 100 | 100 | Australia |
| Medical Insurance Pte Limited | 100 | 100 | Singapore |
| Cochlear Holdings NV | 100 | 100 | Belgium |
| Miaki NV | 100 | 100 | Belgium |
| Cochlear Benelux NV | 100 | 100 | Belgium |
| Cochlear France Holdings SAS | 100 | 100 | France |
| Cochlear France SAS | 100 | 100 | France |
| Cochlear Italia SRL | 100 | 100 | Italy |
| Cochlear Sweden Holdings | 100 | 100 | Sweden |
| Entific Medical Systems AB | 100 | 100 | Sweden |
| Entific Medical Systems Inc | 100 | 100 | USA |
| Entific Canada Inc | 100 | 100 | Canada |
| Entific Medical Systems SAS | 100 | 100 | France |
| Entific Medical Systems Deutschland GmbH | 100 | 100 | Germany |
| Entific Australia Pty Ltd | 100 | 100 | Australia |
| Cochlear Nordic AB ^(a) | 100 | 100 | Sweden |
| Cochlear Executive Plan Pty Ltd | 100 | 100 | Australia |
| Cochlear Executive Long Term Incentive Plan (Performance Shares) Trust | 100 | 100 | Australia |

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

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

11. Contingent liabilities

The detail and estimated maximum amounts of contingent liabilities that may become payable is set out below. The directors are not aware of any circumstance or information which would lead them to believe that these liabilities will crystallise and consequently no provisions are included in the financial statements in respect of these matters.

US Department of Justice Inquiry

In March 2004, the Company was informed by the United States Department of Justice that Cochlear Americas Limited, a wholly-owned subsidiary, is subject to an inquiry under federal healthcare laws in the USA that deal with the Medicare and Medicaid programs, including some with potential criminal sanctions. The Department of Justice has made no specific allegations. The Company is cooperating fully with the inquiry and has engaged a nationally recognised law firm with specialised expertise in US healthcare law. Legal costs incurred as a result of managing the information request have been provided for the current period. It is not possible to estimate the financial impact of this investigation. There has been no change in the status of this matter during the financial period.

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

12. Events subsequent to reporting date

Other than reported below, there has not arisen in the interval between the reporting date and the date of this financial report, any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to 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.

Cochlear Acoustics Pty Ltd

Cochlear Limited and Phonak AG have substantially completed a renegotiation of their respective Shareholdings in Cochlear Acoustics Pty Ltd from the current arrangement whereby Cochlear Limited owns 75% and Phonak AG 25% of the company to one of equal shareholdings. Full Shareholders Agreements and Co-operation and Supply Agreements are expected to be executed shortly to effect the changed shareholdings. The operations of Cochlear Acoustics will not change with the amended shareholding. The financial impact of this arrangement is not determinable at the date of this report and has not been brought to account in the financial statements for the half year ended 31 December 2005.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

13. Explanation of transition to AIFRS

As stated in note 1(a), these are the Consolidated Entity's first condensed consolidated interim financial statements for part of the period covered by the first AIFRS annual consolidated financial statements prepared in accordance with Australian Accounting Standards - AIFRSs.

The accounting policies in note 1 have been applied in preparing the condensed consolidated interim financial statements for the six months ended 31 December 2005, the comparative information for the six months ended 31 December 2004, the financial statements for the year ended 30 June 2005 and the preparation of an opening AIFRS balance sheet at 1 July 2004 (the Consolidated Entity's date of transition).

In preparing its opening AIFRS balance sheet, comparative information for the six months ended 31 December 2004 and financial statements for the year ended 30 June 2005, the Consolidated Entity has adjusted amounts reported previously in financial statements prepared in accordance with its old basis of accounting (previous GAAP).

An explanation of how the transition from previous GAAP to AIFRSs has affected the Consolidated Entity's financial position and financial performance is set out in the following tables and the notes that accompany the tables. The adoption of AIFRS has not affected the statement of cash flows.

(a) Reclassifications

Under AIFRS finance income consisting of interest income and foreign exchange gains has been transferred from the revenue line to the net finance income line in the income statement. For 31 December 2004 this resulted in a reduction in revenue of \$3,052,000 and in 30 June 2005 resulted in a reduction in revenue of \$2,700,000.

