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XERO LIMITED ANNUAL REPORT 2008

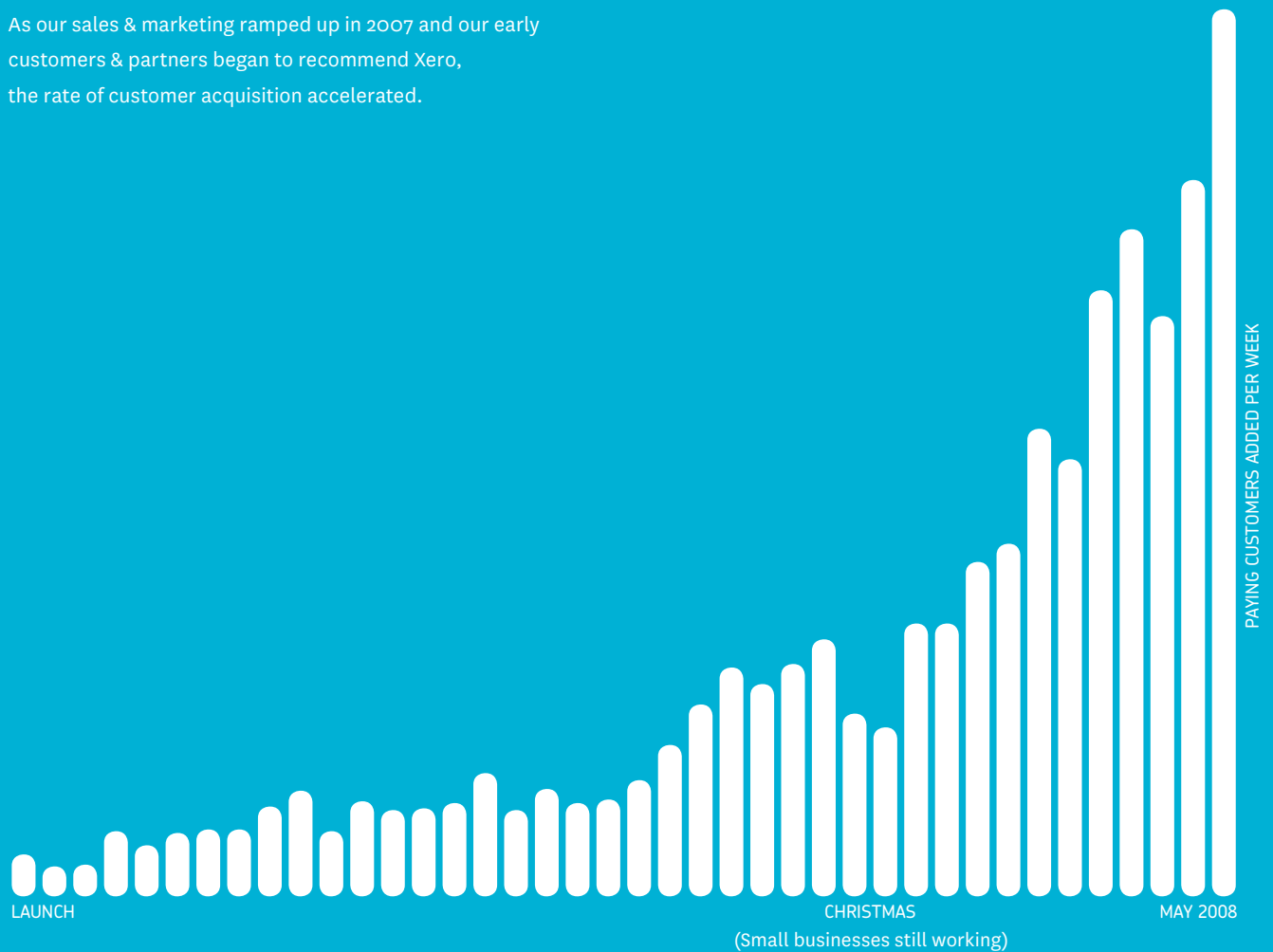


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FROM START-UP TO UNSTOPPABLE

As our sales & marketing ramped up in 2007 and our early customers & partners began to recommend Xero, the rate of customer acquisition accelerated.



### Chairman & Chief Executive's Report

We are pleased to present this first Annual Report as a listed company and to be able to report that, at the end of its first year of operations following the issue of the Company's Offer Document on 11 May 2007, Xero exceeded its customer acquisition forecast securing 1,406 customers and, operating within its costs forecast, finished the year with a better than forecast cash balance.

The Company's online accounting software is targeted at small businesses and delivered via the internet. Xero was designed to leverage the rapid growth in the Software as a Service (SaaS) market and offer small business users the opportunity to increase their productivity.

Development of a SaaS offering requires a significant investment of capital up-front. In the long-term, SaaS businesses have the potential to produce attractive returns as subscription revenues grow. We believed the best way of capturing the international market opportunity was to secure the capital required to build a global business. This was done through the initial public offering and NZX listing.

The Company has laid the foundations to become a market leader. We have developed a world-class software product and a high quality self-service delivery capability that is scalable. Continued positive customer feedback, industry recognition and a number of prestigious awards are testament to the Company's achievements. Xero established a presence in the United Kingdom in late 2007 and as at 10 May 2008 we had secured over 200 customers in that market.

During the last year we have learned a great deal about the small business accounting software market. We have learned about product needs and preferences and have been able to react quickly and reflect these in the product through our regular software release programme.

We deliberately set out to build relationships with the accounting community in New Zealand. With over 100 accounting firms signing on as Xero partners, they have become important endorsers of the product to small business owners.

We have successfully developed unique partnerships with all trading banks in New Zealand whereby bank transaction data can be automatically imported into Xero each day. This is a major point of difference from our competitors.

Xero has the potential to become the accounting engine for a wide variety of industry applications, and this has driven a number of vertical market sales initiatives and the creation of the Xero Network designed to attract and support many market collaborations.

Our software is an appealing substitute for existing products used by small businesses as it offers comparable or better functionality and is easier to use – all for a modest monthly subscription. While tougher economic times are predicted over the next year, we believe Xero will continue to grow quickly as we ride the accelerating wave of interest around internet-based software applications and cost-effectively deliver solutions into a growing number of markets. The reality is that every small business requires an accounting system and will continue to seek efficiencies.

Growth will also be driven through the addition of new modules in the Xero product suite, such as job costing and time recording, and new features in the core accounting offering, for example, multi-currency capability. These will push up the potential revenue available from each customer and grow our addressable market.

We intend to maintain the Company's development operation and most other core functions in New Zealand. The United Kingdom will remain our key market of interest outside of New Zealand during 2008/09 and we will be focused on ramping up our sales and marketing activities, building business partnerships and increasing staff in that region.

During 2008/09, we intend to commit more resources to the Australian market as was outlined in our May 2007 Offer Document.

Xero has already become the primary challenger to the incumbent suppliers of accounting software in the New Zealand market and as the Company expands its offshore operations we will vigorously pursue new customers through partnering arrangements with banks, Internet service providers and similar organisations, vertical market sales initiatives, relationships with the accounting community and a strong focus on the development of a Xero-networked small business ecosystem.

Our success has been accomplished by a multi-disciplined team of 50 staff that have performed at the highest level. We would like to publicly acknowledge their commitment and effort and thank them all. We also acknowledge the advice and guidance we have received from all our external advisors, particularly as we set about becoming a publicly listed company while so young. Finally, we would like to express our appreciation to all our shareholders who have given us the opportunity to build a world-class company from New Zealand.



