Constant Currency Income Statement Framework

Fisher & Paykel Healthcare Corporation Limited

Principles and Purpose

Fisher & Paykel Healthcare Corporation Limited prepares annual and interim financial statements in accordance with international financial reporting standards ("IFRS"). Amongst other things, IFRS requires that:

- the Group adopt a functional and reporting currency. The Group has adopted the NZ dollar;
- all transactions in foreign currencies are recorded and reported at, or near, the actual foreign exchange rates ruling on the dates of the underlying transactions;
- gains or losses from derivatives (i.e. the differences between the actual foreign exchange rate ruling on the dates of the underlying transactions and any derivative entered into as a hedge of those transactions) be recorded and reported separately.

The Group is heavily exposed to movements in foreign exchange rates. Approximately 98% of sales are made in currencies other than the NZ dollar, over two thirds of sales and distribution costs are incurred in foreign currencies and approximately one third of manufacturing costs are incurred in US dollars and Mexican pesos.

Consequently, comparisons of line items in the income statement between different periods can be, and often are, distorted by differences in the exchange rates at which transactions in foreign currencies are recorded in those different periods. Similarly, comparisons of line items in the income statement between actual and budgeted performance for particular periods can be, and often are, distorted by differences in the exchange rates at which transactions in foreign currencies are recorded and the exchange rates at which they were budgeted.

To enable directors and management, and external stakeholders, to better understand underlying changes in financial performance, undistorted by the effects of movements in exchange rates, the Group prepares a Constant Currency Income Statement (the "CCIS") each month for management reporting purposes and also provides a CCIS in its annual and interim financial reports, together with a reconciliation to the IFRS based Income Statement. For these purposes, the results of all reported periods in a particular CCIS are based on "constant" exchange rates, typically the budgeted exchange rates for the current year.

In its simplest sense the CCIS aims to show the financial performance for the reported periods as if there had been no change in exchange rates over the periods covered by the CCIS.

The reconciliation between the profit before tax shown in the CCIS and the IFRS based Income Statement consists of three principal items:

- the elimination of the foreign exchange hedging result, as recorded in the IFRS based Income Statement;
- the elimination of the balance sheet translation adjustments, as recorded in the IFRS based Income Statement; and
- the "spot exchange effect", comprising:
    - the estimated difference between the value of the transactions in foreign currencies converted at the exchange rates used for constant currency purposes (typically the exchange rates used in the budget for the current year) and the value of those transactions converted at the actual exchange rates; plus/(less)
    - minor differences arising from the inaccuracies necessarily inherent in the restatement and estimation procedures followed in preparing the CCIS (effectively the balancing figure).

All periods being reported (in the Annual Report we report the current year and the two preceding years) in a CCIS are reported using the same exchange rates (typically the current year's budget exchange rates). It follows therefore that if a prior year's results have already been reported in an earlier report the absolute results will be different as they would have been restated at different exchange rates. This restatement to different exchange rates follows the same principles as already described. Also as a consequence whenever a CCIS is produced and presented the current year exchange rates must be disclosed.

Because the consolidated management accounts, and ultimately the IFRS compliant audited financial statements, are based on information from a number of sources (ERP systems, databases, excel etc.) restatements and some estimation are necessary in the preparation of the CCIS. For example, it is impractical to re-state every individual ERP transaction in terms of how it would have been reported on a constant currency basis and a series of calculations are required to estimate current and prior period numbers for the CCIS.

The CCIS should:

- provide a materially accurate picture of real comparative financial performance between all periods reported, based on the same (i.e. constant) exchange rates;
- provide the same picture of real comparative financial performance between all periods reported, regardless of which direction(s) foreign exchange rates are moving i.e. the relative reported levels of financial performance in the CCIS should be indifferent to exchange rate movements;
- contain a materially accurate reconciliation between reported (NZ IFRS) profitability and profitability presented on the CCIS; and
- be compliant with the FMA's non-conforming financial information requirements.

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This will be achieved by restating all income statement items to:

- reflect for each period disclosed, as closely as possible and practical, those items as if the foreign exchange rates equivalent to the current year budget exchange rates had prevailed;
- remove foreign exchange hedging results for each period disclosed;
- remove foreign exchange translational impacts for each period; and
- remove any other material foreign exchange rate distortions from each period.

The procedures undertaken to achieve this outcome should be:

- repeatable on a month to month basis;
- reasonably practical to perform on a month by month basis, without being overly burdensome; and
- documented (in this Framework) and available to the Board, management and the Company's Auditors to enable review against these procedures at any time.

It should be remembered that changes in exchange rates are due to many factors, some long term and some short term e.g. a country's economic performance, interest rates and capital flows. Over the very long term the value of a country's currency is likely to be correlated to changes in its purchasing power relative to other currencies. In an environment where inflation rates of the countries in which the Group conducts the majority of its business are reasonably closely aligned to inflation rates in New Zealand during the periods covered by a particular CCIS, that CCIS should enable a fair and reasonable comparison of financial performance between those periods. However, if inflation rates in New Zealand and one or more of the countries in which the Group conducts the majority of its business diverge materially over a number of periods the CCIS may no longer provide reliable comparisons of underlying financial performance.