In addition, other income has been reclassified from gross profit to form part of total operating profit before financing costs. This resulted in a reduction to revenue of \$161,000 for the period ending 31 December 2004 and \$963,000 for the period ending 30 June 2005.

The Consolidated Entity has classified capitalised Enterprise Resource Planning system development costs as Property and Equipment in the financial statements. Under AIFRS, these costs are reclassified as intangible assets. For the Consolidated Entity this resulted in \$3,899,000 being reclassified from plant and equipment to intangible assets at 1 July 2004, \$4,458,000 at 31 December 2004 and \$4,274,000 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.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

Under AIFRS, inventory acquired as part of a business combination is recognised at fair value rather than historical cost. The impact of this change at both transition date and the half year ended 31 December 2004 is nil. For the year ended 30 June 2005, the value of inventory 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 half year ended 31 December 2005 following the sale of inventory in the normal course of business.

(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 (d) for further details on impairment testing).

Research and development

Under AIFRS, expenditure on development activities must be 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 research and development costs as incurred.

Development costs incurred which meet the criteria for deferral were capitalised and an adjustment of \$3,149,000 was made as an increase to retained earnings of the Consolidated Entity at 1 July 2004, \$3,387,000 at 31 December 2004 and \$4,375,000 at 30 June 2005. The research and development expense of the Consolidated Entity for the half year ended 31 December 2004 was decreased by \$3,387,000 and by \$4,375,000 for the full year ended 30 June 2005 as a result of the capitalisation of development costs previously expensed.

Capitalised development costs were reviewed against the recognition criteria and 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 were 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 assets is available

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

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 AGAAP |
|-------------------------------------|--------------|-----------------------|
| Goodwill | Indefinite | 20 years |
| Capitalised development costs | 1-3 years | Expensed |
| Acquired technology assets | 4 years | 4 years |
| Customer related intangibles | 4 years | 4 years |
| Enterprise Resource Planning system | 2.5-4 years | 2.5-4 years |

The impact on the value of intangible assets and retained earnings at transition date is nil, at 31 December 2004 a decrease of \$518,000 and at 30 June 2005 an increase of \$1,858,000. The impact for the half year ended 31 December 2004 is a decrease in field technical expenses of \$273,000 from the reversal of goodwill amortisation for the Consolidated Entity offset by amortisation of \$791,000 on development costs capitalised. The impact on the results for the year ended 30 June 2005 is a decrease in field technical expenses of \$577,000 and in administration expenses of \$2,544,000 from the reversal of the goodwill amortisation for the Consolidated Entity, offset by an increase to research and development expenses due to the amortisation of \$1,263,000 of capitalised development costs.

(d) Impairment

Under previous Australian 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, will be 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 will be 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, will be recognised in the income statement as an impairment loss.

No impairment write downs were recorded either at transition date, 31 December 2004 or at 30 June 2005.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

(e) Employee Benefits

Defined Benefit Plans

Under previous Australian 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 fund'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 fund 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 revised Accounting Standard AASB119, "Employee Benefits", 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 and at 31 December 2004, an amount of \$603,000 was recognised as an asset of the Consolidated Entity 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 financial year ended 30 June 2005 an actuarial assessment resulted in a reduction of the net asset position of the plan in the Consolidated Entity by \$324,000. This has been recognised as an increase in administration expenses in the statement of recognised income and expense.

Share based payments

Under previous Australian GAAP no expense was recognised for options issued to employees.

Under AIFRS, the fair value of options and shares granted must be recognised as an employee benefit 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 performance conditions and expensed over the vesting period after which the employees become unconditionally entitled to the options.

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

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

No adjustment has been made for options granted prior to 7 November 2002 which have 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 half year ending 31 December 2004, employee benefits expense and retained earnings for the Consolidated Entity increased by \$1,949,000 representing the share based payments expense for the period. This was made up of \$585,000 relating to distribution, marketing and field technical expenses, \$1,318,000 relating to administrative expenses and \$46,000 relating to R&D expenses. The equity adjustment arising from share based payments has been recognised in retained earnings.