**Rod Drury**  
Chief Executive



**Phil Norman**  
Chairman

# RAPID EVOLUTION

## XERO LIMITED

Company milestones

April 2007  
Xero goes from private beta to limited release

Auckland office established

June 2007  
Xero IPO

August 2007  
General release of Xero

September 2007  
204 customers & 52 accounting partners

## PRODUCT

Software releases

April 2007  
Limited release of Xero

Added Getting Started tours

May 2007  
Introduced Budget Manager capabilities

June 2007  
Added Contacts Manager

August 2007  
General release of Xero

Introduced My Xero

Introduced Repeating Transactions

September 2007  
Introduced self-learning bank reconciliation

## MARKETING

Online and offline

April 2007  
Official Xero.com launch

May 2007  
Published Xero IPO Prospectus

Accountants' Big Day Out

July 2007  
Microsoft Case Study (NZ)

August 2007  
Xero Revolution Roadshow

## OPERATIONS

Infrastructure and support

April 2007  
Automated bank feeds from ASB

May 2007  
Launched project tracking system

July 2007  
Launched customer tracking system

August 2007  
Launched automated customer sign-up

Credit card billing available

September 2007  
Automated bank feeds from Kiwibank, ANZ & National Bank

Launched automated billing system

October 2007  
Offices  
established in  
Christchurch &  
the UK

December 2007  
UK limited  
release

January 2008  
Over 500  
customers in NZ

March 2008  
Over 950  
customers in NZ  
& 111 accounting  
partners

UK general  
release

April 2008  
Staff numbers  
reached 50

May 2008  
Over 1,400  
customers in NZ  
and the UK

October 2007  
Introduced  
Financial Advisor  
role

November 2007  
Added  
credit notes  
& lock dates

December 2007  
Launched Xero  
UK limited  
release

December 2007  
Launched public  
Help Centre

January 2008  
Added import  
& export  
capabilities to  
Chart of  
Accounts

February 2008  
Introduced  
Tracking

March 2008  
Launched Xero  
Network

Added Setup  
Wizard

Public launch to  
UK market

April 2008  
Added customer  
statements

May 2008  
Launched iPhone  
version

Introduced  
Employee & Cash  
Manager Roles

October 2007  
Worldwide  
Microsoft Case  
Study

Six month  
Interim Report  
published

November 2007  
Web 2.0 for  
Small Business  
event

December 2007  
International  
version of  
www.xero.com  
launched

January 2008  
Switch 08  
campaign

March 2008  
Introduced  
signup codes

Clubs & Charities  
campaign

April 2008  
BNZ campaign

Visa Olympics  
promotion

May 2008  
Added user  
comments  
to blog

Small Biz Expos

Accountants'  
Big Day Out

November 2007  
Automated bank  
feeds from BNZ

December 2007  
UK billing plans  
added

January 2008  
Automated bank  
feeds from TSB  
Bank

February 2008  
Launched sales  
forecasting tools

March 2008  
Migrated to a  
global hosting  
platform

Promotional  
signup codes &  
prepay billing  
available

April 2008  
Launched  
customer  
support ticket  
system

### Directors' responsibilities statement

The Financial Reporting Act 1993 requires the Directors to prepare financial statements for each financial year which 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 those 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;
- 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 which 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 the following financial statements for the year ended 31 March 2008.

The Board of Directors of the Company and Group authorised these financial statements for issue on 13 May 2008.

For and on behalf of the Board of Directors



**Rod Drury**  
Director  
13 May 2008



**Graham Shaw**  
Director  
13 May 2008

### Corporate information

Xero Limited is a New Zealand Company registered under the New Zealand Companies Act 1993. The registered office of the Company is Level 1, Old Bank, 98 Customhouse Quay, Wellington, New Zealand.

Xero Limited changed its name from Xero Live Limited on 30 April 2008.

The financial statements presented are for Xero Limited (the 'Parent Company') and its subsidiaries which comprise Xero Live Limited (UK) and Xero Live Pty Limited, (together 'the Group') for the year ended 31 March 2008.

Comparative information is for the 9 month period ended 31 March 2007. There were no subsidiaries for this period, therefore no Group comparatives are required.

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

The Group's principal activity is the provision of a platform for online accounting & business services to small & medium sized enterprises.

XERO LIMITED – INCOME STATEMENT – FOR THE YEAR ENDED 31 MARCH 2008

	Notes	Group 31 March 2008 (\$000s)	Parent 31 March 2008 (\$000s)	Parent 31 March 2007 (\$000s)
Operating revenue	3 & 14	134	162	10
Operating expenses	3	5,146	5,165	1,149
Operating deficit		(5,012)	(5,003)	(1,139)
<i>Other income/(expenses)</i>	3			
Other income		255	255	105
Interest income		793	798	5
Interest expense		(4)	(4)	-
Depreciation & amortisation	7 & 8	(342)	(341)	(20)
Net profit/(loss) before tax		(4,310)	(4,295)	(1,049)
Income tax	4	-	-	-
<b>Net profit/(loss) after tax</b>		<b>(4,310)</b>	<b>(4,295)</b>	<b>(1,049)</b>
<i>Earnings per share</i>	6			
Basic earnings per share		(0.08)	(0.08)	(0.61)
Diluted earnings per share		(0.08)	(0.08)	(0.61)

The accompanying notes form an integral part of these financial statements

XERO LIMITED – STATEMENT OF CHANGES IN EQUITY

	Notes	Share capital (\$000s)	Retained earnings (\$000s)	Foreign currency translation reserve (\$000s)	Total equity (\$000s)
<b>Year ended 31 March 2008</b>					
<i>Group</i>					
Balance at 31 March 2007		2,781	(1,049)	-	1,732
Income & expense recognised directly in equity		-	-	-	-
Net profit/(loss) after tax		-	(4,310)	-	(4,310)
Total recognised income & expense		-	(4,310)	-	(4,310)
Issue of ordinary shares	5	15,000	-	-	15,000
Cost of issue	5	(1,111)	-	-	(1,111)
Currency translation movements	5	-	-	10	10
<b>Equity at the end of the year</b>		<b>16,670</b>	<b>(5,359)</b>	<b>10</b>	<b>11,321</b>
<i>Parent</i>					
Balance at 31 March 2007		2,781	(1,049)	-	1,732
Income & expense recognised directly in equity		-	-	-	-
Net profit/(loss) after tax		-	(4,295)	-	(4,295)
Total recognised income & expense		-	(4,295)	-	(4,295)
Issue of ordinary shares	5	15,000	-	-	15,000
Cost of issue	5	(1,111)	-	-	(1,111)
<b>Equity at the end of the year</b>		<b>16,670</b>	<b>(5,344)</b>	<b>-</b>	<b>11,326</b>
<b>Period ended 31 March 2007</b>					
<i>Parent</i>					
Balance at 31 March 2006		-	-	-	-
Income & expense recognised directly in equity		-	-	-	-
Net profit/(loss) after tax		-	(1,049)	-	(1,049)
Total recognised income & expense		-	(1,049)	-	(1,049)
Issue of ordinary shares		2,800	-	-	2,800
Cost of issue		(19)	-	-	(19)
<b>Equity at the end of the period</b>		<b>2,781</b>	<b>(1,049)</b>	<b>-</b>	<b>1,732</b>

