ANNUAL REPORT
FOR THE YEAR ENDED 31 MARCH 2012

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XERO LIMITED ANNUAL REPORT **2012**

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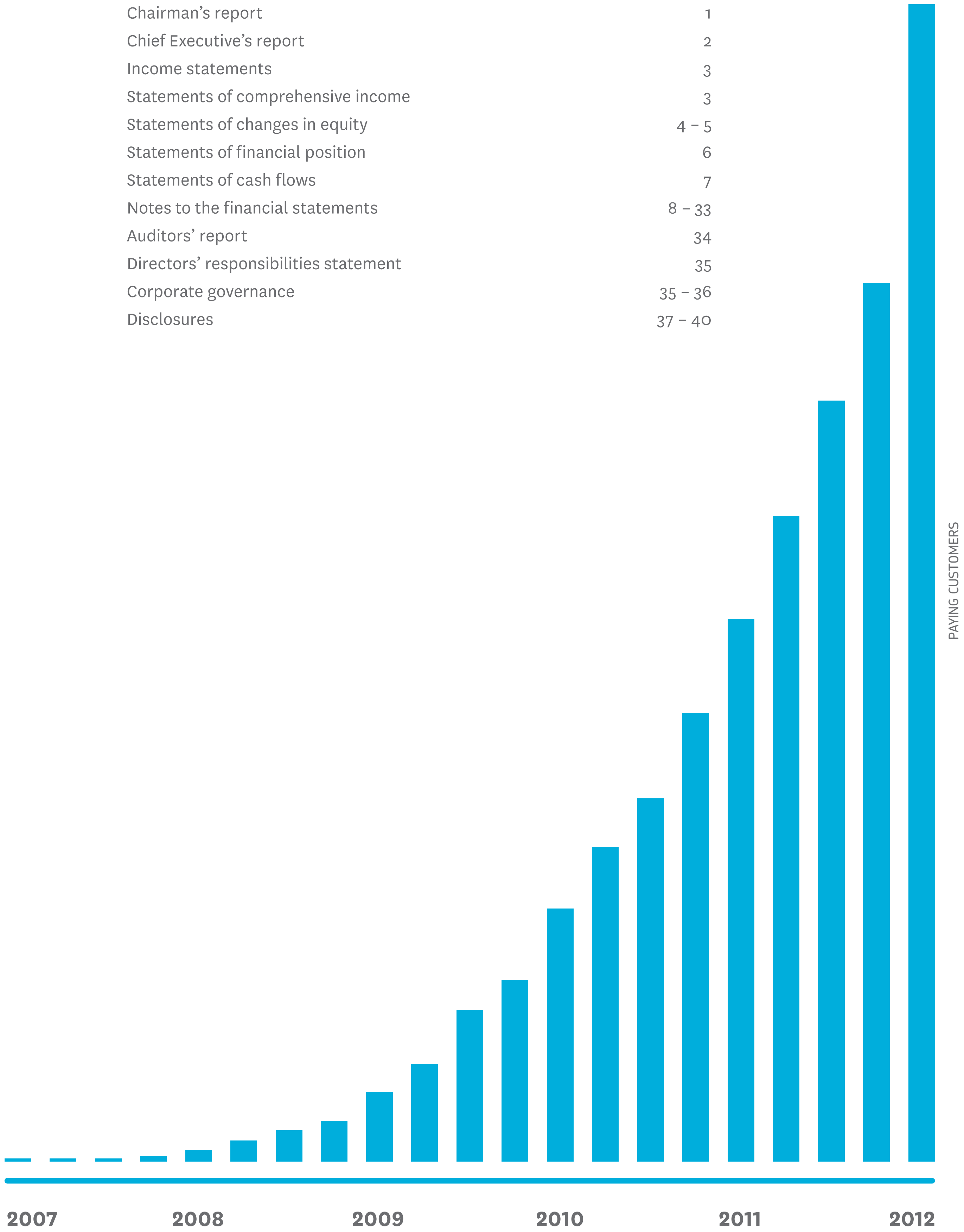

CHAIRMAN'S REPORT

It has been another year of outstanding growth for Xero. Building on the success of the business in New Zealand and validating this model in Australia, we've focused on rapidly scaling the business offshore.

Having invested in Xero at its Initial Public Offering and served as a Director and more recently (since November 2011) as Chairman, I'm proud of the way the Xero team is executing our strategy to be the global leader in online accounting for small businesses.

In line with our guidance given to the market in January 2012, the company more than doubled its revenue from $9.3 million in the year ended 31 March 2011 to over $19.3 million in the year ended 31 March 2012, with customer numbers increasing from 36,000 to more than 78,000.

Expansion in regions outside New Zealand was one of the main drivers behind the growth, resulting in 51% of the $25.5 million annualised committed monthly revenue coming from offshore. Testimony to this was the naming of Xero as New Zealand's fastest-growing exporter in the 2011 Deloitte Fast 50 Index.

As stated at the Xero Annual Meeting in July 2011, the Board is pursuing a growth agenda that provides the flexibility to pursue opportunities that create shareholder value, rather than short-term profitability.

To support accelerated growth in Australia, the United Kingdom and the United States, the company raised total capital of $35.6 million in early 2012. This included a $20 million private placement at $2.75 per share, followed by a Share Purchase Plan (SPP) that raised $15.6 million. The SPP enabled New Zealand-based shareholders to increase their holdings at the same price.

More than 50% of eligible shareholders participated in the SPP, investing on average more than $10,500. This exceeded our expectations and was an endorsement of the company's current growth strategy.

Interest was also strong among the institutional and strategic investor community, prompting the company to facilitate an off-market trade of $5 million (to prevent further dilution, Xero founders and key staff divested a small portion of their shareholdings). The result is a significant strengthening of the share register with the addition of new investors, including co-founder of rival accounting software provider MYOB, Brad Schofer, Rangatira Limited, Milford Asset Management and US-based institutional investors Sophrosyne Capital LLC and Matrix Capital Management.

It is pleasing to have the confidence of such experienced investors, and that confidence has been reflected in the steady rise in the company's value.

As previously announced, former Chairman Phil Norman has tendered his resignation with effect from 26 July 2012. Having spent five years as founding Chairman of this fast-growing company, Phil believed it was an appropriate time to stand down. The Board would like to thank Phil for playing such an integral part in positioning Xero for future growth.

Xero co-founder Hamish Edwards also stepped down as a Director during the year. Hamish too has made a significant contribution to the success of the company, and the Board thanks him for his dedication. Hamish continues to advise Xero on product matters and business relationships with the accounting community.

The Board acknowledges our accounting partners, who have showed faith in Xero since the beginning and whom we continue to consult as we improve and further develop the application.

At the 2012 Annual Meeting the Board will be seeking approval to increase the Directors' remuneration pool to provide for the appointment of up to three new Directors, likely to be based in Xero's key offshore markets. In transitioning to the next growth phase the company is seeking to build on the current skill base by adding diversity and a broader geographic spread of members of the Board.

The coming year is shaping up to be another ground-breaking one. I am pleased to say that scaling the business so we gain traction in large overseas markets is going to plan. To maintain momentum the company must continue to invest in its internal infrastructure, systems and personnel around the globe, and this will result in continued losses for the year ending 31 March 2013.

I'm excited about the possibilities ahead and we will be working hard to keep hitting our milestones. You, our shareholders, play an important part – thank you for your continued support.

Sam Knowles
Chairman

CHIEF EXECUTIVE'S REPORT

Looking back on 2011/12, our team has been proud to achieve a 107% increase in revenue while continuing to deliver new and enhanced features and operate a robust platform on which small businesses all over the world can rely.

It's the behind-the-scenes activities that provide the real story of the past year. We've made good progress in building a scalable infrastructure for long-term growth by:

- recruiting 81 new staff, taking the team to 194 people at 31 March, with 44 based offshore;
- opening three new offices, in Australia (Canberra), the UK (Milton Keynes) and the US (San Francisco) and moving into larger premises in Auckland, Wellington and Melbourne; and
- completing two acquisitions (Paycycle and Max Solutions Holdings Limited) and successfully integrating them into the business.

With more than 78,000 active customers and $19 million in annual revenue, Xero is rapidly earning an international reputation as a leading vendor of global online accounting software.

- We've now processed $100 billion in transactions, with more than $20 billion of those in the last quarter.
- We acquired 42,000 new customers during the year. Our channel strategy is working: 3,600 accounting firms now have clients using Xero.
- Customer support enquiries have decreased by 30% on a per customer basis, reflecting the quality of our software, training and channel support.
- More than 80 solution partners have connected their solutions to Xero.

Xero's international business is starting to deliver, with offshore revenue increasing from $3.4 million in 2010/11 to $9 million in 2011/12.

In Australia, our Accounting Partner roadshows attracted thousands of accountants. Our Australian team has grown from 14 to 27 and customer numbers have almost tripled to 16,000.

In July 2011 we acquired Australian online payroll provider Paycycle for NZ$1.9 million through a mixture of cash and shares. We expect to release an integrated payroll service in Australia in May, removing what has been a major impediment for our customers.

In the UK, online accounting is becoming increasingly accepted, and customer growth has accelerated with the availability of business banking feeds. Our sales and marketing team continues to expand to maximise the opportunities offered by this significant market.

We've made steady progress in entering the US since establishing our office in San Francisco and appointing a US President and well respected senior staff. Our strategy to connect with key influencers in the accounting software industry is working well.

Xero is fundamentally disrupting the accounting software industry by providing both small business and professional accountant tools on a single platform, with common data.

Traditionally, vendors have 'double dipped' by charging both accountants and small businesses for separate tools processing the same data. Our true partnering approach and 'Single Ledger' platform is transforming the way accountants work, enabling them to achieve significant productivity gains and save money. By providing them with the tools they need to run their businesses, we're also making it more likely that they'll use our products to manage their relationships with their clients.

The highly complex task of building tools that combine both business and accountant features requires an enormous investment of time and resources. It's clearly creating a barrier for new players, as we've yet to see smaller companies making the investment required to compete.

In January 2012 we expanded our portfolio even further with the $6 million acquisition (through a mixture of cash and shares) of leading software developer Max Solutions Holdings Limited – the company behind WorkflowMax, an online job, time and invoice management solution. WorkflowMax is used by more than 1,500 businesses in 35 countries, and is now being used to provide an integrated practice management and tax solution for accountants.

The substantial growth in customer numbers, plus the integration of the newly acquired Paycycle and WorkflowMax applications, has involved a significant investment in design and implementation in scaling up the underlying service management and hosting infrastructure. We now have more than 50 servers across two data centres in the US and manage more than 50 terabytes of production data.