For the financial year ended 30 June 2005, employee benefits expense and retained earnings for the Consolidated Entity increased by \$2,592,000 representing the share based payments expense for the period. This was made up of \$789,000 relating to Distribution, marketing and field technical expenses, \$1,696,000 relating to administrative expenses and \$105,000 relating to R&D 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 Australian GAAP, the costs of refurbishment were not recognised until the expenditure is incurred, whereas under AIFRS a provision for refurbishment costs must be recognised over the period of the lease, measured at the expected cost of refurbishment at each reporting date.

At 1 July 2004 a provision for make good costs associated with these operating leases of \$153,000 for the Consolidated Entity was recognised. This provision increased by \$51,000 for the half year ending 31 December 2004 resulting in an increase in administration expenses of \$40,000 and in distribution, marketing and field technical expenses by \$11,000. For the full year ending 30 June 2005, the provision increased by \$103,000 resulting in an increase in administration expenses of \$82,000 and in distribution, marketing and field technical expense by \$21,000.

(g) Foreign operations

Under previous Australian 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 and revenue and expense items were translated at the

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

average exchange rates. Exchange differences arising on translation were recorded in the balance sheet.

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 of this change on results for the year ended 31 December 2004 for the Consolidated Entity is to increase profit by \$59,000 representing the reclassification of foreign exchange translation losses from a foreign controlled branch to the foreign currency translation reserve. This resulted in a decrease in administration expenses of \$59,000.

The impact at 30 June 2005 was a decrease to profit of \$385,000 through an increase in research and development expenses. In addition, the value of goodwill for the Consolidated Entity decreased by \$13,920,000 with a corresponding decrease to the foreign currency translation reserve as a result of valuing goodwill at exchange rates prevailing at balance date rather than at historical rates. No adjustment was required at 31 December 2004 due to the timing of relevant business acquisitions.

(h) Financial instruments

The Consolidated Entity has taken the election in AASB 1 to not restate comparatives for AASB 132 "Financial Instruments: Disclosure and Presentation" and AASB 139 "Financial Instruments: Recognition and Measurement". As such, there are no adjustments in relation to financial instruments at transition date, for the half year ended 31 December 2004 or for the financial year ended 30 June 2005 as previous Australian 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.

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

No adjustment was required at 31 December 2004 however resulted in a decrease in other receivables of \$434,000 and a decrease in financial liabilities of \$434,000 in the Consolidated Entity as at 30 June 2005.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

(i) Revenue recognition

Under previous Australian 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 Australian 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 from the deferral of revenue previously recognised under existing Australian GAAP. For the half year ended 31 December 2004, revenue increased by \$4,770,000 due to the release of revenue. For the financial year ended 30 June 2005, revenue increased by \$4,112,000 resulting from a release of deferred revenue of \$6,006,000 offset by the deferral of revenue of \$1,894,000.

(j) Treasury shares

The Company operates the Cochlear Executive Long Term Incentive Plan Trust (CELTIP). The main purpose of the trust is to hold unvested performance shares as part of the CELTIP. Under previous Australian 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 must be included in the Consolidated Entity.

At transition date, the Trust held shares of the Company. Under AIFRS, the shares are accounted for as treasury stock and treated as a reduction in the share capital of the Consolidated Entity. The impact on the Consolidated Entity at transition date is a decrease in share capital of \$1,371,000. No further adjustment is required for the half year ended 31 December 2004 or the full year ended 30 June 2005.

At transition date, the Consolidated Entity 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 is to increase retained earnings by \$374,000 representing the amortisation of asset to that date and a decrease to the deferred asset of \$997,000. The impact for the half year ended 31 December 2004 is a decrease in administration costs of \$249,000 and a decrease to the deferred asset of \$748,000. The impact for the full year ended 30 June 2005 is a decrease to administration costs of \$499,000 and a decrease to the deferred asset by \$499,000.

(k) Taxation

Previous Australian GAAP required the application of the income statement liability method of tax effect accounting, whilst AIFRS requires the balance sheet method, whereby

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

income tax on the profit or loss for the year comprises current and deferred taxes. Income tax will be recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it will be recognised in equity.

There have not been any changes to retained earnings or the deferred tax balance for the Consolidated Entity at transition date or for the half year ended 31 December 2004 or for the full 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 and the previously reported tax expense is an increase in deferred tax assets of \$3,160,000 and an increase in retained earnings of \$3,160,000.

The tax impact on the Consolidated Entity for the half year ended 31 December 2004 is an increase in the tax expense of the Consolidated Entity by \$2,452,000 and an increase in the deferred tax asset of \$405,000.