The accompanying notes form an integral part of these financial statements



XERO LIMITED – BALANCE SHEET – AS AT 31 MARCH 2008

	Notes	Group 31 March 2008 (\$000s)	Parent 31 March 2008 (\$000s)	Parent 31 March 2007 (\$000s)
<b>Assets</b>				
<i>Non-current assets</i>				
Property, plant & equipment	7	472	460	286
Intangible assets	8	1,065	1,065	39
Other non-current assets	9	387	387	-
<b>Total non-current assets</b>		<b>1,924</b>	<b>1,912</b>	<b>325</b>
<i>Current assets</i>				
Cash & cash equivalents		9,517	9,471	1,514
Current tax receivable	4	210	210	2
Trade receivables & other assets	9	228	167	165
<b>Total current assets</b>		<b>9,955</b>	<b>9,848</b>	<b>1,681</b>
<b>Total assets</b>		<b>11,879</b>	<b>11,760</b>	<b>2,006</b>
<b>Liabilities</b>				
<i>Current liabilities</i>				
Trade payables & other liabilities	10	532	408	243
Finance lease	11	6	6	4
<b>Total current liabilities</b>		<b>538</b>	<b>414</b>	<b>247</b>
<i>Non-current liabilities</i>				
Finance lease	11	20	20	27
<b>Total non-current liabilities</b>		<b>20</b>	<b>20</b>	<b>27</b>
<b>Total liabilities</b>		<b>558</b>	<b>434</b>	<b>274</b>
<b>Net assets</b>		<b>11,321</b>	<b>11,326</b>	<b>1,732</b>
<b>Equity</b>				
Share capital	5	16,670	16,670	2,781
Retained earnings		(5,359)	(5,344)	(1,049)
Foreign currency translation reserve	5	10	-	-
		<b>11,321</b>	<b>11,326</b>	<b>1,732</b>

The accompanying notes form an integral part of these financial statements

XERO LIMITED – STATEMENT OF CASH FLOWS – FOR THE YEAR ENDED 31 MARCH 2008

Notes	Group 31 March 2008 (\$000s)	Parent 31 March 2008 (\$000s)	Parent 31 March 2007 (\$000s)
<b>Operating activities</b>			
<i>Cash was provided from</i>			
Receipts from customers	130	125	-
GST received	202	195	-
Interest received & other income	975	1,017	97
	1,307	1,337	97
<i>Cash was applied to</i>			
Payments to suppliers & employees	(4,947)	(5,036)	(1,033)
Income tax paid (RWT)	(235)	(235)	(17)
	(5,182)	(5,271)	(1,050)
<b>Net cash flows from operating activities</b>	<b>(3,875)</b>	<b>(3,934)</b>	<b>(953)</b>
2			
<b>Investing activities</b>			
<i>Cash was applied to</i>			
Purchase of property, plant & equipment	(330)	(317)	(275)
Capitalised development costs	(1,215)	(1,215)	-
Intangible assets	(19)	(19)	-
Loans to directors	(300)	(300)	-
Other assets	(75)	(75)	(39)
<b>Net cash flows from investing activities</b>	<b>(1,939)</b>	<b>(1,926)</b>	<b>(314)</b>
<b>Financing activities</b>			
<i>Cash was provided from</i>			
Issue of ordinary shares	15,000	15,000	2,800
	15,000	15,000	2,800
<i>Cash was applied to</i>			
Cost of share issue	(1,111)	(1,111)	(19)
Finance lease repayments	(5)	(5)	-
	(1,116)	(1,116)	(19)
<b>Net cash flows from financing activities</b>	<b>13,884</b>	<b>13,884</b>	<b>2,781</b>
<b>Net increase (decrease) in cash held</b>	<b>8,070</b>	<b>8,024</b>	<b>1,514</b>
Foreign currency translation adjustment	(67)	(67)	-
Cash & cash equivalents at beginning of the year	1,514	1,514	-
<b>Cash &amp; cash equivalents at end of year</b>	<b>9,517</b>	<b>9,471</b>	<b>1,514</b>

The accompanying notes form an integral part of these financial statements

## Notes to the financial statements

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) **Basis of preparation** The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice ("NZ GAAP"). 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. Compliance with NZ IFRS ensures that the financial statements also 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 Parent and Group are profit-oriented companies for financial reporting purposes.

The consolidated financial statements have been prepared on the historical cost basis except for financial instruments which have been measured at fair value.

Prior year comparatives have been reclassified where appropriate to comply with the current year's presentation.

The preparation of financial statements require management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

In particular, information about significant areas of uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in the following notes:

Note 4 – Utilisation of tax losses

Note 8 – Intangible assets: development expenditure

(b) **Basis of consolidation** Subsidiaries are the entities controlled, directly or indirectly by Xero Limited. The consolidated financial statements are prepared from the accounts of the Parent and its subsidiaries using the purchase method of consolidation from the date on which control is transferred to the Group. The effects of all intercompany transactions are eliminated on consolidation.

(c) **Revenue** Revenue 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 exclusive of GST. 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 based on the monthly licence fees as outlined in the licence agreement.

**Interest** – Revenue is recognised as the interest accrues.

**Rental income** – Rental income arising on subleased properties is accounted for on a straight-line basis over the lease term.

(d) **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 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 balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

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

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 benefit will be realised.

(e) **GST** Revenues, expenses and assets are recognised net of the amount of GST (or similar overseas tax) except where the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the Balance Sheet.

Cash flows are included in the Cash Flow Statement on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority are classified as operating cash flows.

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

(f) **Foreign currency translation** These financial statements are presented in New Zealand dollars (\$), which is the Group's functional and presentation currency. All financial information is presented in New Zealand dollars and has been rounded to the nearest thousand dollar.

Transactions denominated in foreign currencies are recorded at the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the balance date closing rate. Exchange variations arising from these translations are recognised in the Income Statement, except where they relate to investment in foreign operations. Exchange variations on monetary assets and liabilities that relate to investments in foreign operations are recognised in the Foreign Currency Translation Reserve.

The functional currency of overseas subsidiaries is the currency used in the country in which they are based. The assets and liabilities of overseas foreign operations are translated at the balance date closing rate. Revenue and expense items are translated at the spot rate at the transaction date or a rate approximating that rate. Foreign currency exchange differences are recognised in the Foreign Currency Translation Reserve.

**(g) Property, plant & equipment** Property, plant and equipment is stated at cost less accumulated depreciation and any impairment in value.

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

<i>Leasehold improvements</i>	<i>Terms of lease</i>
Motor vehicles	3 - 4 years
Fixtures & fittings	1 - 7 years
Computer equipment	2 - 3 years

The assets' residual value 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 amount and are taken to the Income Statement.

#### **(h) Intangible assets**

(I) Research and development costs are expensed as incurred.

Costs associated with developing or maintaining internal computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Costs include the software development employee costs and an appropriate portion of relevant overheads. Any expenditure so capitalised is amortised over the period of expected benefit from the related project and taken to the Income Statement.

(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 the useful life and tested for impairment whenever there is indication that the asset may be impaired.

(III) Amortisation is recognised in the Income Statement on a straight line basis over the estimated useful lives of the intangible assets, from the date they are available for use.

The estimated useful lives are:

Trademarks / patents	10 years
Domains	10 years
Capitalised development costs	3 - 4 years

Where estimated useful lives or recoverable values have been diminished due to technological change or market conditions, amortisation is accelerated or the carrying value is impaired.

**(i) Impairment** 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. Individual assets are generally not independent of those in a group and the recoverable amount is calculated on the cash generating unit to which the asset belongs.

**(j) Non-derivative financial instruments** Non-derivative financial instruments comprise, trade and other receivables, cash and cash equivalents, and trade and other payables.

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control of substantially all risks and rewards of the asset. Regular purchases and sales of financial assets are accounted for at trade date, i.e. the date the Group commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

Non-derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition non-derivative financial instruments are measured as described below:

(I) Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts.

(II) Trade and other receivables are stated at their estimated realisable values after writing off bad debts and making suitable provisions for doubtful debts. Bad debts are written off when identified.

(III) Trade and other payables are carried at cost. 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.

(IV) Revenue in Advance represents amounts where clients have been invoiced ahead of rendering of services.

**(k) 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.

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

**(l) 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 item, are capitalised at the inception of the lease at the fair value of the leased property 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.

**(m) Government grants** Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

**(n) Earnings per share** The Group presents basic 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 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 of convertible notes and share options granted to employees.