During the year we released more than 12 major software updates, adding new and extended features to the core Xero accounting system, Xero Personal and Xero Touch, our mobile application. We believe we're setting a benchmark in releasing high-quality and complex business software.

Our strong cash position, product innovation, focus on developing a channel of advisors, thriving ecosystem and five years of investment place Xero in a very strong position.

We'll continue to build the business to support customer acquisition in large overseas markets – and with a goal of gaining a million customers, we'll continue to invest in our internal infrastructure, systems and personnel around the globe.

At our core we're a team of passionate software people committed to responding to market opportunities more swiftly than our competitors. We truly believe that it's not the big that eat the small, but the fast that eat the slow. Our collective feet remain on the throttle!

Thank you to our staff, customers, partners and shareholders for your support in creating a significant global company.

Rod Drury
Chief Executive

XERO LIMITED – INCOME STATEMENTS – FOR THE YEAR ENDED 31 MARCH 2012

	Notes	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Operating revenue	4	19,370	9,341	15,186	8,858
Other income	4	401	325	427	325
Total revenue & other income		19,771	9,666	15,613	9,183
Operating expenses	4	28,385	18,017	24,720	17,655
Operating deficit		**(8,614)**	**(8,351)**	**(9,107)**	**(8,472)**
Net interest income	4	612	880	607	878
Net operating loss before tax		(8,002)	(7,471)	(8,500)	(7,594)
Gain on investment in associate	11	170	–	178	–
Share of profit of associate	12	38	10	–	–
Net loss before tax		**(7,794)**	**(7,461)**	**(8,322)**	**(7,594)**
Income tax expense	5	(110)	(26)	–	–
Net loss after tax		**(7,904)**	**(7,487)**	**(8,322)**	**(7,594)**
Net loss for the year attributable to the shareholders of the Company		**(7,904)**	**(7,487)**	**(8,322)**	**(7,594)**
Earnings per share					
Basic & diluted loss per share	14	($0.08)	($0.08)	($0.09)	($0.09)

XERO LIMITED – STATEMENTS OF COMPREHENSIVE INCOME – FOR THE YEAR ENDED 31 MARCH 2012

	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Net loss after tax	(7,904)	(7,487)	(8,322)	(7,594)
Other comprehensive income				
Exchange difference on translation of international subsidiaries	(39)	(53)	–	–
Total other comprehensive (expense)/ income for the year, net of tax	**(39)**	**(53)**	**–**	**–**
Total comprehensive loss for the year attributable to the shareholders of the Company	**(7,943)**	**(7,540)**	**(8,322)**	**(7,594)**

The accompanying notes form an integral part of these financial statements

XERO LIMITED – STATEMENTS OF CHANGES IN EQUITY – FOR THE YEAR ENDED 31 MARCH 2012

	Notes	Share capital ($000s)	Treasury stock ($000s)	Share-based payment reserve ($000s)	Accumulated losses ($000s)	Foreign currency translation reserve ($000s)	Total equity ($000s)
Year ended 31 March 2012							
Group							
Balance at 1 April 2011		50,168	(1,113)	702	(28,047)	(22)	21,688
Net (loss) after tax		–	–	–	(7,904)	–	(7,904)
Currency translation movements		–	–	–	–	(39)	(39)
Total comprehensive income		**–**	**–**	**–**	**(7,904)**	**(39)**	**(7,943)**
Transactions with owners:							
Issue of ordinary shares (net of issue costs)	13	36,365	–	–	–	–	36,365
Issue of ordinary shares – purchase of Paycycle assets	11	1,294	(1,294)	512	–	–	512
Issue of ordinary shares – purchase of Max Solutions Holdings Limited	11	4,000	(4,000)	407	–	–	407
Issue of ordinary shares under employee restricted share plan	21	1,424	(1,424)	–	–	–	–
Vesting of ordinary shares in employee restricted share plan		–	957	262	–	–	1,219
Balance as at 31 March 2012		93,251	(6,874)	1,883	(35,951)	(61)	52,248
Parent							
Balance at 1 April 2011		50,168	(1,113)	702	(28,105)	–	21,652
Net (loss) after tax		–	–	–	(8,322)	–	(8,322)
Total comprehensive income		**–**	**–**	**–**	**(8,322)**	**–**	**(8,322)**
Transactions with owners:							
Issue of ordinary shares (net of issue costs)	13	36,365	–	–	–	–	36,365
Issue of ordinary shares – purchase of Paycycle assets	11	1,294	(1,294)	512	–	–	512
Issue of ordinary shares – purchase of Max Solutions Holdings Limited	11	4,000	(4,000)	407	–	–	407
Issue of ordinary shares under employee restricted share plan	21	1,424	(1,424)	–	–	–	–
Vesting of ordinary shares in employee restricted share plan		–	957	262	–	–	1,219
Balance as at 31 March 2012		**93,251**	**(6,874)**	**1,883**	**(36,427)**	**–**	**51,833**

XERO LIMITED – STATEMENTS OF CHANGES IN EQUITY – FOR THE YEAR ENDED 31 MARCH 2012

	Notes	Share capital ($000s)	Treasury stock ($000s)	Share-based payment reserve ($000s)	Accumulated losses ($000s)	Foreign currency translation reserve ($000s)	Total equity ($000s)
Year ended 31 March 2011							
Group							
Balance at 1 April 2010		45,270	(738)	371	(20,560)	31	24,374
Net (loss) after tax		–	–	–	(7,487)	–	(7,487)
Currency translation movements		–	–	–	–	(53)	(53)
Total comprehensive income		**–**	**–**	**–**	**(7,487)**	**(53)**	**(7,540)**
Transactions with owners:							
Issue of ordinary shares (net of issue costs)	13	4,040	–	–	–	–	4,040
Issue of ordinary shares under employee restricted share plan	21	858	(858)	–	–	–	–
Vesting of ordinary shares in employee restricted share plan		–	483	331	–	–	814
Balance as at 31 March 2011		**50,168**	**(1,113)**	**702**	**(28,047)**	**(22)**	**21,688**
Parent							
Balance at 1 April 2010		45,270	(729)	371	(20,511)	–	24,401
Net (loss) after tax		–	–	–	(7,594)	–	(7,594)
Total comprehensive income		**–**	**–**	**–**	**(7,594)**	**–**	**(7,594)**
Transactions with owners:							
Issue of ordinary shares (net of issue costs)	13	4,040	–	–	–	–	4,040
Issue of ordinary shares under employee restricted share plan	21	858	(858)	–	–	–	–
Vesting of ordinary shares in employee restricted share plan		–	474	331	–	–	805
Balance as at 31 March 2011		**50,168**	**(1,113)**	**702**	**(28,105)**	**–**	**21,652**

The accompanying notes form an integral part of these financial statements

XERO LIMITED – STATEMENTS OF FINANCIAL POSITION – AS AT 31 MARCH 2012

	Notes	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Assets					
Current assets					
Cash & cash equivalents	6	38,976	16,922	36,722	16,651
Trade & other receivables	7	3,023	1,503	5,409	1,187
Total current assets		**41,999**	**18,425**	**42,131**	**17,838**
Non-current assets					
Property, plant & equipment	9	4,195	466	3,990	384
Intangible assets	10	10,260	4,773	8,033	4,741
Investment in subsidiaries	11	–	–	2,638	262
Investment in associate	12	–	207	–	200
Deferred tax benefit	5	85	35	–	–
Trade & other receivables	7	1,234	441	1,169	423
Total non-current assets		**15,774**	**5,922**	**15,830**	**6,010**
Total assets		**57,773**	**24,347**	**57,961**	**23,848**
Liabilities					
Current liabilities					
Trade & other payables	8	3,046	1,538	4,472	1,273
Employee entitlements		2,408	1,060	1,657	923
Income tax	5	71	61	(1)	–
Total current liabilities		**5,525**	**2,659**	**6,128**	**2,196**
Total liabilities		**5,525**	**2,659**	**6,128**	**2,196**
Net assets		**52,248**	**21,688**	**51,833**	**21,652**
Equity					
Share capital	13	86,377	49,055	86,377	49,055
Share based payment reserve		1,883	702	1,883	702
Accumulated losses		(35,951)	(28,047)	(36,427)	(28,105)
Foreign currency translation reserve		(61)	(22)	–	–
Total equity		**52,248**	**21,688**	**51,833**	**21,652**

The accompanying notes form an integral part of these financial statements

XERO LIMITED – STATEMENTS OF CASH FLOWS – FOR THE YEAR ENDED 31 MARCH 2012

	Notes	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Operating activities					
Cash was provided from					
Receipts from customers		18,560	8,615	14,774	8,308
GST received		-	136	-	39
Dividends received		26	-	26	-
Other income		283	362	283	325
Interest received		632	898	627	896
		19,501	**10,011**	**15,710**	**9,568**
Cash was applied to					
Payments to suppliers & employees		(23,379)	(15,231)	(22,217)	(14,934)
GST paid		(833)	-	(329)	-
Income tax paid		(150)	-	-	-
		(24,362)	**(15,231)**	**(22,546)**	**(14,934)**
Net cash flows from operating activities	**18**	**(4,861)**	**(5,220)**	**(6,836)**	**(5,366)**
Investing activities					
Cash was provided from					
Cash acquired on acquisition of subsidiary	11	259	-	-	-
		259	**-**	**-**	**-**
Cash was applied to					
Purchase of property, plant & equipment		(3,963)	(307)	(3,777)	(237)
Capitalised development costs		(3,519)	(2,752)	(3,499)	(2,747)
Intangible assets		(37)	(18)	(38)	(8)
Other assets		(299)	(18)	(253)	-
Investment in associate		-	(200)	-	(200)
Investment in subsidiary		(1,000)	-	(1,000)	(67)
		(8,818)	**(3,295)**	**(8,567)**	**(3,259)**
Net cash flows from investing activities		**(8,559)**	**(3,295)**	**(8,567)**	**(3,259)**
Financing activities					
Cash was provided from					
Director's loan		100	-	100	-
Repayment of other loans		100	-	100	-
Share issue		35,638	4,000	35,638	4,000
		35,838	**4,000**	**35,838**	**4,000**
Cash was applied to					
(Cost)/refund of share issue		(364)	40	(364)	40
Net cash flows from financing activities		**35,474**	**4,040**	**35,474**	**4,040**
Net increase/(decrease) in cash held		22,054	(4,475)	20,071	(4,585)
Foreign currency translation adjustment		-	-	-	-
Cash & cash equivalents at beginning of the year	6	16,922	21,397	16,651	21,236
Cash & cash equivalents at end of the year	**6**	**38,976**	**16,922**	**36,722**	**16,651**

The accompanying notes form an integral part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS

1. CORPORATE INFORMATION

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

The financial statements presented are for Xero Limited (the "Company") and its subsidiaries comprising Xero (UK) Limited, Xero Pty Limited (Australia), Xero Inc (United States), Xero Trustee Limited, Max Solutions Holdings Limited ("MSHL") and Max Solutions Limited (together "the Group") for the year ended 31 March 2012.