The impact of the IFRS adjustments for the financial year ended 30 June 2005 is an increase in the tax expense of the Consolidated Entity by \$2,321,000 and a decrease in deferred tax assets of \$1,440,000.

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

13. Explanation of transition to AIFRS (continued)

BALANCE SHEET

The following table sets out the adjustments to the balance sheet of the Consolidated Entity at transition to AIFRS as at 1 July 2004 and for the AIFRS comparative period balance sheets as at 31 December 2004 and 30 June 2005.

| | Note | CONSOLIDATED 1 JULY 2004 | | | CONSOLIDATED 31 DECEMBER 2004 | | | CONSOLIDATED 30 JUNE 2005 | | |
|--------------------------------------|-------------|-----------------------------|-------------------------------|----------------|----------------------------------|-------------------------------|----------------|------------------------------|-------------------------------|----------------|
| | | AGAAP \$000 | Transition Impact \$000 | AIFRS \$000 | AGAAP \$000 | Transition Impact \$000 | AIFRS \$000 | AGAAP \$000 | Transition Impact \$000 | AIFRS \$000 |
| Current assets | | | | | | | | | | |
| Cash and cash equivalents | | 75,946 | - | 75,946 | 71,419 | - | 71,419 | 106,077 | - | 106,077 |
| Trade receivables | | 53,992 | - | 53,992 | 55,538 | - | 55,538 | 65,611 | - | 65,611 |
| Inventories | (b) | 44,837 | - | 44,837 | 40,748 | - | 40,748 | 49,120 | 398 | 49,518 |
| Income tax receivable | | 807 | - | 807 | 269 | - | 269 | - | - | - |
| Forward exchange contracts | | 12,664 | - | 12,664 | 19,387 | - | 19,387 | 17,350 | - | 17,350 |
| Other | (e),(h),(i) | 12,156 | (394) | 11,762 | 13,957 | (145) | 13,812 | 12,872 | (274) | 12,598 |
| Total current assets | | 200,402 | (394) | 200,008 | 201,318 | (145) | 201,173 | 251,030 | 124 | 251,154 |
| Non-current assets | | | | | | | | | | |
| Forward exchange contracts | | 9,458 | - | 9,458 | 11,175 | - | 11,175 | 9,938 | - | 9,938 |
| Other financial assets | (h) | 175 | - | 175 | - | - | - | 522 | (335) | 187 |
| Plant and equipment | (a),(f) | 29,523 | (2,724) | 26,799 | 27,793 | (3,334) | 24,459 | 28,589 | (3,200) | 25,389 |
| Intangible assets | a b c g k | 7,190 | 7,048 | 14,238 | 21,742 | 10,476 | 32,218 | 191,764 | 1,800 | 193,564 |
| Deferred tax assets | (k) | 17,791 | 3,160 | 20,951 | 19,466 | 405 | 19,871 | 23,904 | (1,440) | 22,464 |
| Total non-current assets | | 64,137 | 7,484 | 71,621 | 80,176 | 7,547 | 87,723 | 254,717 | (3,175) | 251,542 |
| Total assets | | 264,539 | 7,090 | 271,629 | 281,494 | 7,402 | 288,896 | 505,747 | (3,051) | 502,696 |
| Current liabilities | | | | | | | | | | |
| Payables | | 31,657 | - | 31,657 | 37,456 | (117) | 37,339 | 46,539 | - | 46,539 |
| Interest bearing liabilities | | 25,867 | - | 25,867 | 28,441 | - | 28,441 | 64,206 | - | 64,206 |
| Current tax liabilities | | 4,781 | - | 4,781 | 5,407 | - | 5,407 | 12,455 | - | 12,455 |
| Provisions | (e) | 22,352 | (324) | 22,028 | 19,947 | (324) | 19,623 | 25,617 | - | 25,617 |
| Deferred Revenue | (i) | 8,975 | 11,376 | 20,351 | 9,163 | 5,969 | 15,132 | 20,782 | 7,264 | 28,046 |
| Deferred foreign exchange payable | | 12,664 | - | 12,664 | 19,387 | - | 19,387 | 17,350 | - | 17,350 |
| Total current liabilities | | 106,296 | 11,052 | 117,348 | 119,801 | 5,528 | 125,329 | 186,949 | 7,264 | 194,213 |
| Non-current liabilities | | | | | | | | | | |
| Interest bearing liabilities | (h) | - | - | - | - | - | - | 139,286 | (434) | 138,852 |
| Provisions | (f) | 3,256 | 1,328 | 4,584 | 1,604 | 1,328 | 2,932 | 3,704 | 1,328 | 5,032 |
| Deferred foreign exchange payable | | 9,458 | - | 9,458 | 11,175 | - | 11,175 | 9,938 | - | 9,938 |
| Total non-current liabilities | | 12,714 | 1,328 | 14,042 | 12,779 | 1,328 | 14,107 | 152,928 | 894 | 153,822 |
| Total liabilities | | 119,010 | 12,380 | 131,390 | 132,580 | 6,856 | 139,436 | 339,877 | 8,158 | 348,035 |
| Net assets | | 145,529 | (5,290) | 140,239 | 148,914 | 546 | 149,460 | 165,870 | (11,209) | 154,661 |
| Equity | | | | | | | | | | |
| Issued capital | (j) | 50,746 | (1,371) | 49,375 | 50,746 | (1,371) | 49,375 | 50,746 | (1,371) | 49,375 |
| Reserves | (g) | (995) | (806) | (1,801) | (1,394) | (414) | (1,808) | 10,424 | (14,341) | (3,917) |
| Retained earnings | | 89,267 | (3,113) | 86,154 | 93,898 | 2,331 | 96,229 | 99,959 | 4,503 | 104,462 |
| Total parent entity interest | | 139,018 | (5,290) | 133,728 | 143,250 | 546 | 143,796 | 161,129 | (11,209) | 149,920 |
| Minority interest | | 6,511 | - | 6,511 | 5,664 | - | 5,664 | 4,741 | - | 4,741 |
| Total equity | | 145,529 | (5,290) | 140,239 | 148,914 | 546 | 149,460 | 165,870 | (11,209) | 154,661 |