**(o) Standards or interpretations issued but not yet effective** NZ IFRS 8 Operating Segments was approved by the Accounting Standards Review Board in December 2006 and is applicable for accounting periods beginning on or after 1 January 2009, although early adoption is encouraged. The standard requires additional disclosures about the Group's operating segments and is not expected to have a material impact on the Group's financial statements. The Group has not yet determined whether it will be an early adopter of the standard and these financial statements do not include any adjustments for this standard. NZ IAS 1 amendments require certain additional disclosures, including a Statement of Comprehensive Income. This will result in revised disclosure.

## 2. RECONCILIATION OF OPERATING CASH FLOWS

	<b>Group</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2007 (\$000s)
<i>Reconciliation from the net profit/(loss) after tax to the net cash flows from operation</i>			
Net profit/(loss) after tax	(4,310)	(4,295)	(1,049)
<i>Adjustments</i>			
Depreciation	134	133	20
Amortisation	208	208	-
Net (profit)/loss on disposal of property, plant & equipment	10	10	-
Unrealised foreign currency (gains)/losses	67	67	-
Translation of foreign operations	10	-	-
Interest on loans to directors	(12)	(12)	-
<i>Changes in working capital items</i>			
(Increase)/decrease in trade receivables & prepayments	(63)	(14)	(50)
(Decrease)/increase in trade payables & accruals	196	102	209
(Increase)/decrease in GST receivable	(82)	(70)	(33)
(Increase)/decrease in current tax receivable	(208)	(208)	(2)
(Decrease)/increase in employee entitlements	59	59	34
(Decrease)/increase in income in advance	34	4	-
Issue costs	82	82	(82)
<b>Net cash from operating activities</b>	<b>(3,875)</b>	<b>(3,934)</b>	<b>(953)</b>

### 3. REVENUES AND EXPENSES

	<b>Group</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2007 (\$000s)
<b>Operating revenue</b>	<b>134</b>	<b>162</b>	<b>10</b>
<i>Other income</i>			
Government grants	216	216	89
Rent received	39	39	16
	255	255	105
<b>Total revenue</b>	<b>389</b>	<b>417</b>	<b>115</b>
<i>Operating expenses</i>			
Audit fees	24	24	-
Employee entitlements	2,187	2,090	813
Lease/rental costs	238	237	-
Directors' fees & expenses	171	171	-
Research expenditure charged directly to expenses in the income statement	533	533	-
Loss/(profit) on disposal of property, plant & equipment	10	10	-
Loss/(profit) on foreign exchange transactions - unrealised	67	67	-
Other operating expenses	1,916	2,033	336
<b>Total operating expenses</b>	<b>5,146</b>	<b>5,165</b>	<b>1,149</b>
<i>Depreciation &amp; amortisation expense</i>			
Property, plant & equipment	124	123	20
Finance lease - office equipment	10	10	-
Amortisation of intangibles	6	6	-
Amortisation of development costs	202	202	-
<b>Total depreciation &amp; amortisation</b>	<b>342</b>	<b>341</b>	<b>20</b>
<i>Net interest income</i>			
Interest income - bank	781	780	5
Interest income - loan to related party	12	12	-
Interest income - loan to subsidiaries	-	6	-
Interest expense - finance charges payable under finance lease	(4)	(4)	-
<b>Net interest income</b>	<b>789</b>	<b>794</b>	<b>5</b>
<b>Net profit/(loss) before tax</b>	<b>(4,310)</b>	<b>(4,295)</b>	<b>(1,049)</b>

#### 4. INCOME TAX

**Income tax expense reported in income statement** A reconciliation of income tax expense applicable to accounting profit/(loss) before income tax at the statutory income tax rate to income tax expense at the Company's effective income tax rate for the year ended 31 March 2008 is as follows:

	<b>Group</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2007 (\$000s)
Accounting profit/(loss) before income tax	(4,310)	(4,295)	(1,049)
At the statutory income tax rate of 33%	(1,422)	(1,417)	(346)
Non-deductible expenditure due to temporary differences	72	71	47
Total tax losses not recognised	1,350	1,346	299
<b>Income tax expense reported in income statement</b>	-	-	-
Resident withholding tax paid	236	236	2
Resident withholding tax refunded	(26)	(26)	-
<b>Current tax receivable</b>	<b>210</b>	<b>210</b>	<b>2</b>

The Company has New Zealand tax losses available to carry forward of \$4,987,000 subject to shareholder continuity being maintained as required by New Zealand tax legislation.

The Company has not recognised the tax losses in terms of a deferred tax asset as outlined in Note 1 Summary of Significant Accounting Policies.

#### Imputation credit account

	<b>Group</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2007 (\$000s)
Balance as at 1 April 2007	2	2	0
Imputation credits attached to dividends received during the year	-	-	-
Imputation credits attached to dividends paid during the year	-	-	-
New Zealand Income Tax payments during the year	236	236	2
Tax refunds received	(28)	(28)	-
<b>Balance at end of the year</b>	<b>210</b>	<b>210</b>	<b>2</b>

#### 5. SHARE CAPITAL

	<b>Group</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2007 (\$000s)
Balance as at 1 April 2007	2,781	2,781	-
Issue of ordinary shares	15,000	15,000	2,800
Cost of issue	(1,111)	(1,111)	(19)
	<b>16,670</b>	<b>16,670</b>	<b>2,781</b>

On 15 May 2007 a share subdivision took place where existing shareholders received 23.2 shares for every one ordinary share held at that date. On 1 June 2007 a further 15,000,000 shares were issued through IPO.

Included within the value of share capital are transaction costs associated with the issue of ordinary shares of \$15 million.

These transaction costs were directly associated with the equity transactions and accordingly have been accounted for as a deduction from Equity. Included within these costs were \$22,767 paid to the Group auditors for due diligence & audit services.



Movement in ordinary shares on issue

	Group 31 March 2008 (000s)	Parent 31 March 2008 (000s)	Parent 31 March 2007 (000s)
Balance as at 1 April 2007	1,724	1,724	-
Issue of shares on incorporation	-	-	1,500
Additional shares issued	-	-	224
Share split at listing	38,276	38,276	-
Issue on IPO listing	15,000	15,000	-
<b>Ordinary shares on issue at 31 March 2008</b>	<b>55,000</b>	<b>55,000</b>	<b>1,724</b>

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

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All shares rank equally with regard to the Company's residual assets.

Foreign currency translation reserve

	Group 31 March 2008 (\$000s)
Balance as at 31 March 2007	-
Revaluation reserve for year	10
<b>Balance as at 31 March 2008</b>	<b>10</b>

6. EARNINGS PER SHARE

Profit attributable to ordinary shareholders:

	Notes	Group 31 March 2008 (000s)	Parent 31 March 2008 (000s)	Parent 31 March 2007 (000s)
Net profit/(loss) after tax		(\$4,310)	(\$4,295)	(\$1,049)
Issued ordinary shares	5	55,000	55,000	1,724
Basic earnings per share		(\$0.08)	(\$0.08)	(\$0.61)
Diluted earnings per share		(\$0.08)	(\$0.08)	(\$0.61)