Xero Limited is an issuer for the purposes of the Financial Reporting Act 1993.

The consolidated financial statements of the Group for the year ended 31 March 2012 were authorised for issue in accordance with a resolution of the Directors on 24 May 2012.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 3.

(b) Changes in accounting policy & disclosures The accounting policies adopted are consistent with those of the previous year.

(c) Basis of consolidation Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases. The acquisition method of accounting is used to account for the acquisition of subsidiaries by the Group. The consideration transferred for an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Costs directly attributable to the acquisition are expensed in the Income Statement. Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries are consistent with the policies adopted by the Group.

(d) Associates Associates are all entities over which the Group has significant influence but not control. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost.

The Group's share of its associates' post-acquisition profits or losses is recognised in the Income Statement, and its share of post acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

(e) Revenue Revenue in relation to subscriptions and training is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is recorded net of GST and discounts and after eliminating sales within the Group. The following specific recognition criteria must also be met before revenue is recognised:

Services – Revenue is recognised in the accounting period in which the service is rendered. Consideration received prior to the service being rendered is recognised in the Statement of Financial Position as income in advance and included within trade and other payables. Revenue for which services have been rendered but invoices have not been issued is recognised within the Income Statement and in the Statement of Financial Position as accrued income within trade and other receivables.

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

Government grants – Government grants are recognised at their fair value where there is reasonable assurance that the grants will be received and all attaching conditions will be complied with. When a grant relates to an expense item, it is recognised as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

(f) Income tax Income tax expense comprises current and deferred tax. Income tax expense 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 other Comprehensive Income and equity.

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

Deferred tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary differences can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related benefits will be realised. As permitted by NZIAS 12: Income Taxes, deferred tax assets in relation to tax losses have been recognised to the extent of the Group's deferred tax liabilities.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liabilities where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income tax levied by the same taxation authority on either the same taxable entity or different entities where there is an intention to settle the balance on a net basis.

(g) GST The Income Statements and the Statements of Cash Flows have been prepared so that all components are stated exclusive of GST, except where GST is not recoverable. All items in the Statement of Financial Position are stated net of GST with the exception of receivables and payables, which include GST invoiced.

Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

(h) Foreign currency translation Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in New Zealand dollars ($), which is the Company's functional currency. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Income Statement. Foreign exchange gains and losses are presented in the Income Statement within operating expenses.

The Group translates the results of its foreign operations from their functional currencies to the presentation currency of the Group using the closing exchange rate at balance date for assets and liabilities and the average monthly exchange rates for income and expenses.

The difference arising from translation of the Statement of Financial Position at closing rate and the Income Statement at average rate is recorded within the foreign currency translation reserve.

(i) Property, plant & equipment Property, plant and equipment are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Depreciation on assets is calculated using the straight-line method to allocate their costs to their residual values over their estimated useful lives, as follows:

Leasehold improvements	Terms of lease
Motor vehicles	3–4 years
Furniture & equipment	1–7 years
Computer equipment	2–3 years

The assets' residual values and useful lives are reviewed and adjusted if appropriate at each balance date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amounts, and are recognised in the Income Statement.

(j) Intangible assets

(I) Research costs are expensed as incurred.

Costs associated with maintaining internal computer software programs are recognised as an expense as incurred. Costs that are directly associated with the development of the software products controlled by the Group are recognised as intangible assets where the following criteria are met:

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

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

(III) Amortisation is recognised in the Income Statement on a straight-line basis over the estimated useful life of the intangible asset, from the date it is available for use.

The estimated useful lives are:

Trademarks/patents	10 years
Domains	10 years
Capitalised development costs	3–5 years

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

Recoverable amount is the greater of fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(l) Non-derivative financial instruments The Group classifies its financial assets as loans and receivables. The classifications depend on the purposes for which the financial assets were acquired. Management determines the classifications of its financial assets at initial recognition.

(m) Loans & receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those with maturities greater than 12 months after the reporting date. These are classified as non-current assets. The Group's loans and receivables comprise "trade & other receivables" and "cash & cash equivalents" in the Statement of Financial Position. Loans and receivables are carried at amortised cost using the effective interest method. The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. Impairment testing of trade receivables is described in Note 2.(o). The Group does not have any derivatives.

(n) Cash & cash equivalents include cash in hand, deposits held at call with banks, other short-term and highly liquid investments with original maturities of six months or less.

(o) Trade & other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The carrying amount of an asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the Income Statement. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against the Income Statement.

(p) Trade & other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method. They represent liabilities for goods and services provided to the Group prior to the end of the financial year that are unpaid. The amounts are unsecured, non-interest bearing and are usually paid within 45 days of recognition.

(q) Provisions Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as interest expense.

(r) Employee entitlements The liability for employees' compensation for future leave is accrued in relation to the length of service rendered by employees and relates to the vested and unvested entitlements.

The Group operates both short-term and long-term incentive plans. Employee incentive obligations are measured at the amounts expected to be paid when the liability is settled and are expensed as the related service is provided. The Group operates an equity-settled, share-based compensation plan, under which the entity receives services from employees as consideration for equity instruments of the Group. The value of the employee services received for the grant of non transferable share options and shares is recognised as an expense over the vesting period and the amount is determined by reference to the fair value of the options and shares granted.

(s) Leases Operating lease payments are recognised as an expense in the Income Statement on a straight-line basis over the lease term.

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased items, are capitalised at the inception of the leases at the fair value of the leased assets or, if lower, at the present value of the minimum lease payments. The leased assets and corresponding liabilities are therefore recognised and the assets are depreciated in line with the Group's depreciation policy to reflect estimated useful lives.

Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are included in the Income Statement as interest costs.

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

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

Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise convertible notes and share options granted to employees.

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

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

(w) Standards or interpretations issued but not yet effective
NZ IFRS 9 Financial Instruments addresses the classification, measurement and derecognition of financial assets and financial liabilities. The standard is not applicable until 1 January 2015 but is available for early adoption. Financial assets are classified according to their measurement, fair at either value or amortised cost. It is not expected to have a material impact on the Company or Group.

NZ IFRS 44 New Zealand Additional Disclosures (effective for accounting periods beginning on or after 1 July 2011). This standard relocates New Zealand specific disclosures that were previously embedded within the standards to one place and revises disclosures relating to compliance with NZ-IFRS, the statutory basis or reporting framework for financial statements, audit fees, imputation credits, reconciliation of net operating cash flows to profit or loss, prospective financial statements, and elements in the statement of financial performance. The standard is not expected to have a material impact on the Group financial statements. The Group will adopt the standard for the year ending 31 March 2013.

Harmonisation Admendments: Amendments to NZ-IFRS to Harmonise with IFRS and Australian Accounting Standards (effective for accounting periods beginning on or after 1 July 2011). The harmonisation amendments relate to the joint Trans-Tasman project to align New Zealand and Australian accounting standards with IFRS and to remove disclosures to a separate standard (FRS 44) that were previously included within the associated reporting standard. This standard is not expected to have a material impact on the Group financial statements. The Group will adopt the standard for the year ending 31 March 2013.

There are a number of other amendments to accounting standards as part of the ongoing improvement process. None of these changes is expected to impact significantly on the Group.

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

3. SIGNIFICANT ACCOUNTING JUDGEMENTS

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

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

(a) Deferred tax asset Deferred tax benefits relating to carry forward tax losses and deductible temporary differences are recognised by the Group and Company to the extent that it is probable that taxable profits will be available against which those losses and temporary differences can be recognised. Deferred tax assets in relation to tax losses have been recognised to the extent of the Group's deferred tax liabilities.

The Group has not recognised deferred tax benefits in relation to all carry forward losses. The Company has not yet reached break–even and is expected to make a further loss in the year ending 31 March 2013. It is not considered prudent to recognise a deferred tax asset in respect of losses and other temporary differences until the point that the Company reaches break–even.

(b) Capitalised development costs The Group capitalises its development costs based on a proportion of employee costs. The percentages applied are in line with industry standards. The Group regularly reviews the carrying value of capitalised development costs to ensure they are supported by the associated future economic benefits. The development costs are amortised over three to five years, being the expected useful life of the software.

(c) Business combinations Business combinations are accounted for using the acquisition method. The amounts transferred in a business combination are measured at fair value, which is calculated as the sum of the acquisition date fair value of the assets transferred and the liabilities incurred by the Group to former owners of the acquiree.

Management has assessed the fair value of the financial assets and liabilities in accordance with the contractual terms, economic conditions, the Group's operating and accounting policies and other relevant conditions as at the acquisition date.

4. REVENUES & EXPENSES

	Notes	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Operating revenue from the rendering of services		**19,370**	**9,341**	**15,186**	**8,858**
Other income					
Government grants*		401	52	401	52
Research & development tax credit		–	273	–	273
Dividends received	11	–	–	26	–
		401	**325**	**427**	**325**
Total revenue & other income		**19,771**	**9,666**	**15,613**	**9,183**
Operating expenses					
Employee entitlements		19,272	11,047	12,742	8,760
Employee entitlements capitalised		(5,426)	(2,753)	(3,206)	(2,747)
Advertising & marketing		2,976	2,237	1,231	1,490
IT infrastructure costs		3,266	2,046	2,856	2,046
Intercompany market support payments	15	–	–	4,703	3,644
Consulting & subcontracting		1,222	412	792	368
Travel related		839	537	487	339
Lease/rental		958	472	766	433
Communication & office administration		484	325	338	246
Superannuation costs		330	204	139	94
Directors' fees		220	222	220	222
Fees paid to auditors	16	167	143	142	99
Loss on disposal of property, plant & equipment		119	–	121	–
Loss/(gain) on foreign exchange transactions		(8)	(40)	(8)	15
Other operating expenses		2,072	2,012	1,559	1,523
Total operating expenses exc. depreciation & amortisation		**26,491**	**16,864**	**22,882**	**16,532**
Depreciation & amortisation expense					
Property, plant & equipment	9	320	207	259	186
Amortisation of other intangible assets	10	11	10	10	7
Amortisation of development costs	10	1,563	936	1,569	930
Total depreciation & amortisation		**1,894**	**1,153**	**1,838**	**1,123**
Total operating expenses		**28,385**	**18,017**	**24,720**	**17,655**
Interest income					
Interest income – bank		587	868	582	866
Interest income – loan to related party	15	20	8	20	8
Interest income – other		5	4	5	4
Net interest income		**612**	**880**	**607**	**878**
Net operating loss before tax		**(8,002)**	**(7,471)**	**(8,500)**	**(7,594)**

*Government grants have been received from the Ministry of Science and Innovation (2011: New Zealand Trade and Enterprise). The grants were claimed retrospectively on qualifying expenditure, and all conditions have been fulfilled at balance date.