Cochlear Limited and its Controlled Entities**Notes to the condensed consolidated interim financial statements****For the half-year ended 31 December 2005****13. Explanation of transition to AIFRS (continued)**

The effect of the above adjustments on retained earnings is as follows:

| A\$000s | Note | 1 Jul 2004 | 31 Dec 2004 | 30 Jun 2005 |
|--|-------------|-------------------|--------------------|--------------------|
| Defined benefit asset | (e) | 929 | 929 | 324 |
| Change in functional currency | (g) | 513 | 572 | 128 |
| Capitalised research & development costs | (c) | 3,149 | 5,745 | 6,263 |
| Consolidation of Trust (CELTIP) | (j) | 374 | 623 | 872 |
| Change to revenue recognition policies | (i) | (11,083) | (4,322) | (5,554) |
| Make good costs on leases | (f) | (153) | (204) | (254) |
| Impact of taxation | (k) | 3,158 | (1,283) | (397) |
| Reversal of goodwill amortisation | (c) | - | 271 | 3,121 |
| Total adjustment to equity | | <u>(3,113)</u> | <u>2,331</u> | <u>4,503</u> |
| Attributable to: | | | | |
| Equity holders of the parent | | (3,113) | 2,331 | 4,503 |
| Minority Interest | | - | - | - |
| | | <u>(3,113)</u> | <u>2,331</u> | <u>4,503</u> |