## 7. PROPERTY, PLANT & EQUIPMENT

	Leasehold improvements (\$000s)	Motor vehicles (\$000s)	Computer equipment (\$000s)	Furniture and equipment (\$000s)	Total (\$000s)
<b>Group - Year ended 31 March 2008</b>					
<i>Cost</i>					
Balance as at 1 April 2007	202	-	36	68	306
Additions	32	60	163	75	330
Reclassification	(2)	-	27	(25)	-
Disposals	-	-	(15)	-	(15)
<b>Balance as at 31 March 2008</b>	<b>232</b>	<b>60</b>	<b>211</b>	<b>118</b>	<b>621</b>
<i>Depreciation</i>					
Accumulated depreciation	4	-	7	9	20
Depreciation expense	39	8	70	17	134
Disposals	-	-	(5)	-	(5)
<b>Balance as at 31 March 2008</b>	<b>43</b>	<b>8</b>	<b>72</b>	<b>26</b>	<b>149</b>
<b>Net carrying amount</b>	<b>189</b>	<b>52</b>	<b>139</b>	<b>92</b>	<b>472</b>
<b>Parent - Year ended 31 March 2008</b>					
<i>Cost</i>					
Balance as at 1 April 2007	202	-	36	68	306
Additions	32	60	150	75	317
Reclassification	(2)	-	27	(25)	-
Disposals	-	-	(15)	-	(15)
<b>Balance as at 31 March 2008</b>	<b>232</b>	<b>60</b>	<b>198</b>	<b>118</b>	<b>608</b>
<i>Depreciation</i>					
Accumulated depreciation	4	-	7	9	20
Depreciation expense	39	8	69	17	133
Disposals	-	-	(5)	-	(5)
<b>Balance as at 31 March 2008</b>	<b>43</b>	<b>8</b>	<b>71</b>	<b>26</b>	<b>148</b>
<b>Net carrying amount</b>	<b>189</b>	<b>52</b>	<b>127</b>	<b>92</b>	<b>460</b>
<b>Parent - Period ended 31 March 2007</b>					
<i>Cost</i>					
Additions	202	-	36	68	306
<i>Depreciation</i>					
Depreciation expense	4	-	7	9	20
<b>Net carrying amount</b>	<b>198</b>	<b>-</b>	<b>29</b>	<b>59</b>	<b>286</b>

**Change in calculation basis** For the year ended 31 March 2008 depreciation rates have been adjusted to reflect the useful economic life of the asset. For the year ended 31 March 2007 tax based rates were used on a diminishing value basis. The effect of this change in the year under review is less than \$1,000, and is estimated to not be material in future years.

## 8. INTANGIBLE ASSETS

	Patents & trademarks (\$000s)	Research & development* (\$000s)	Domains (\$000s)	TOTAL (\$000s)
<b>Group &amp; Parent - Year ended 31 March 2008</b>				
<i>Cost</i>				
Balance as at 1 April 2007	8	-	31	39
Additions	9	1,215	10	1,234
Disposals	-	-	-	-
<b>Balance as at 31 March 2008</b>	<b>17</b>	<b>1,215</b>	<b>41</b>	<b>1,273</b>
<i>Amortisation &amp; impairment</i>				
Balance as at 1 April 2007	-	-	-	-
Amortisation during year	1	202	5	208
<b>Balance as at 31 March 2008</b>	<b>1</b>	<b>202</b>	<b>5</b>	<b>208</b>
<b>Net carrying amount</b>	<b>16</b>	<b>1,013</b>	<b>36</b>	<b>1,065</b>
<b>Parent - Period ended 31 March 2007</b>				
<i>Cost</i>				
Additions	8	-	31	39
<i>Amortisation &amp; impairment</i>				
Amortisation during year	-	-	-	-
<b>Net carrying amount</b>	<b>8</b>	<b>-</b>	<b>31</b>	<b>39</b>

\*Research & Development has been internally generated

## 9. TRADE RECEIVABLES & OTHER ASSETS

	Notes	Group 31 March 2008 (\$000s)	Parent 31 March 2008 (\$000s)	Parent 31 March 2007 (\$000s)
<i>Current assets</i>				
Trade receivables		51	15	11
Trade receivables from related parties	15	-	-	10
Non-trade receivables		-	-	5
Interest receivable		27	26	-
Prepayments/deposits		35	23	24
GST receivable		115	103	33
Issue costs		-	-	82
		<b>228</b>	<b>167</b>	<b>165</b>
<i>Non-current assets</i>				
Loans to Directors - non-current	15	312	312	-
NZX Bond		75	75	-
		<b>387</b>	<b>387</b>	<b>-</b>
		<b>615</b>	<b>554</b>	<b>165</b>

## 10. TRADE PAYABLES & OTHER LIABILITIES

Notes	Group 31 March 2008 (\$000s)	Parent 31 March 2008 (\$000s)	Parent 31 March 2007 (\$000s)
Trade payables	227	185	155
Trade payables due to related parties	15	1	6
Other payables & accrued expenses	177	120	41
	<b>405</b>	<b>311</b>	<b>209</b>
Income in advance	34	4	-
Employee entitlements arising through the year	93	93	34
	<b>532</b>	<b>408</b>	<b>243</b>

## 11. FINANCE LEASE

[Finance lease liability](#) Present value of minimum lease payments

	Minimum payments (\$000s)	Lease interest (\$000s)	Principal (\$000s)
<b>For the year ended 31 March 2008</b>			
<b>Group &amp; Parent</b>			
Less than 1 year	8	2	6
Between 1 and 5 years	24	4	20
	<b>32</b>	<b>6</b>	<b>26</b>
<b>For the period ended 31 March 2007</b>			
<b>Parent</b>			
Less than 1 year	8	4	4
Between 1 and 5 years	33	6	27
	<b>41</b>	<b>10</b>	<b>31</b>

## 12. AUDITORS' REMUNERATION

	Group 31 March 2008 (\$000s)	Parent 31 March 2008 (\$000s)	Parent 31 March 2007 (\$000s)
<i>Amounts received or due &amp; receivable by BDO Spicers for:</i>			
Audit of financial statements	24	24	8
IPO prospectus work	23	23	-
Other services in relation to the entity	-	-	3

IPO Prospectus work included audit or review of the financial information included. These costs were offset against the capital raised, as per Note 5 – Share capital.

Other audit related services include services for the audit or review of financial information other than financial reports other audits required for local regulatory purposes.

### 13. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES

**Financial instruments** Financial instruments recognised in the Balance Sheet include cash balances, receivables, payables and finance leases. 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.

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** Interest rate risk is the risk that the value of the Group's assets and liabilities will fluctuate due to changes in market interest rates. The Group is exposed to interest rate risk primarily through cash balances. The Group does not enter into forward rate agreements or any interest rate hedges.

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

	Interest rate (\$000s)	Balance Sheet (\$000s)	12 months (\$000s)	24 months (\$000s)	>24 months (\$000s)
<b>Year ended 31 March 2008</b>					
<b>Group</b>					
<i>Financial assets</i>					
Cash at bank	8.45%	9,517	9,517	-	-
Loans to Directors	4.00%	312	-	-	312
<b>Total</b>		<b>9,829</b>	<b>9,517</b>	<b>-</b>	<b>312</b>
<i>Financial liabilities</i>					
Finance lease	12.67%	26	6	7	13
<b>Total</b>		<b>26</b>	<b>6</b>	<b>7</b>	<b>13</b>
<b>Parent</b>					
<i>Financial assets</i>					
Cash at bank	8.45%	9,471	9,471	-	-
Loans to Directors	4.00%	312	-	-	312
<b>Total</b>		<b>9,783</b>	<b>9,471</b>	<b>-</b>	<b>312</b>
<i>Financial liabilities</i>					
Finance lease	12.67%	26	6	7	13
Loans to subsidiaries	7.00%	5	5	5	-
<b>Total</b>		<b>31</b>	<b>11</b>	<b>12</b>	<b>13</b>
<b>Period ended 31 March 2007</b>					
<b>Parent</b>					
<i>Financial assets</i>					
Cash at bank	1.55%	1,514	1,514	-	-
<b>Total</b>		<b>1,514</b>	<b>1,514</b>	<b>-</b>	<b>-</b>
<i>Financial liabilities</i>					
Finance lease	12.67%	31	5	6	20
<b>Total</b>		<b>31</b>	<b>5</b>	<b>6</b>	<b>20</b>

Of the financial assets and liabilities above only the Cash at Bank is subject to floating interest rate risk. Loans to Directors and Finance lease liability are subject to fixed rate interest risk. All other financial assets and liabilities of the Group are not subject to interest rate risk.