5. CURRENT & DEFERRED INCOME TAX

Current income tax

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

	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Accounting loss before income tax	(7,794)	(7,461)	(8,322)	(7,594)
At the statutory income tax rate of 28% (2011: 30%)	(2,182)	(2,238)	(2,330)	(2,278)
Non-deductible expenditure	27	20	(37)	11
Effect of change in income tax rate	39	–	–	–
Tax rate variance of subsidiary	63	(3)	–	–
Tax expense on share of associate company profit	11	3	–	–
Total tax losses not recognised	2,152	2,244	2,367	2,267
Income tax expense reported in income statement	**110**	**26**	**–**	**–**
Comprising:				
Income tax	160	61	–	–
Deferred tax	(50)	(35)	–	–
Income tax expense	**110**	**26**	**–**	**–**

Income tax payable/receivable

Opening balance	61	–	–	–
Income tax liability for the year	160	61	–	–
Income tax paid	(150)	–	(1)	–
Current tax payable/(receivable)	**71**	**61**	**(1)**	**–**

Imputation credit account

Balance as at 1 April	–	–	–	–
New Zealand income tax payments during the year	1	–	1	–
Balance at 31 March	**1**	**–**	**1**	**–**

5. CURRENT & DEFERRED INCOME TAX (CONTINUED)

Deferred income tax

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

	Group provisions & employee entitlements ($000s)	Group accelerated depreciation ($000s)	Group tax losses ($000s)	Group net ($000s)
Deferred tax/(liability) balances:				
At 1 April 2011	296	(571)	310	35
Effect of change in income tax rate on opening balance	(20)	38	21	39
Adjustment in respect of prior periods	(97)	–	(2)	(99)
Charged to income statement	345	(229)	(6)	110
At 31 March 2012	**524**	**(762)**	**323**	**85**
At 1 April 2010	–	–	–	–
Charged to income statement	296	(571)	310	35
At 31 March 2011	296	(571)	310	35

	Parent provisions & employee entitlements ($000s)	Parent accelerated depreciation ($000s)	Parent tax losses ($000s)	Parent net ($000s)
Deferred tax/(liability) balances:				
At 1 April 2011	261	(571)	310	–
Effect of change in income tax rate on opening balance	(17)	38	(21)	–
Adjustment in respect of prior periods	(155)	–	155	–
Charged to income statement	238	(229)	(9)	–
At 31 March 2012	**327**	**(762)**	**435**	**–**
At 1 April 2010	–	–	–	–
Charged to income statement	261	(571)	310	–
At 31 March 2011	261	(571)	310	–

With the exception of $77,000 it is not anticipated that deferred tax balances will be recovered within 12 months. Deferred tax assets and liabilities have been offset where the balances are due to/receivable from the same counterparties. Deferred income tax assets are recognised for carried forward tax losses to the extent of the Company's deferred tax liabilities. The Company has unrecognised New Zealand tax losses available to carry forward of $35,051,000 (2011: $26,698,000) subject to shareholder continuity being maintained as required by New Zealand tax legislation.

6. CASH & CASH EQUIVALENTS

	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Cash at bank	2,607	380	416	151
Bank term deposits	36,369	16,542	36,306	16,500
	38,976	**16,922**	**36,722**	**16,651**

7. TRADE & OTHER RECEIVABLES

	Notes	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Current assets					
Trade receivables		1,347	814	832	587
Trade receivables from related parties	15	–	–	3,213	122
Accrued income		687	350	357	221
Prepayments		311	172	147	90
Interest receivable		138	167	138	167
Government grant receivable		170	–	170	–
GST receivable		–	–	182	–
Rental bonds		250	–	250	–
Loans to Directors	15	120	–	120	–
		3,023	**1,503**	**5,409**	**1,187**
Non-current assets					
Loans to Directors	15	–	232	–	232
Loans to key management	15	1,094	–	1,094	–
NZX & rental bonds		140	75	75	75
Other loans		–	116	–	116
Other assets		–	18	–	–
		1,234	**441**	**1,169**	**423**

Trade receivables that are less than three months past due are not considered impaired. As of 31 March 2012, trade receivables of the Parent and Group of $64,000 were past due (2011: $24,000). These relate to a number of independent customers for whom there is no recent history of default. The Group has created a provision of $7,000 (2011: $16,000) for impaired receivables.

8. TRADE & OTHER PAYABLES

	Notes	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Trade payables		969	915	738	768
Trade payables due to related parties	15	–	–	1,913	207
Accrued expenses		651	478	528	265
Onerous lease provision	23	275	–	275	–
Amounts payable on acquisition of subsidiary	11	1,000	–	1,000	–
Income in advance		90	–	18	–
GST payable		61	145	–	33
		3,046	**1,538**	**4,472**	**1,273**

9. PROPERTY, PLANT & EQUIPMENT

	Leasehold improvements ($000s)	Motor vehicles ($000s)	Computer equipment ($000s)	Furniture & equipment ($000s)	Total ($000s)
Group – Year ended 31 March 2012					
Cost					
Balance as at 1 April 2011	308	80	565	252	1,205
Additions	2,792	36	617	752	4,197
Disposals	(316)	–	(177)	(132)	(625)
Foreign exchange adjustment	–	–	(2)	(2)	(4)
Balance as at 31 March 2012	**2,784**	**116**	**1,003**	**870**	**4,773**
Depreciation					
Balance as at 1 April 2011	182	62	391	104	739
Depreciation expense	75	16	177	52	320
Disposals	(242)	–	(162)	(76)	(480)
Foreign exchange adjustment	(1)	–	(2)	2	(1)
Balance as at 31 March 2012	**14**	**78**	**404**	**82**	**578**
Net carrying amount	**2,770**	**38**	**599**	**788**	**4,195**
Parent – Year ended 31 March 2012					
Cost					
Balance as at 1 April 2011	306	80	487	213	1,086
Additions	2,752	36	519	684	3,991
Disposals	(304)	–	(173)	(132)	(609)
Balance as at 31 March 2012	**2,754**	**116**	**833**	**765**	**4,468**
Depreciation					
Balance as at 1 April 2011	182	62	357	101	702
Depreciation expense	70	16	133	40	259
Disposals	(244)	–	(163)	(76)	(483)
Balance as at 31 March 2012	**8**	**78**	**327**	**65**	**478**
Net carrying amount	**2,746**	**38**	**506**	**700**	**3,990**

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	Leasehold improvements ($000s)	Motor vehicles ($000s)	Computer equipment ($000s)	Furniture & equipment ($000s)	Total ($000s)
Group – Year ended 31 March 2011					
Cost					
Balance as at 1 April 2010	255	60	422	162	899
Additions	53	20	144	90	307
Disposals	–	–	–	–	–
Foreign exchange adjustment	–	–	(1)	–	(1)
Balance as at 31 March 2011	**308**	**80**	**565**	**252**	**1,205**
Depreciation					
Balance as at 1 April 2010	125	48	282	77	532
Depreciation expense	57	14	109	27	207
Disposals	–	–	–	–	–
Foreign exchange adjustment	–	–	–	–	–
Balance as at 31 March 2011	**182**	**62**	**391**	**104**	**739**
Net carrying amount	**126**	**18**	**174**	**148**	**466**
Parent – Year ended 31 March 2011					
Cost					
Balance as at 1 April 2010	255	60	379	155	849
Additions	51	20	108	58	237
Disposals	–	–	–	–	–
Balance as at 31 March 2011	**306**	**80**	**487**	**213**	**1,086**
Depreciation					
Balance as at 1 April 2010	125	48	266	77	516
Depreciation expense	57	14	91	24	186
Disposals	–	–	–	–	–
Balance as at 31 March 2011	**182**	**62**	**357**	**101**	**702**
Net carrying amount	**124**	**18**	**130**	**112**	**384**

10. INTANGIBLE ASSETS

	Patents & trademarks ($000s)	Software development* ($000s)	Domains ($000s)	Total ($000s)
Group – Year ended 31 March 2012				
Cost				
Balance as at 1 April 2011	29	7,688	81	7,798
Additions	3	7,054	34	7,091
Disposals	–	–	(33)	(33)
Foreign exchange adjustment	–	–	(1)	(1)
Balance as at 31 March 2012	**32**	**14,742**	**81**	**14,855**
Amortisation & impairment				
Balance as at 1 April 2011	7	2,997	21	3,025
Amortisation during year	3	1,563	8	1,574
Disposals	–	–	(4)	(4)
Balance as at 31 March 2012	**10**	**4,560**	**25**	**4,595**
Net carrying amount	**22**	**10,182**	**56**	**10,260**
Parent – Year ended 31 March 2012				
Cost				
Balance as at 1 April 2011	26	7,682	49	7,757
Additions	6	4,834	31	4,871
Balance as at 31 March 2012	**32**	**12,516**	**80**	**12,628**
Amortisation & impairment				
Balance as at 1 April 2011	7	2,991	18	3,016
Amortisation during year	3	1,569	7	1,579
Balance as at 31 March 2012	**10**	**4,560**	**25**	**4,595**
Net carrying amount	**22**	**7,956**	**55**	**8,033**

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	Patents & trademarks ($000s)	Software development* ($000s)	Domains ($000s)	Total ($000s)
Group – Year ended 31 March 2011				
Cost				
Balance as at 1 April 2010	22	4,935	70	5,027
Additions	7	2,753	11	2,771
Balance as at 31 March 2011	**29**	**7,688**	**81**	**7,798**
Amortisation & impairment				
Balance as at 1 April 2010	5	2,061	13	2,079
Amortisation during year	2	936	8	946
Balance as at 31 March 2011	**7**	**2,997**	**21**	**3,025**
Net carrying amount	**22**	**4,691**	**60**	**4,773**
Parent – Year ended 31 March 2011				
Cost				
Balance as at 1 April 2010	22	4,935	45	5,002
Additions	4	2,747	4	2,755
Balance as at 31 March 2011	**26**	**7,682**	**49**	**7,757**
Amortisation & impairment				
Balance as at 1 April 2010	5	2,061	13	2,079
Amortisation during year	2	930	5	937
Balance as at 31 March 2011	**7**	**2,991**	**18**	**3,016**
Net carrying amount	**19**	**4,691**	**31**	**4,741**

*Capitalised development costs have been internally generated.