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

INCOME STATEMENT

| | Note | For the 6 months ended 31 December 2004 | | | For the year ended 30 June 2005 | | |
|--|---------------------------|--|-------------------------------------|----------------|------------------------------------|--|----------------|
| | | Previous GAAP | Effect of transition to AIFRS | AIFRS | Previous GAAP | Effect of transition to AIFRS | AIFRS |
| Revenue | (i) | 160,402 | 4,770 | 165,172 | 344,854 | 4,112 | 348,966 |
| Cost of Sales | | (46,376) | - | (46,376) | (99,699) | - | (99,699) |
| Gross Profit | | 114,026 | 4,770 | 118,796 | 245,155 | 4,112 | 249,267 |
| Other operating income | | 161 | - | 161 | 963 | - | 963 |
| Distribution, marketing and field technical expenses | (e),(f) (c) | (44,507) | (323) | (44,831) | (100,736) | (232) | (100,968) |
| Administrative expenses | (c) (e) (f) (g) (j) | (10,193) | (1,050) | (11,243) | (26,530) | 941 | (25,589) |
| Research and development expenses | (c) (e) (g) | (20,911) | 2,550 | (18,361) | (43,760) | 2,622 | (41,138) |
| Operating profit before financing costs | | 38,576 | 5,947 | 44,522 | 75,092 | 7,443 | 82,535 |
| Financial income | | 1,888 | - | 1,888 | 2,700 | - | 2,700 |
| Financial expense | | (454) | - | (454) | (2928) | - | (2928) |
| Net financing costs | | 1,434 | - | 1,434 | (228) | - | (228) |
| Profit before tax | | 40,010 | 5,947 | 45,956 | 74,864 | 7,443 | 82,307 |
| Income tax expense | (k) | 10,994 | 2,452 | 13,446 | 21,512 | 2,321 | 23,833 |
| Net profit | | 29,016 | 3,495 | 32,510 | 53,352 | 5,122 | 58,474 |
| Net loss attributable to outside equity interests | | 449 | - | 449 | 1,168 | - | 1,168 |
| Net profit attributable to members of the parent entity | | 29,465 | 3,495 | 32,959 | 54,520 | 5,122 | 59,642 |
| Basic earnings per share from continuing operation (AUD) | | 54.3 | | 60.9 | 100.5 | | 110.1 |
| Diluted earnings per share from continuing operations (AUD) | | 54.3 | | 60.8 | 100.5 | | 109.2 |

Cochlear Limited and its Controlled Entities

Notes to the condensed consolidated interim financial statements

For the half-year ended 31 December 2005

14. Change in Accounting Policy

Reconciliation of financial instruments as if AASB 139 was applied at 1 July 2005

In the current financial year the Consolidated Entity adopted AASB 132: Financial Instruments: Disclosure and Presentation and AASB 139: Financial Instruments: Recognition and Measurement. 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 Consolidated Entity recognising all derivative financial instruments as assets or liabilities at fair value. This has resulted in a reclassification of the deferred foreign exchange gain from liabilities to equity in the 31 December 2005 period.

When the hedge effectiveness criteria of AASB 139 is satisfied, hedge gains / losses are recognised as a separate component in equity. Previously, deferred hedge gains / losses were recognised in the balance sheet as a liability / asset.

This change has been accounted for by reclassifying the net deferred hedge gain from liabilities into the hedging reserve at 1 July 2005, resulting in an increase in equity of \$27,288,000.

This change has not impacted the statement of income.



Independent review report to the members of Cochlear Limited

Scope

We have reviewed the financial report of Cochlear Limited ("the Company") for the half-year ended 31 December 2005, consisting of the condensed consolidated interim statement of income, balance sheet, statement of recognised income and expense, statement of cash flows, accompanying notes 1 to 14 and the directors' declaration. The financial report includes the consolidated financial statements of the consolidated entity comprising the Company and the entities it controlled at the end of the half-year or from time to time during the half-year. The Company's directors are responsible for the financial report including the relevant reconciling information regarding adjustments required under the Australian Accounting Standard AASB 1 *First-Time Adoption of Australian equivalents to International Financial Reporting Standards*.

We have performed an independent review of the financial report in order to state whether, on the basis of the procedures described, anything has come to our attention that would indicate that the financial report is not presented fairly in accordance with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and other mandatory financial reporting requirements in Australia and statutory requirements, so as to present a view which is consistent with our understanding of the consolidated entity's financial position, and performance as represented by the results of its operations and its cash flows and in order for the Company to lodge the financial report with the Australian Securities and Investments Commission.

Our review has been conducted in accordance with Australian Auditing Standards applicable to review engagements. A review is limited primarily to inquiries of company personnel and analytical procedures applied to the financial data. These procedures do not provide all the evidence that would be required in an audit, thus the level of assurance is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Statement

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Cochlear Limited is not in accordance with:

- (a) the Corporations Act 2001, including:
 - i. giving a true and fair view of the consolidated entity's financial position as at 31 December 2005 and of its performance for the half-year ended on that date; and
 - ii. complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and
- (b) other mandatory financial reporting requirements in Australia.

KPMG

John Wigglesworth
Partner

Place: Sydney

Date: 14 February 2006