As at 31 March 2008 if interest rates had been 0.5% higher or lower with all other variables held constant, interest income, net loss and retained earnings for the Group would have changed by less than \$100,000 (2007: <\$100,000).

**Liquidity risk** The Group is an early stage technology business. Through the Parent Company, the Group raised sufficient cash from its public offering in May 2007 to operate debt free for at least two years. At the time, the Directors indicated that they didn't expect the Group to be profitable for at least three years, a view they still hold. Management of the Group's liquidity risk is therefore focused primarily on generating sufficient revenue from sales to cover the ongoing costs of operation. In addition, the Group is exploring the options of seeking additional funding to maintain and/or expand its business should it be required.

The following table sets out the contractual cash flows for all financial liabilities and for derivatives that are settled on a gross cash flow basis.

	Balance Sheet (\$000s)	Contractual cash flows (\$000s)	6 months or less (\$000s)	6-12 months (\$000s)	1-2 years (\$000s)	2-5 years (\$000s)	More than 5 years (\$000s)
<b>Year ended 31 March 2008</b>							
<b>Group</b>							
Finance lease	26	33	4	4	9	16	-
Trade payables	405	405	405	-	-	-	-
<b>Total non-derivative liabilities</b>	<b>431</b>	<b>438</b>	<b>409</b>	<b>4</b>	<b>9</b>	<b>16</b>	<b>-</b>
<b>Parent</b>							
Finance lease	26	33	4	4	9	16	-
Trade payables	311	311	311	-	-	-	-
<b>Total non-derivative liabilities</b>	<b>337</b>	<b>344</b>	<b>315</b>	<b>4</b>	<b>9</b>	<b>16</b>	<b>-</b>
<b>Period ended 31 March 2007</b>							
<b>Parent</b>							
Finance lease	31	41	4	4	8	25	-
Trade payables	209	209	209	-	-	-	-
<b>Total non-derivative liabilities</b>	<b>240</b>	<b>250</b>	<b>213</b>	<b>4</b>	<b>8</b>	<b>25</b>	<b>-</b>

**Credit risk** To the extent that 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 which 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 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. 72% of current receivables are refunds of GST and Resident Withholding Tax due from respective tax authorities in New Zealand and the United Kingdom.

**Maximum exposure to credit risk at balance date**

	Group 31 March 2008 (\$000s)	Parent 31 March 2008 (\$000s)	Parent 31 March 2007 (\$000s)
Cash & cash equivalents	9,517	9,471	1,514
Receivables	438	377	167
Non-current receivables	387	387	-
	<b>10,342</b>	<b>10,235</b>	<b>1,681</b>

**Fair value** The fair value of each class of financial assets and financial liabilities has been recognised as the carrying value.

**Foreign currency risk** The Group faces the risk of movements in foreign currency exchange rates against the New Zealand dollar. The Group's only foreign operating subsidiary is in the United Kingdom. As a result the Group's Income Statement and Balance Sheet can be affected by movements in exchange rates.

The United Kingdom 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 revenue in the United Kingdom.

The United Kingdom revenues, losses, assets and liabilities are exposed to exchange rate fluctuations in the value of the New Zealand dollar relative to the UK pound. As at 31 March 2008, if the New Zealand dollar had strengthened or weakened by 5% against the UK pound with all other variables remaining constant, the net loss and retained earnings for the Group would have changed by less than \$10,000 (2007: <\$10,000).

**Classification & fair values** Set out below is a comparison by category of carrying amounts of all the Group's financial instruments that are carried in the financial statements at other than fair value through profit or loss.

	Loans & receivables (\$000s)	At amortised cost (\$000s)	Total carrying value (\$000s)	Fair value (\$000s)
<b>Year ended 31 March 2008</b>				
<i>Assets</i>				
Trade receivables & other assets	228		228	228
Cash & cash equivalents	9,517		9,517	9,517
Loans to Directors	312		312	312
NZX Bond	75		75	75
<b>Total assets</b>	<b>10,132</b>	<b>-</b>	<b>10,132</b>	<b>10,132</b>
<i>Liabilities</i>				
Finance lease – current	-	20	20	20
Finance lease – non-current	-	6	6	6
Trade payables & other liabilities	-	405	405	405
<b>Total liabilities</b>	<b>-</b>	<b>431</b>	<b>431</b>	<b>431</b>
<b>Period ended 31 March 2007</b>				
<i>Assets</i>				
Trade receivables & other assets	165		165	165
Cash & cash equivalents	1,514		1,514	1,514
<b>Total assets</b>	<b>1,679</b>	<b>-</b>	<b>1,679</b>	<b>1,679</b>
<i>Liabilities</i>				
Finance lease – current		27	27	27
Finance lease – non-current		4	4	4
Trade payables & other liabilities		209	209	209
<b>Total liabilities</b>	<b>-</b>	<b>240</b>	<b>240</b>	<b>240</b>

#### 14. SEGMENT INFORMATION

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

The primary format is geographical segments, based on the Group's Management and internal reporting structure.

Inter-segment pricing is determined on an arm's length basis.

For the period ended 31 March 2007 there was only one segment - New Zealand.

For the year ended 31 March 2008 there were two segments - New Zealand and United Kingdom.

	New Zealand (\$000s)	United Kingdom (\$000s)	Total (\$000s)
<b>For the year ended 31 March 2008</b>			
<b>Group</b>			
Total segment revenue	162	336	498
Inter-segment revenue	32	332	364
Revenue from external customers	130	4	134
Adjusted EBITDA	(4,295)	(15)	(4,310)
Depreciation & amortisation	(341)	(1)	(342)
Segment assets	11,760	119	11,879
Segment liabilities	434	124	558
Capital expenditure	1,551	13	1,564
<b>For the period ended 31 March 2007</b>			
<b>Parent</b>			
Total segment revenue	10		10
Revenue from external customers	10		10
Adjusted EBITDA	(1,049)		(1,049)
Depreciation & amortisation	(20)		(20)
Segment assets	2,006		2,006
Segment liabilities	274		274
Capital expenditure	306		306

**Business segments** The Group currently operates in one business segment, providing an online accounting solution for small and medium sized enterprises (SMEs).



## 15. RELATED PARTIES

### Xero Live Limited (UK)

	Group 31 March 2008 (\$000s)	Parent 31 March 2008 (\$000s)
Operating revenue/(expense)	-	(300)
Interest income	-	6
Due to subsidiary	-	(5)

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. None of the balances are secured.

### Loans to Directors

	Loan 31 March 2008 (\$000s)	Interest payable 31 March 2008 (\$000s)	Balance outstanding 31 March 2008 (\$000s)	Balance outstanding 31 March 2007 (\$000s)
Guy Haddleton	100	4	104	-
Phil Norman	100	4	104	-
Graham Shaw	100	4	104	-
	<b>300</b>	<b>12</b>	<b>312</b>	<b>-</b>

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%, with the loans and interest being repayable 5 years after the date of issue.

### Other related parties

	Notes	Transaction value for year 2008 (\$000s)	Transaction value for period 2007 (\$000s)	Balance outstanding 31 March 2008 (\$000s)	Balance outstanding 31 March 2007 (\$000s)
Rod Drury - Share capital (called but unpaid)	(i)	-	4	-	4
Hamish Edwards - Openside CA Limited	(ii)	25	18	-	6
<b>Trade receivables from related parties</b>		<b>25</b>	<b>22</b>	<b>-</b>	<b>10</b>
Hamish Edwards - Openside CA Limited	(iii)	58	54	1	13
<b>Trade payables due to related parties</b>		<b>58</b>	<b>54</b>	<b>1</b>	<b>13</b>

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. None of the balances are secured.

(i) The Company called the capital issued on incorporation.

(ii) The Company entered into a sublease agreement with Openside CA Limited, of which Hamish Edwards is a director and holds a voting interest of 67%. Amounts were based on normal market rates for office space and are receivable under normal payment terms.