11. BUSINESS COMBINATIONS

Paycycle Holdings Pty Limited

On 1 August 2011 the Group acquired the assets and business of Paycycle Holdings Pty Limited. The transaction will cost a total of NZ $1.9 million comprising a cash component and an equity component.

The following table summarises the cash component paid and the amount of assets acquired. No liabilities were assumed.

	($000s)
Cash consideration at 1 August 2011	377
Contingent consideration paid December 2011	251
Total cash consideration	**628**
Recognised amounts of identifiable assets acquired	
Software development costs	628
Goodwill	–
Total identifiable assets	**628**

The equity component of the consideration comprised the issue of 606,130 shares in Xero Limited to the owners of Paycycle Holdings Pty Limited at the volume weighted average price ("VWAP") for the twenty days prior to 1 August 2011 which was $2.13. The total equity component was $1.3 million.

The vesting of the shares is to be recognised separately from the acquisition and is contingent on continued employment by the Group of the owners for a three year period and will be recognised as an employment cost over that period. As these employees are involved in the development of software an element of these amounts will be capitalised under the Group's software development capitalisation policy.

The revenue from the Paycycle business included in the Group's Income Statement for the period ended 31 March 2012 was $235,000. The Paycycle business incurred a loss of $110,000 for the period. Had the acquisition occured at the start of the financial year the result of the Group would not have materially changed.

Max Solutions Holdings Limited

On 27 January 2012 the Group acquired the remaining shares (84.1%) in Max Solutions Holdings Limited ("MSHL"). The transaction will cost a total of $6 million comprising a cash component and an equity component. Control of the assets and business of MSHL was obtained on 1 November 2011, consolidation commenced from this date.

$1 million of the cash component was paid on completion. Deferred consideration arrangements require the Group to pay the owners of MSHL a further $1 million in cash; $500,000 being payable six months after completion date and $500,000 payable 12 months after completion date.

The equity component of the consideration comprised the issue of 1,261,830 shares in Xero Limited to the owners of MSHL at the VWAP price for the twenty days prior to 23 March 2012 which was $3.17. The total equity component was $4 million.

The vesting of the shares is to be recognised separately from the acquisition and is contingent on continued employment by the Group of the owners for a three year period and will be recognised as an employment cost over that period. As these employees are involved in the development of software an element of these amounts will be capitalised under the Group's software development capitalisation policy.

The fair value of MSHL at acquisition date was $2,378,000.

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The following table summarises the consideration paid and the amounts of assets and liabilities assumed:

	($000s)
Cash consideration at 27 January 2012 (Completion date)	1,000
Deferred consideration	1,000
Total consideration for remaining shareholding	**2,000**
Recognised amounts of identifiable assets & liabilities acquired	
Cash & cash equivalents	259
Property, plant & equipment	14
Intangible assets – software development	2,204
Amounts payable to outside parties	(47)
Income tax payable	(52)
Enterprise value	**2,378**
Satisfied by:	
Cash consideration	1,000
Deferred cash consideration	1,000
15.9% investment at acquisition date	200
Share of pre-acquisition profits net of tax	34
Dividends received	(26)
Gain on revaluation of investment to fair value	170
	2,378

Prior to the acquisition the Group held a 15.9% stake in MSHL which had been acquired for $200,000 cash. The Group recognised in its Statement of Comprehensive Income a gain of $170,000 as a result of re-measuring at fair value its 15.9% share, as required by NZ IFRS 3.

The costs directly attributable to the acquisition of MSHL were $51,000. These have been expensed within the Group's Income Statements as an operating expense.

The revenue from MSHL included in the Group's Income Statement for the period 1 November 2011 to 31 March 2012 was $601,000. MSHL reported a profit of $251,000 for the same period ending 31 March 2012.

Had the business combination taken place from 1 April 2011, MSHL would have reported revenues of $1,299,000 and a profit of $492,000 for the year ended 31 March 2012.

12. INVESTMENT IN ASSOCIATE

	Group 2012 ($000s)	Group 2011 ($000s)
At 1 April	207	–
Acquisition of associate	–	200
Share of profit	38	10
Dividend received	(26)	–
Income tax expense	(11)	(3)
Consideration received	(378)	–
Gain on disposal	170	–
At 31 March	–	**207**

Xero Limited purchased 189 shares of MSHL, an unlisted company, on 24 December 2010.
Xero Limited purchased the remaining shares to acquire MSHL as a subsidiary on 27 January 2012.

13. SHARE CAPITAL

Movement in ordinary shares on issue

	Notes	Group 2012 (000s)	Group 2011 (000s)	Parent 2012 (000s)	Parent 2011 (000s)
Balance as at 1 April		91,012	87,631	91,012	87,640
Issue of ordinary shares		13,352	2,681	13,352	2,681
Issue of ordinary shares – purchase of Paycycle assets	11	606	–	606	–
Issue of ordinary shares – purchase of Max Solutions Holdings Limited	11	1,262	–	1,262	–
Issue of ordinary shares under employee restricted share plan	21	550	700	550	691
Ordinary shares on issue at 31 March		**106,782**	**91,012**	**106,782**	**91,012**
Treasury stock		(2,683)	(763)	(2,683)	(763)
Ordinary shares on issue at 31 March		**104,099**	**90,249**	**104,099**	**90,249**

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

During the year the Company undertook a share placement programme whereby a total of 7.27 million shares were issued at $2.75. In March 2012 a Share Purchase Plan was completed with a total of 5.69 million shares issued at $2.75 to existing shareholders. In addition, shares were issued to key management personnel (note 15).

The Company issued 550,000 shares in June 2011 as part of the Company's Employee Restricted Share Plan at an average price of $2.29.

Included within the value of share capital are transaction costs associated with the issue of new ordinary shares. These transaction costs were directly associated with the equity transactions and accordingly have been accounted for as a deduction from equity.

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

14. EARNINGS PER SHARE

Loss attributable to ordinary shareholders:

	Notes	Group 2012 (000s)	Group 2011 (000s)	Parent 2012 (000s)	Parent 2011 (000s)
Net loss after tax		($7,904)	($7,487)	($8,322)	($7,594)
Issued ordinary shares	13	106,782	91,012	106,782	91,012
Weighted average of issued ordinary shares		93,472	89,322	93,472	89,322
Basic & diluted loss per share		($0.08)	($0.08)	($0.09)	($0.09)

15. RELATED PARTIES

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

	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Xero (UK) Limited (UK)				
Market support payments to subsidiary	–	–	739	1,421
Distribution charge to subsidiary	–	–	1,211	985
Management fee charged to subsidiary	–	–	224	–
Due from/(to) subsidiary	–	–	693	(140)
Xero Pty Limited (Australia)				
Market support payments to subsidiary	–	–	2,652	2,223
Intercompany transaction fees paid to subsidiary	–	–	39	–
Distribution charge to subsidiary	–	–	1,889	1,319
Management fee charged to subsidiary	–	–	488	–
Due from/(to) subsidiary	–	–	474	122
Xero Inc (United States)				
Market support payments to subsidiary	–	–	1,312	–
Intercompany transaction fees paid to subsidiary	–	–	1	–
Distribution charge to subsidiary	–	–	79	–
Management fee charged to subsidiary	–	–	184	–
Due from/(to) subsidiary	–	–	333	(67)
Xero Trustee Limited				
Due from subsidiary in relation to shares issued during the year	–	–	–	–

Xero Trustee Limited acts as Trustee for the Xero Limited Employee Restricted Share Plan. (Note 21).

Max Solutions Holdings Limited				
Due from/(to) subsidiary	–	–	(200)	–

All transactions and outstanding balances with these related parties are priced to provide a fair return on assets employed and revenues generated and are to be settled in cash and under normal commercial terms. None of the balances are secured.

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

15. RELATED PARTIES (CONTINUED)

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

Loans to Directors and key management

	Loan principal 2012 ($000s)	Loan interest 2012 ($000s)	Balance outstanding 2012 ($000s)	Loan interest 2011 ($000s)	Balance outstanding 2011 ($000s)
Directors					
Phil Norman	-	4	120	4	116
Graham Shaw	-	2	-	4	116
Key management	1,080	14	1,094	-	-
	1,080	**20**	**1,214**	**8**	**232**

Unsecured loans were issued to Directors during the year ended 31 March 2008 to purchase shares in the Company at $1.00 per share. Simple interest is accrued at a rate of 4% per annum, with the loans and interest being repayable five years after the date of issue.

Secured loans were issued to key management during the year ended 31 March 2012 to purchase shares in the Company at $2.75 per share. Simple interest is accrued at a rate of 4% per annum, with the loans and interest being repayable three years after the date of issue.

Other related parties – key management & directors

	Transaction value for year 2012 ($000s)	Transaction value for year 2011 ($000s)	Balance outstanding 2012 ($000s)	Balance outstanding 2011 ($000s)
Sam Morgan, Graham Shaw, Craig Winkler – Anaplan Inc.	55	–	–	–
	55	–	–	–

All transactions and outstanding balances with these related parties are priced on an arm's length basis and are to be settled in cash and under normal commercial terms. Transactions relate to the provision of Financial Reporting software provided by Anaplan Inc. None of the balances are secured.

Some members of key management and Directors subscribe to the Xero services provided by the Group. None of these related party transactions were significant to either the Company or the Directors.

Some members of key management participate in the Employee Restricted Share Plan (Note 21).

No amounts with any related parties have been written off or foregone during the year (2011: Nil).

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

	2012 ($000s)	2011 ($000s)
Short-term employee benefits	2,480	1,878
Share options (under Employee Share Options Scheme)	14	–
Share based payments (under Employee Restricted Share Plan)	487	243

16. AUDITORS' REMUNERATION

	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Amounts received or due & receivable by PricewaterhouseCoopers for:				
Audit of financial statements	72	86	47	42
Accounting advice & agreed upon procedures review*	57	19	57	19
Taxation services**	38	38	38	38
Total fees paid to auditors	**167**	**143**	**142**	**99**

** Services relate to agreed upon procedures for the Group's half year result, audit of the Company's share register and technical accounting advice.*
*** Services relate to the provision of assurance services for the annual tax return, tax advice on the Group's incentive plans and taxation of offshore employees.*

17. FINANCIAL INSTRUMENTS & FINANCIAL RISK MANAGEMENT OBJECTIVES

Financial instruments Financial instruments recognised in the Statement of Financial Position include cash balances, receivables and payables. It is, and has been, through the period of these financial statements, the Group's policy that no trading in financial instruments shall be undertaken.

Classification & fair values The carrying value of the Parent's and Group's financial instruments approximates their fair value. Set out below is a comparison by category of the carrying amounts of all the Parent's and Group's financial instruments and their fair values.

	Loans & receivables ($000s)	Financial liabilities at amortised cost ($000s)	Total carrying value ($000s)	Fair value ($000s)
Group – Year ended 31 March 2012				
Assets				
Trade & other receivables	2,732	–	2,732	2,732
Cash & cash equivalents	38,976	–	38,976	38,976
Loans to Directors	120	–	120	120
Loans to key management	1,094	–	1,094	1,094
Total financial assets	**42,922**	**–**	**42,922**	**42,922**
Liabilities				
Trade & other payables	–	2,710	2,710	2,710
Total financial liabilities	**–**	**2,710**	**2,710**	**2,710**
Group – Year ended 31 March 2011				
Assets				
Trade & other receivables	1,406	–	1,406	1,406
Cash & cash equivalents	16,922	–	16,922	16,922
Loans to Directors	232	–	232	232
Other loans	134	–	134	134
Total financial assets	**18,694**	**–**	**18,694**	**18,694**
Liabilities				
Trade & other payables	–	1,393	1,393	1,393
Total financial liabilities	**–**	**1,393**	**1,393**	**1,393**

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

	Loans & receivables ($000s)	Financial liabilities at amortised cost ($000s)	Total carrying value ($000s)	Fair value ($000s)
Parent – Year ended 31 March 2012				
Assets				
Trade & other receivables	5,035	–	5,035	5,035
Cash & cash equivalents	36,722	–	36,722	36,722
Loans to Directors	120	–	120	120
Loans to key management	1,094	–	1,094	1,094
Total financial assets	**42,971**	**–**	**42,971**	**42,971**
Liabilities				
Trade & other payables	–	4,197	4,197	4,197
Total financial liabilities	**–**	**4,197**	**4,197**	**4,197**
Parent – Year ended 31 March 2011				
Assets				
Trade & other receivables	1,172	–	1,172	1,172
Cash & cash equivalents	16,651	–	16,651	16,651
Loans to Directors	232	–	232	232
Other loans	116	–	116	116
Total financial assets	**18,171**	**–**	**18,171**	**18,171**
Liabilities				
Trade & other payables	–	1,240	1,240	1,240
Total financial liabilities	**–**	**1,240**	**1,240**	**1,240**

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

Interest rate risk The Group's interest rate risk arises from its cash balances. These are placed on deposit at variable rates that expose the Group to cash flow interest rate risk. The Group does not enter into forward rate agreements or any interest rate hedges.

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

Continued on next page ...

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

	Interest Rate	Balance sheet ($000s)	12 Months ($000s)	24 Months ($000s)	>24 Months ($000s)
Group – Year ended 31 March 2012					
Financial assets					
Cash at bank	4.9%	38,976	38,976	–	–
Loans to Directors & key management	4.0%	1,214	120	–	1,094
Total		**40,190**	**39,096**	**–**	**1,094**
Parent – Year ended 31 March 2012					
Financial assets					
Cash at bank	4.9%	36,722	36,722	–	–
Loans to Directors & key management	4.0%	1,214	120	–	1,094
Total		**37,936**	**36,842**	**–**	**1,094**
Group – Year ended 31 March 2011					
Financial assets					
Cash at bank	4.9%	16,922	16,922	–	–
Loans to Directors	4.0%	232	–	232	–
Other loans	4.0%	116	–	116	–
Other assets	5.5%	18	–	18	–
Total		**17,288**	**16,922**	**366**	**–**
Parent – Year ended 31 March 2011					
Financial assets					
Cash at bank	4.9%	16,651	16,651	–	–
Loans to Directors	4.0%	232	–	232	–
Other loans	4.0%	116	–	116	–
Total		**16,999**	**16,651**	**348**	**–**

Of the financial assets and liabilities above, only the cash at bank is subject to floating interest rate risk. Loans to Directors and other loans are subject to fixed rate interest. All other financial assets and liabilities of the Group are not subject to interest rate risk.

As at 31 March 2012 if interest rates had been 1.0% higher/lower with all other variables held constant, interest income, net loss and retained earnings for the Company and the Group would have decreased/increased by $364,000 (2011: $186,000).

Liquidity risk Liquidity risk is the risk that the Company or Group cannot pay contractual liabilities as they fall due. During the year, the Company raised $36.6 million by way of private placement and the Share Purchase Plan. Following the receipt of the proceeds of the capital raising, the Company has sufficient cash to meet its requirements in the foreseeable future. The Group has no debt and therefore management remains focused on generating sufficient revenue from sales to cover the ongoing costs of operation.

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

The following table sets out the undiscounted contractual cash flows for all financial liabilities of the Company and Group:

	Balance sheet ($000s)	Contractual cash flows ($000s)	6 months or less ($000s)	6-12 months ($000s)	1-2 years ($000s)	More than 2 years ($000s)
Group – Year ended 31 March 2012						
Trade & other payables	2,710	2,710	2,710	500	–	–
Total non-derivative liabilities	**2,710**	**2,710**	**2,710**	**500**	**–**	**–**
Parent – Year ended 31 March 2012						
Trade payables	4,197	4,197	3,197	500	–	–
Total non-derivative liabilities	**4,197**	**4,197**	**3,197**	**500**	**–**	**–**
Group – Year ended 31 March 2011						
Trade payables	1,393	1,393	1,393	–	–	–
Total non-derivative liabilities	**1,393**	**1,393**	**1,393**	**–**	**–**	**–**
Parent – Year ended 31 March 2011						
Trade payables	1,240	1,240	1,240	–	–	–
Total non-derivative liabilities	**1,240**	**1,240**	**1,240**	**–**	**–**	**–**

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

The Group manages its exposure to credit risk by monitoring the credit quality of the financial institutions that hold its cash balances. The credit risk associated with trade receivables is small because of the inherently low individual transaction value and the spread over many customers.

Maximum exposure to credit risk at balance date

	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Cash & cash equivalents	38,976	16,922	36,722	16,651
Receivables	2,712	1,406	5,080	1,172
Non-current receivables	1,234	366	1,169	348
Total	**42,922**	**18,694**	**42,971**	**18,171**

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

Both the UK and Australian operations are now self funding. The US operation is funded directly from New Zealand and will continue to require funding support for at least the next year. During this time the foreign currency risk will increasingly be mitigated by the generation of revenues in the US.

The potential effect on the Company's and Group's results for the year ended 31 March 2012 if the New Zealand dollar had weakened by 10% against the other operating currencies, with all other variables remaining constant, would be an increase in the net loss and retained earnings for the Group of $188,000 (2011: $122,000).

18. RECONCILIATION OF OPERATING CASH FLOWS

	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Reconciliation from the net loss after tax to the net cash from operating activities				
Net loss after tax	(7,904)	(7,487)	(8,322)	(7,594)
Adjustments				
Depreciation	320	207	259	186
Amortisation	1,574	946	1,579	937
Deferred tax	(50)	(35)	–	–
Associate profit	(38)	(7)	–	–
Gain on investment in associate	(170)	–	(178)	–
Loss/(gain) on foreign exchange transactions	(8)	(53)	(8)	–
Loss on disposal on property, plant & equipment	119	–	121	–
Employee entitlements	1,380	814	950	805
Interest on loans	(18)	(12)	(18)	(12)
Changes in working capital items				
(Increase)/decrease in trade receivables & prepayments	(1,162)	(545)	(3,697)	(407)
(Decrease)/increase in trade payables & accruals	(202)	688	2,008	415
(Increase)/decrease in GST	(84)	126	(215)	33
(Increase)/decrease in current tax payable	10	61	(1)	–
(Decrease)/increase in employee entitlements	1,282	175	668	312
(Decrease)/increase in income in advance	90	(98)	18	(41)
Net cash from operating activities	**(4,861)**	**(5,220)**	**(6,836)**	**(5,366)**

19. SEGMENT INFORMATION

The Group has three reporting segments based on the geographical locations of the operations and revenue streams.

These segments have been determined based on the reports reviewed by the Chief Operating Decision Maker to make strategic decisions.

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

Sales between segments are carried out at arm's length. The revenue from external parties reported to the Board is measured in a manner consistent with that in the Income Statement. Entities are domiciled in New Zealand, the United Kingdom and Australia. Revenue from external customers is generated in their domiciliation countries.

The total of non-current assets, other than financial instruments, located in New Zealand is $11,097,000 (2011: $5,748,000) and the total of non-current assets located in other countries is $191,000 (2011: 139,000).

	New Zealand ($000s)	United Kingdom ($000s)	Australia ($000s)	Rest of World ($000s)	Inter-Segment eliminations ($000s)	Total ($000s)
Group – For the year ended 31 March 2012						
Revenue from external customers	10,325	2,723	5,024	1,298	–	19,370
Inter-segment revenue	4,075	739	2,691	1,313	(8,818)	–
Total segment revenue	14,400	3,462	7,715	2,611	(8,818)	19,370
Depreciation & amortisation	(1,842)	(6)	(44)	(2)	–	(1,894)
Interest income	609	–	3	–	–	612
Segment net (loss)/profit before tax	(9,398)	154	347	1,103	–	(7,794)
Segment net (loss)/profit after tax	(9,456)	138	312	1,102	–	(7,904)
Non-current asset additions	11,098	3	165	22	–	11,288
Segment assets	60,615	1,286	2,037	477	(6,642)	57,773
Segment liabilities	5,965	1,113	1,860	411	(3,824)	5,525
Group – For the year ended 31 March 2011						
Revenue from external customers	5,937	1,294	1,494	616	–	9,341
Inter-segment revenue	2,305	1,421	2,223	–	(5,949)	–
Total segment revenue	8,242	2,715	3,717	616	(5,949)	9,341
Depreciation & amortisation	(1,123)	(9)	(21)	–	–	(1,153)
Interest income	878	–	2	–	–	880
Segment net (loss)/profit before	(8,210)	30	38	616	65	(7,461)
Segment net (loss)/profit after tax	(8,213)	26	19	616	65	(7,487)
Non-current asset additions	3,271	16	86	–	(58)	3,315
Segment assets	23,848	860	916	–	(1,277)	24,347
Segment liabilities	2,196	706	875	–	(1,118)	2,659

20. COMMITMENTS & CONTINGENCIES

There were no capital commitments or contingent liabilities as at 31 March 2012 (2011: Nil).