(iii) The Company also used accounting services of Openside CA Limited.

**Key management personnel remuneration** NZ IFRS also requires disclosure of remuneration paid to key management personnel of the Group. 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, including any Directors. The following table summarises remuneration paid to key management personnel.

	31 March 2008 (\$000s)	31 March 2007 (\$000s)
Short-term employee benefits	924	152

## 16. COMMITMENTS & CONTINGENCIES

There are no capital commitments or contingent liabilities as at 31 March 2008 (2007 Nil).

## 17. OPERATING LEASE COMMITMENTS

	<b>Group</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2008 (\$000s)	<b>Parent</b> 31 March 2007 (\$000s)
Within one year	391	391	177
After one year but not more than five years	1,065	1,065	709
More than five years	-	-	133
	<b>1,456</b>	<b>1,456</b>	<b>1,019</b>

## 18. GROUP ENTITIES

During the year the Company took control of two shell companies, Xero Live Limited and Xero Live Pty Limited, for a nominal value. All of the subsidiaries of the Company have a 31 March balance date.

### Subsidiaries

	<b>Country of incorporation</b>	<b>Interest 2008 (%)</b>	<b>Interest 2007 (%)</b>
Xero Live Limited	United Kingdom	100	-
Xero Live Pty Limited*	Australia	100	-
Xero Trustee Limited**	New Zealand	48	-

\* Xero Live Pty Limited did not trade in the year ended 31 March 2008

\*\* Xero Trustee Limited was incorporated on 1 May 2008 and is the trustee for the Xero Limited Employee Restricted Share Plan

## 19. EVENTS AFTER THE BALANCE SHEET DATE

The Company changed its name to Xero Limited on 30 April 2008.

Subsequent to year end the Company has established the Xero Limited Employee Restricted Share Plan and:

- On 1 May 2008 Xero Trustee Limited was incorporated to act as Trustee for the plan, but has not traded.
- On 5 May 2008 the Company filed a prospectus for registration in respect of the issue of shares.

### Auditors' report

**To the Shareholders of Xero Limited** We have audited the financial statements on pages 5 to 24. The financial statements provide information about the past financial performance of the Company and Group and their financial position as at 31 March 2008. This information is stated in accordance with the accounting policies set out on pages 9 to 11.

**Board of Directors' Responsibilities** The Directors are responsible for the preparation of financial statements which give a true and fair view of the financial position of the Company and Group as at 31 March 2008 and the results of its operations and cash flows for the year ended on that date.

**Auditors' Responsibilities** It is our responsibility to express an independent opinion on the financial statements presented by the Directors.

**Basis of Opinion** An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgements made by the Directors in the preparation of the financial statements, and
- whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with New Zealand Auditing Standards. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Other than in our capacity as auditor we have no relationship with, or interests in, the Company or Group.

**Unqualified Audit Opinion** We have obtained all the information and explanations we have required.

In our opinion:

- proper accounting records have been kept by the Company and Group as far as appears from our examination of those records; and
- the financial statements on pages 5 to 24:
  - comply with generally accepted accounting practice in New Zealand; and
  - give a true and fair view of the financial position of the Company and Group as at 31 March 2008 and the results of its operations and cash flows for the year ended on that date.

Our audit was completed on 13 May 2008 and our unqualified opinion is expressed as at that date.



**BDO Spicers Wellington**  
Chartered Accountants  
Wellington, New Zealand

## Corporate governance

**The role of the Board** The Board of Directors is elected by shareholders to govern in their interests. The Board is the overall and final body responsible for all decision-making within the Company. The Board Charter, which is on the Xero website, describes the Board's role and responsibilities and regulates internal Board procedure.

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 Officer. The terms of the delegation by the Board to the Chief Executive Officer are clearly documented.

**Membership, size and composition** The Board is comprised of six Directors, being a Non-executive Chairman, two Executive Directors, and three Non-executive Directors. The Board has the broad range of IT, financial, sales, business and other skills and expertise necessary to meet its objectives.

**Selection and 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 Officer. 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 Officer.

**Director independence** The Board Charter requires that a majority of Directors be "independent".

As required by the NZX listing rules, the Company'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 NZX listing rules provide guidance as to the types of relationships which 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 the Company. 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 relationship.

The Board considers that Guy Haddleton, Phil Norman, Graham Shaw and Sam Morgan were independent and that Rod Drury and Hamish Edwards were not independent by virtue of their executive responsibilities.

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

**Nominations and 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 candidates to act as Director, the Board takes into account such factors as it deems appropriate, including the experience, qualifications, availability and judgement of a candidate and the candidate's ability to work with other Directors.

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

**Board Committees** The Board operated two Committees during the year, the Audit and Risk Management Committee and the Remuneration Committee. The Charters of each Committee are on the Xero website. The membership of each Committee is as follows:

Audit and Risk Management Committee – Graham Shaw (Chair), Sam Morgan, Phil Norman

Remuneration Committee – Phil Norman (Chair), Guy Haddleton, Graham Shaw

In May 2008 the Board established a Nominations Committee comprising the non-executive directors of the Board. A Charter for the Committee will be produced during the coming financial year.

**Retirement and 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 for the past year were \$180,000, in line with planned levels.

**Board access to information and advice** The Directors generally receive materials for Board meetings five days in advance, except in the case of special meetings for which the time period may be shorter due to the urgency of the matter to be considered. The 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 the Board meeting 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 has the right, subject to the approval of the Chairman, to seek independent professional advice at the Company'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 a Director.

**Directors' share ownership** All Directors and employees are required to comply with the Company's Insider Trading Policy and Guidelines, in undertaking any trading in the Company's shares.

Details of the Directors' shareholdings are included in the Disclosures sections 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 willful acts or omissions.

**Board meetings** Board meetings are held each month and additional meetings are held when necessary. At each meeting the Board considers items of key financial and operational information as well as matters of strategic importance.

Executives and other senior people 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 General Manager Finance 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 Officer is responsible for ensuring that high standards of conduct are maintained by all 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 during the year ended 31 March 2008.

**Directors' interests** As at 31 March 2008 the following Directors have made the following general disclosures in the Interests Register of Xero Limited.

<b>Rod Drury</b>	
<i>Entity</i>	<i>Relationship</i>
Rodanna Investments Limited	Director and shareholder
Plan HQ Limited	Director and shareholder
Infinitus 2007 Limited	Director and shareholder
Aranui Consulting Limited	Director and shareholder
<b>Hamish Edwards</b>	
<i>Entity</i>	<i>Relationship</i>
Grenadier Limited	Director and shareholder
Openside CA Limited	Director and shareholder
EAL Trustees Limited	Ceased to be a director
Virtual CFO Limited	Ceased to be a director
Compliance Plus Limited	Ceased to be a director
Eplus Limited	Ceased to be a director
<b>Guy Haddleton</b>	
<i>Entity</i>	<i>Relationship</i>
Ascadia Inc.	Director and shareholder
C2C Technologies LLC	Director and shareholder
<b>Sam Morgan</b>	
<i>Entity</i>	<i>Relationship</i>
Jasmine Investment Holdings Limited	Director and shareholder
Sonar Limited	Director and shareholder
Morgan Hayward Limited	Director and shareholder
iVistra	Director and shareholder
Victoria University Commerce Faculty Advisory Board	Director
TradeMe Advisory Board	Director
Autobase Limited	Ceased to be a director
Light Keyboard Limited	Ceased to be a director and shareholder
<b>Phil Norman</b>	
<i>Entity</i>	<i>Relationship</i>
Nortek Management Services Limited	Director and shareholder
Activedocs Limited	Shareholder
<b>Graham Shaw</b>	
<i>Entity</i>	<i>Relationship</i>
Corporate Concern Limited	Director and shareholder
Plants to You Limited	Director and shareholder
Solvam Corporation Limited	Chairman and shareholder
Downer EDI Limited	Ceased to be a shareholder

**Share dealings of Directors** The Directors disclosed the following transactions in Xero Limited shares in the year ended 31 March 2008.