21. SHARE BASED PAYMENTS

Employee Restricted Share Plan

In May 2008 the Xero Limited Employee Restricted Share Plan ('RSP') was introduced for selected executives and employees of the Group. Under the RSP, ordinary shares in Xero Limited are issued to a trustee, Xero Trustee Limited, a wholly-owned subsidiary, and allocated to participants, on grant date, using funds lent to them by the Company.

Under the RSP, the shares are beneficially owned by the participants. The length of retention period before the shares vest is between one and three years. The price for each share issued during the year under the RSP is the higher of the volume-weighted average end-of-day market price reported on the New Zealand Exchange for the 20 business days immediately preceding the date on which the share is allocated or the invitation price.

If the individual is still employed by the Group at the end of this specific period, the employee is given a cash bonus that must be used to repay the loan and the shares are then transferred to the individual. The number of shares awarded is determined by the Remuneration Committee of the Board of Directors. The weighted average grant date fair value of restricted shares issued during the year was $2.29 (2011: $1.44). Shares with a grant date fair value of $580,000 vested during the year (2011: $483,000). The Group has no legal or constructive obligation to repurchase the shares or settle the RSP for cash.

	Number of shares 2012 (000s)	Number of shares 2011 (000s)
Unvested shares as at 1 April	679	420
Awarded pursuant to Employee Restricted Share Plan	621	721
Forfeited	(49)	(118)
Vested	(493)	(344)
Unvested shares as at 31 March – allocated to employees	758	679
Forfeited shares not yet reallocated – held by Trustee	57	84
	815	763
Percentage of total ordinary shares	0.8%	0.8%
Ageing of unvested shares		
Balance of shares to vest within one year	455	358
Balance of shares to vest after one year but not more than two years	303	321
	758	**679**

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

21. SHARE BASED PAYMENTS (CONTINUED)

Employee Share Options Scheme

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

Options are conditional on the employee completing the necessary years' service (the vesting period) as appropriate to that tranche. The options tranches are exercisable in equal amounts over five years from the grant date. No options can be exercised later than the first anniversary of the final vesting date (a total of six years from the vesting date).

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

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

	Average exercise price	2012 Options (000s)	Average exercise price	2011 Options (000s)
At 1 April	–	–	–	–
Granted	2.75	200	–	–
At 31 March	**2.75**	**200**	**–**	**–**

Of the 200,000 outstanding options none were exercisable as at 31 March 2012.

Expiry date – 27 January	Exercise price	Shares (000s) 2012	Shares (000s) 2011
2013	2.75	40	–
2014	2.75	40	–
2015	2.75	40	–
2016	2.75	40	–
2017	2.75	40	–
		200	–

The weighted average fair value of options granted during the period determined using the Black-Scholes valuation model was $0.70 per option.

The significant inputs into the model were the spot share price of $2.75 at the grant date, the exercise price shown above, the expected annualised volatility of 33%, a dividend yield of 0%, an expected option life of between one and six years and an annual risk-free interest rate of between 2.5% and 3.5%.

The volatility measured is the standard deviation of continuously compounded share returns and based on a statistical analysis of daily share prices over the last 12 months.

22. OPERATING LEASE COMMITMENTS

	Group 2012 ($000s)	Group 2011 ($000s)	Parent 2012 ($000s)	Parent 2011 ($000s)
Within one year	1,198	403	902	339
After one year but not more than five years	3,667	245	3,595	144
More than five years	2,943	–	2,943	–
	7,808	**648**	**7,440**	**483**

Operating lease commitments are for the Group's premises.

23. PROVISIONS

	Group ($000s)	Parent ($000s)
Balance at 1 April 2011	–	–
Provision for onerous lease commitments	292	275
Amounts incurred	(17)	–
Closing balance at 31 March 2012	**275**	**275**

The onerous lease provision consists of the full amount payable over the remainder of the contracts for rental on premises in Wellington and Melbourne that are no longer used by the Group and had no arrangements for subleasing at 31 March 2012.

24. GROUP ENTITIES

Subsidiaries

	Principal activity	Country of incorporation	Balance date	Interest 2012 (%)	Interest 2011 (%)
Xero Inc	Limited risk distributor	United States	31 December	100%	100%
Xero (UK) Limited	Limited risk distributor	United Kingdom	31 March	100%	100%
Xero Pty Limited	Limited risk distributor	Australia	30 June	100%	100%
Xero Trustee Limited	Trustee	New Zealand	31 March	100%	100%
Max Solutions Holdings Limited	Holding company	New Zealand	31 March	100%	15.9%
Max Solutions Limited	Business software developer	New Zealand	31 March	100%	15.9%

Xero Inc was incorporated on 24 February 2011 and commenced trading on 16 August 2011.
Xero Trustee Limited is the Trustee for Xero Limited Employee Restricted Share Plan.
During the period Xero Inc and Xero Pty Limited applied to change their balance dates from 31 December and 30 June respectively to 31 March.

25. EVENTS AFTER THE BALANCE SHEET DATE

There were no events after balance date.

AUDITORS' REPORT

We have audited the financial statements of Xero Limited ("the Company") on pages 3 to 33, which comprise the statements of financial position as at 31 March 2012, the income statements, statements of comprehensive income, statements of changes in equity and statement of cash flow, for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information for both the Company and the Group. The Group comprises the Company and the entities it controlled at 31 March 2012 or from time to time during the financial year.

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

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

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

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

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

Opinion In our opinion, the financial statements on pages 3 to 33:

(i) comply with generally accepted accounting practice in New Zealand;
(ii) comply with International Financial Reporting Standards; and
(ii) give a true and fair view of the financial position of the Company and the Group as at 31 March 2012, and their financial performance and cash flows for the year then ended.

Report on Other Legal and Regulatory Requirements We also report in accordance with Sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993. In relation to our audit of the financial statements for the year ended 31 March 2012:

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

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

PricewaterhouseCoopers

PricewaterhouseCoopers
Chartered Accountants
Wellington, New Zealand
24 May 2012

DIRECTORS' RESPONSIBILITIES STATEMENT

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

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

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

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

The Directors have pleasure in presenting these financial statements for the year ended 31 March 2012.

The Board of Directors of the Company and Group authorised these financial statements for issue on 24 May 2012.

For and on behalf of the Board of Directors

Sam Knowles
Chairman
24 May 2012

Graham Shaw
Director
24 May 2012

CORPORATE GOVERNANCE

The role of the Board The Board of Directors is elected by shareholders to govern Xero in the best interests of the Company. The Board is the overall and final body responsible for all decision-making within the Company. The Board Charter describes the Board's role and responsibilities and regulates internal Board procedures.

The Board has the responsibility to work to enhance the value of the Company in the interests of the Company and its shareholders.

Delegation of authority framework To enhance efficiency, the Board has delegated some of its powers to Board Committees and other powers to the Chief Executive. The terms of the delegation by the Board to the Chief Executive are clearly documented. The Chief Executive has, in some cases, formally delegated certain authorities to his direct reports and has established a formal process for his direct reports to sub-delegate certain authorities.

Membership size & composition The Board comprises six Directors, being a non-executive Chairman, one Executive Director and four non-executive Directors. In December 2011, Executive Director and Co-founder Hamish Edwards stepped down from the Board and in May 2012, Phil Norman announced his forthcoming retirement from the Board. The Board has a broad range of IT, financial, sales, business and other skills and expertise necessary to meet its objectives.

Selection & role of Chairman The Chairman is elected by the Board from the non-executive Directors. The Board supports the separation of the role of Chairman and Chief Executive. The Chairman's role is to manage the Board effectively, to provide leadership to the Board and to facilitate the Board's interface with the Chief Executive.

During the year Sam Knowles took over the role of Chairman from Phil Norman.

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

As required by the NZSX listing rules, Xero's approach to Director independence is to have regard to relationships that could (or could be perceived to) materially interfere with the exercise of the unfettered and independent judgement of a Director. The NZSX listing rules provide guidance as to the types of relationship that constitute "material relationships", affecting independence or the perception of independence.

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

CORPORATE GOVERNANCE (CONTINUED)

The Board considers that Phil Norman, Graham Shaw and Sam Knowles are independent. The Board determined that Rod Drury is not independent by virtue of his executive responsibilities. Further the Board considers that Craig Winkler and Sam Morgan are not independent. It should be noted that Sam Morgan's status as a Director changed during the year as a result of him becoming a substantial security holder in the Company.

Conflicts of interest The Board Charter outlines the Board's policy on conflicts of interest. Where conflicts of interest do exist at law, Directors excuse themselves from discussions and do not receive the relevant paper in respect of those interests, and in accordance with the relevant stock exchange listing rules do not exercise their right to vote in respect of such matters.

Nomination & appointment The procedures for the appointment and removal of Directors are ultimately governed by the Company's Constitution. The suitability of candidates for appointment is based on pre-established criteria. When recommending a candidate to act as Director, the Board takes into account such factors as it deems appropriate, including the experience, qualifications, availability and judgement of the candidate and the candidate's ability to work with other Directors.

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

Board Committees The Board operated three Committees during the year: the Audit and Risk Management Committee, the Remuneration Committee and the Nominations Committee. The Charters of each Committee are on the Xero website. The membership of each Committee at 31 March 2012 was:

1. Audit and Risk Management Committee
   – Graham Shaw (Chair), Sam Knowles, Phil Norman, Craig Winkler
2. Remuneration Committee
   – Sam Knowles (Chair), Graham Shaw, Craig Winkler
3. Nominations Committee
   – Sam Morgan (Chair), Rod Drury, Sam Knowles

Retirement & re-election The Constitution provides that a Director is required to stand for re-election at the third Annual Meeting following the Director's appointment or three years, whichever is the longer.

Director remuneration Directors' fees have been previously set at $250,000 for the non-executive Directors. The fees paid for the past year were $220,000.

In April 2012 the Board resolved after a review of directors fees paid in comparable companies that the Chairman's fee be increased from $60,000 per annum to $80,000 per annum effective 1 April 2012 and that the Chair of the Audit and Risk Management Committee be paid a supplementary fee of $10,000 per annum for the additional time and responsibilites associated with this role.

Board access to information & advice The Directors generally receive materials for Board meetings four days in advance, except in the case of special meetings for which the time period may be shorter owing to the urgency of the matter to be considered. Xero's Company Secretary is responsible for supporting the effectiveness of the Board by ensuring that policies and procedures are followed and co-ordinating the completion and dispatch of the Board agenda and papers.

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

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

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

Directors' share ownership All Directors and employees are required to comply with Xero's Insider Trading Policy and Guidelines, in undertaking any trading in Xero shares. The table of Directors' shareholdings is included in the Disclosures section of this Annual Report.

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

The Directors' and Officers' Liability insurance covers risks normally covered by such policies arising out of acts or omissions of Directors and employees in their capacity as such. Insurance is not provided for dishonest, fraudulent, malicious or wilful acts or omissions.

Board meetings The Board met formally ten times in the year ended 31 March 2012 and there were also separate meetings of the Board Committees. At each meeting the Board considers items of key financial and operational information as well as matters of strategic importance.

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

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

Board performance Board and Committee performance is subject to regular discussion at meetings of the Board and Committees.

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

Ethics The Board maintains high standards of ethical conduct and the Chief Executive is responsible for ensuring that high standards of conduct are maintained by all Xero staff, although no formal code of ethics is documented at this time.

DISCLOSURES

ENTRIES RECORDED IN THE INTERESTS REGISTER

The following are particulars of entries made in the Interests Register for the period 1 April 2011 – 31 March 2012.

Directors' interests Directors disclosed interests, or cessations of interest, in the following entities pursuant to section 140 of the Companies Act 1993 during the year ended 31 March 2012.

Entity	*Relationship*
Sam Knowles	
Growthcom Limited	Became a director and shareholder
Com Investments Limited	Became a director and shareholder
Rangatira Limited	Became a director
Partners Life Limited	Became a director and shareholder
Magritek Limited	Became a director and shareholder
Phil Norman	
Nextspace Limited	Became a director
Maclean Computing Limited	Became a member of an advisory board
Touchpoint Limited	Became a member of an advisory board
Western Mailing Limited	Became a member of an advisory board
Martin Aircraft Limited	Ceased to be a director
Sam Morgan	
Outsmart Limited	Became a director
Sonar6 Limited	Ceased to be a director
Gareth Morgan Kiwisaver Limited	Ceased to be a director
Gareth Morgan Investments Limited	Ceased to be a director
Trade Me Group Limited	Became a director
Hamish Edwards	
Hedgebook Limited	Became a director
Spotlight Workpapers Limited	Became a director and shareholder

Share dealings of Directors Directors disclosed, pursuant to section 148 of the Companies Act 1993, the following acquisitions and disposals of relevant interest in Xero shares during the year ended 31 March 2012

	Date of acquisition/ disposal	Consideration per share	Number of shares acquired/ (disposed)
Sam Morgan	12 August 2011	2.40	14,000
Sam Knowles	2 February 2012	2.75	363,636
Sam Morgan	2 February 2012	2.75	1,818,182
Craig Winkler	2 February 2012	2.75	1,454,545
Rod Drury	9 February 2012	2.75	(1,090,909)
Hamish Edwards	9 February 2012	2.75	(545,455)
Graham Shaw	13 March 2012	2.75	5,455

DISCLOSURES (CONTINUED)

Shareholdings of Directors as at 31 March 2012

	Number of shares
Rod Drury	22,553,113
Sam Knowles	569,191
Sam Morgan	6,122,609
Phil Norman	505,546
Graham Shaw	1,336,010
Craig Winkler	20,954,545

An Unsecured loan was provided to Mr Norman in the year ended 31 March 2008 to purchase shares in Xero at $1.00 per share. Simple interest is repayable at a rate of 4% per annum, with the loan being repayable in June 2012.

Remuneration of Directors Details of the total remuneration of, and the value of other benefits received by each Director of Xero during the financial year ended 31 March 2012 are as follows:

	Fees ($000s)	Salary ($000s)
Rod Drury*	–	255
Hamish Edwards**	–	159
Sam Knowles***	47	–
Sam Morgan	40	–
Phil Norman	53	–
Graham Shaw	40	–
Craig Winkler	40	–
	220	**414**

**Mr Drury is an Executive Director and receives remuneration from Xero in the form of a salary. He does not participate in the Xero Employee Restricted Share Plan.*
***Mr Edwards ceased to be a Director on 12 December 2011.*
****Mr Knowles replaced Mr Norman as the Chairman on 18 November 2011.*

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Employee remuneration The following table shows the number of employees (including employees holding office as Directors of subsidiaries) whose remuneration and benefits for the year ended 31 March 2012 were within the specified bands above $100,000. The remuneration figures shown in the table include all monetary payments actually paid during the course of the year ended 31 March 2012. They also include the value of all restricted shares provided to individuals during the same period. The table does not include amounts paid post 31 March 2012 that related to the year ended 31 March 2012, such as the short-term incentive scheme bonus. The table below includes the remuneration of Mr Drury and Mr Edwards. No director of a subsidiary receives or retains any remuneration or other benefits from Xero for acting as such.

	Number of employees	Number of employees acting as directors of subsidiaries
$100,000 – 109,999	11	
$110,000 – 119,999	8	
$120,000 – 129,999	10	
$130,000 – 139,999	2	
$140,000 – 149,999	2	
$150,000 – 159,999	5	
$160,000 – 169,999	1	
$170,000 – 179,999	2	
$190,000 – 199,000	1	
$200,000 – 209,999	1	
$250,000 – 259,999	3	
$260,000 – 269,999	1	
$300,000 – 309,999	1	1
$370,000 – 379,999	1	1
$420,000 – 429,000	1	
	50	**2**

Analysis of shareholding as at 16 May 2012

	Number of holders	Number of shares	% of issued capital
1 – 1,000	627	357,247	0.34
1,001 – 5,000	940	2,534,352	2.37
5,001 – 10,000	556	4,056,067	3.80
10,001 – 100,000	602	13,327,113	12.48
100,001 and over	56	86,507,441	81.01
Total	**2,781**	**106,782,220**	**100.00**

DISCLOSURES (CONTINUED)

Twenty largest shareholders as at 16 May 2012

Shareholder rank & name	Holding	Percentage of total shares on issue
1. Anna Drury & Kenneth Drury (Rod Drury)	22,553,113	21.12
2. Givia Pty Limited (Craig Winkler)	20,954,545	19.62
3. Hamish Edwards & Tineke Edwards & Andrew Finch (Hamish Edwards)	6,125,632	5.74
4. Jasmine Investment Holdings Limited (Sam Morgan)	6,122,609	5.73
5. New Zealand Central Securities Depository Limited	4,458,640	4.18
6. Valar Ventures LP	4,135,870	3.87
7. Bank of New Zealand	2,177,778	2.04
8. Nicola Wilson & David Wilson & Christoper Ritchie	1,962,819	1.84
9. Anna Grigg & Alastair Grigg & Claymore Trustees Limited (Alastair Grigg)	1,351,776	1.27
10. Graham Shaw & Delwyn Shaw	1,336,010	1.25
11. FNZ Custodians Limited	1,201,531	1.13
12. W5 Limited	965,561	0.90
13. Xero Limited (Employee Restricted Share Plan)	815,124	0.76
14. Craig Walker & Catherine Walker	738,898	0.69
15. Gavin George & Jacquetta George	630,915	0.59
16. Spence Corporate Trustee Limited	630,915	0.59
17. Gareth Morgan & Joanne Morgan & Charles Purcell	545,455	0.51
18. Philip Norman	505,546	0.47
19. Ravere Pty Limited	503,636	0.47
20. Andrew Finch & Raymond Bishop & Elaine Bishop	495,000	0.46

Substantial Security Holders According to notices given under the Securities Markets Act 1988 the following persons were Substantial Security Holders in Xero Limited as at 16 May 2012 in respect of the number of voting securities set opposite their names:

1. Anna Drury & Kenneth Drury (Rod Drury)	22,553,113
2. Givia Pty Limited (Craig Winkler)	20,954,545
3. Hamish Edwards & Tineke Edwards & Andrew Finch (Hamish Edwards)	6,125,632
4. Jasmine Investment Holdings Limited (Sam Morgan)	6,122,609

The total number of issued voting securities of Xero Limited as at 16 May 2012 was 106,782,220 (104,099,000 after excluding Treasury Stock).

NZX Waivers Xero Limited has had no NZX waivers granted or published by NZX within or relied upon it in the 12 months immediately preceding 24 May 2012.

Subsidiary Company Directors The following people held office as Directors of subsidiary companies as at 31 March 2012:
Xero (UK) Limited – Rod Drury, Gary Turner
Xero Pty Limited – Rod Drury, Chris Ridd
Xero Inc – Rod Drury
Xero Trustee Limited – Rod Drury, Graham Shaw
Max Solutions Holdings Limited – Rod Drury, Graham Shaw
Max Solutions Limited – Rod Drury, Graham Shaw

Annual Meeting Xero's Annual Meeting of shareholders will be held at the Mac's Function Centre, 4 Taranaki Street, Wellington on Thursday 26 July 2012 at 4pm. A notice of Annual Meeting and Proxy Form will be circulated to shareholders in June 2012.

REGISTERED OFFICE:

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WELLINGTON 6142

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FACSIMILE: 04 819 4801

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WWW.XERO.COM

DIRECTORS:

SAM KNOWLES
CHAIRMAN

ROD DRURY

SAM MORGAN

PHIL NORMAN

GRAHAM SHAW

CRAIG WINKLER

MANAGEMENT:

ROD DRURY
CHIEF EXECUTIVE, CO-FOUNDER

HAMISH EDWARDS
CO-FOUNDER

ROSS JENKINS
CHIEF FINANCIAL OFFICER

ALASTAIR GRIGG
CHIEF OPERATING OFFICER

NATASHA HUBBARD
GENERAL MANAGER HUMAN RESOURCES

PAULA JACKSON
GENERAL MANAGER MARKETING

DUNCAN RITCHIE
GENERAL MANAGER OPERATIONS

PAUL WILLIAMS
GENERAL MANAGER FINANCE

LEANNE GRAHAM
COUNTRY MANAGER – NEW ZEALAND

CHRIS RIDD
MANAGING DIRECTOR – AUSTRALIA

GARY TURNER
MANAGING DIRECTOR – UNITED KINGDOM

JAMIE SUTHERLAND
PRESIDENT – UNITED STATES

AUDITOR:

PRICEWATERHOUSECOOPERS

LEGAL ADVISOR:

BELL GULLY

COMPANY SECRETARY:

LINDA COX
CORPORATE NAVIGATOR LIMITED

BANKERS:

ASB BANK LIMITED

BANK OF NEW ZEALAND LIMITED

HSBC LIMITED

NATIONAL AUSTRALIA BANK LIMITED

SILICON VALLEY BANK

SHARE REGISTRAR:

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LEVEL 16, BROOKFIELDS HOUSE
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