	Date of acquisition	Consideration per share	Number of shares acquired
Guy Haddleton	1 June 2007	\$1.00	100,000
Sam Morgan	1 June 2007	\$1.00	1,000,000
Phil Norman	1 June 2007	\$1.00	100,000
Graham Shaw	1 June 2007	\$1.00	150,000

**Shareholdings of Directors** The Directors disclosed the following shareholdings in Xero Limited as at 31 March 2008

	Number of shares
Rod Drury	24,668,002
Hamish Edwards	6,960,000
Guy Haddleton*	300,007
Sam Morgan	1,800,006
Phil Norman*	499,968
Graham Shaw*	594,001

\*Unsecured loans were issued to these Directors during the year ended 31 March 2008 to purchase shares in Xero Limited at \$1.00 per share. Simple interest is accrued at a rate of 4% per annum, with the loans and interest being repayable 5 years after the date of issue.

**Remuneration of Directors** Details of the total remuneration and the value of other benefits received by each Director of Xero Limited during the year ended 31 March 2008 are as follows:

	Fees	Salary
Rod Drury*		213,000
Hamish Edwards*		191,000
Phil Norman**	60,000	
Guy Haddleton	40,000	
Sam Morgan	40,000	
Graham Shaw	40,000	

\*Mr Drury and Mr Edwards are Executive Directors and receive remuneration in the form of a salary.

\*\*Mr Norman was paid additional fees of \$16,000 for additional work associated with the initial public offering of Xero Limited in May 2007.

**Employee remuneration** The following table shows the number of employees (including employees holding office as Directors of Subsidiaries) whose remuneration and benefits are within the specified bands above \$100,000. The table below includes the remuneration of Mr Drury and Mr Edwards.

	Number of employees	Number of employees acting as Directors of Subsidiaries
100,000 - 109,999	6	
120,000 - 129,999	2	
140,000 - 149,999	1	
150,000 - 159,999	1	
190,000 - 199,999	1	1
200,000 - 209,999	1	
210,000 - 219,999	1	1
	13	2

Distribution of quoted security holders and security holdings as at 16 May 2008

	Number of holders	Number of shares	Percentage of issued capital (%)
1 to 1,000	195	176,738	0.32
1,001 to 5,000	612	2,119,987	3.82
5,001 to 10,000	254	2,208,633	3.98
10,001 to 100,000	169	4,855,979	8.76
100,001 and Over	35	46,099,356	83.12
<b>Total</b>	<b>1,265</b>	<b>55,460,693</b>	<b>100.00</b>

Twenty largest shareholders as at 16 May 2008

Holder name and rank	Holding	Percentage of total shares on issue (%)
1 Anna Stuck & Kenneth Drury (Rod Drury)	24,668,002	44.48
2 Hamish Edwards & Tineke Edwards & Andrew Finch	6,960,000	12.55
3 Jasmine Investment Holdings Limited (Sam Morgan)	1,800,006	3.25
4 Anna Grigg & Alastair Grigg & Claymore Trustees Limited	1,600,011	2.88
5 FNZ Custodians Limited	1,140,647	2.06
6 W5 Limited	1,000,006	1.80
7 Craig Walker & Catherine Walker	659,994	1.19
8 Anthony Bishop & Andrew Finch	599,998	1.08
9 Graham Shaw & Delwyn Shaw	594,001	1.07
10 David Edward Kirk	559,400	1.01
11 Hubbard Churcher Trust Management Limited	500,000	0.90
12 Sparkbox Limited	500,000	0.90
13 Phil Norman	499,991	0.90
14 Fletcher Brown & Karen Oakley-Harness	464,000	0.84
15 Philip Fierlinger & Hadley Fierlinger & Murray Haddon	464,000	0.84
16 Ed Robinson & Catherine Robinson	464,000	0.84
17 Shayne Patrick Hodge & Lynden Hodge & Nigel Munro Moody	461,591	0.83
18 Xero Trustee Limited	460,693	0.83
19 Guy Haddleton	300,007	0.54
20 Dagger Nominees Limited	250,000	0.45

**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 2008 in respect of the number of voting securities set opposite their names:

	Holding	Percentage of total shares on issue (%)
Anna Stuck & Kenneth Drury (Rod Drury)	24,668,002	44.48
Hamish Edwards & Tineke Edwards & Andrew Finch	6,960,000	12.55

The total number of issued voting securities of Xero Limited as at 16 May 2008 was 55,460,693.



#### **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 16 May 2008.

#### **SUBSIDIARY COMPANY DIRECTORS**

The following people held office as Directors of Subsidiary Companies as at 31 March 2008:

**Xero Live Limited (UK)** - Rod Drury, Hamish Edwards

**Xero Live Pty Limited (Australia)** - Rod Drury, Hamish Edwards, Karen Gambles

**Xero Trustee Limited** - Rod Drury, Graham Shaw (incorporated 1 May 2008)

#### **ANNUAL MEETING OF SHAREHOLDERS**

Xero Limited's Annual Meeting of shareholders will be held at the NZX Centre, Level 2, 11 Cable Street, Wellington on Thursday 24 July 2008 at 4pm.

A notice of Annual Meeting and Proxy Form has been circulated to shareholders.

## AWARDS

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### Microsoft New Zealand Partner Awards 2007

*Winner Overall Partner Solution of the Year Small Business*

*Winner Software Solution of the Year*

### Telecommunications Users Association of New Zealand (TUANZ) Innovation Awards 2007

*Winner Overall TUANZ Telecommunications Innovation of the Year Award*

*Winner TUANZ Commerce Award*

### Telecommunications Users Association of New Zealand (TUANZ) Business Internet Awards 2007

*Winner Software-as-a-Service Award*

### International Business Wales and Technium UK International Technium Challenge

*Winner 2007 International Technium Challenge*

### PricewaterhouseCoopers New Zealand Hi-Tech Awards 2007

*Winner NZX Entrepreneur of the Year Award, Rod Drury, Chief Executive, Xero*

*Winner Endace Young Achiever Award Craig Walker, Chief Technology Officer, Xero*

*Winner PR/Marketing Campaign Award*

### Designers' Institute of New Zealand Best Awards 2007

*Winner Graphic/Corporate Communication Silver Award*

### Business Awards for Enterprise & Excellence Wellington Region Gold Awards 2007

*Finalist Discovering Gold Award*

### Vero Excellence In Small Business Support Awards 2008

*Winner Business under \$5M turnover, one to many*

**Registered office:**

Level 1, Old Bank  
98 Customhouse Quay  
PO Box 24 537  
Wellington

Telephone: 04 819 4800  
Facsimile: 04 819 4801

**Website:**

[www.xero.com](http://www.xero.com)

**Directors:**

Rod Drury - Chief Executive Officer,  
Co-Founder

Hamish Edwards - UK Managing  
Director, Co-Founder

Guy Haddleton

Sam Morgan

Phil Norman - Chairman

Graham Shaw

**Management:**

Rod Drury - Chief Executive Officer,  
Co-Founder

Hamish Edwards - UK Managing  
Director, Co-Founder

Alastair Grigg - Chief Operating Officer

Vivian Morresey – General Manager  
Sales

Paul Williams – General Manager  
Finance

**Auditors:**

BDO Spicers

**Legal advisors:**

Bell Gully

Quigg Partners

**Company secretary:**

Linda Cox  
Corporate Navigator Limited

**Bankers:**

ASB Bank Limited

Bank of New Zealand Limited

HSBC Limited

**Share registrar:**

Link Market Services Limited  
Level 12, 120 Albert Street  
PO Box 91976  
Auckland 1030

Telephone: 09 375 5999

Facsimile: 09 375 5990



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