AARNet Pty Ltd Financial Report 2012

for the year ended 31 December 2012

ABN 54 084 540 518

Contents

Directors' report 31 December 2012

Your Directors present their report on the Company, AARNet Pty Limited ("AARNet"), for the year ended 31 December 2012.

The following persons were Directors of AARNet during the whole of the financial year and up to the date of this report:

Emeritus Professor GR Sutton AO (Chair of the Board and Chair of the Nomination and Remuneration Committee)

Professor MN Barber

Mr OJ Barrett (Deputy Chair of the Board and member of the Audit, Finance and Risk Committee)

Mr CM Hancock (Chief Executive Officer)

Professor L Kristjanson

Mr P Nikoletatos

Mr N Poole (member of the Nomination and Remuneration Committee)

Mr JF Rohan (Chair of the Audit, Finance and Risk Committee and member of the Nomination and Remuneration Committee)

Emeritus Professor MS Wainwright AM (member of the Audit, Finance and Risk Committee)

Professor IR Young AO

Mr P Campbell was a director from the beginning of the financial year until his resignation on 28 November 2012. Mr KBR Adams was a director from the beginning of the financial year until his resignation on 14 May 2012.

Dr I Tebbett was appointed a director on 14 May 2012 and continues in office at the date of this report.

Principal activities

AARNet is a not for profit, proprietary company in which 38 Australian universities and the Commonwealth Scientific and Industrial Research Organisation (CSIRO) have an equal shareholding. AARNet's principal activity is the provision of internet and advanced network services to its shareholders ("Members") and to other relevant organisations ("Customers"). Services are provided in accordance with the AARNet Access Policy in order that Members and Customers may:

(a) use AARNet's Internet and other telecommunications facilities and services to provide educational programs and conduct research activities in an efficient and cost effective manner; and

(b) collaborate with other parties (nationally and internationally) in furtherance of research and education objectives.

Other activities

In addition, AARNet:

(a) makes representations to all levels of government on policy, legislation and programs to improve the telecommunications facilities and services available to its Members and Customers;

(b) participates in the design and deployment of advanced network infrastructure, applications and services in partnership with network organisations in Australia and internationally, to develop national and global research and education networks; and

(c) facilitates the construction of connections (fibre tails) to the AARNet backbone for Members and Customers.

Dividends

AARNet's constitution prohibits the payment of dividends or other distributions to its shareholders. Accordingly, no dividends have been paid, declared or recommended either during the financial year or in the period since that year ended (2011: nil).

Review of operations

Network Performance

During the year AARNet's network services again provided high levels of performance and availability. In particular:

(a) the volume of traffic carried across the network increased by 49.8% (2011: 41.3%);

(b) network availability at 99.941% (2011: 99.977%) was marginally below target (99.95%) due to a small number of outages in sectors of the network where diverse (redundant) links were not provided due to the disproportionate cost involved.

Over the five years up to and including 2012 telecommunications traffic across the AARNet network has grown at an annualised rate of 49.5%. Despite this growth, Members' access and subscriptions have, over the same period, only increased at an annualised rate of 3.2%. In 2012, Members' access and subscriptions charges were only 1.9% higher than in 2011. This has provided increasing value for money for Members and Customers.

Network Expansion

During 2012 AARNet significantly expanded its international capacity. A new 10 Gigabits/sec circuit was established between Sydney and AARNet's point of presence in Seattle. In addition, capacity from Sydney to San Jose was increased to 7.5Gbps on a 10Gbps circuit. This increased AARNet's commercial/commodity capacity to North America from 10 to 25 Gigabits/sec. To complement these upgrades to trans-Pacific capacity, one commercial transit and two peering exchange services in North America were also upgraded to 10 Gigabits/sec. Further upgrades to international capacity, backhaul, international transit and peering services are scheduled for 2013.

AARNet also made significant progress in expanding and extending its domestic network. During the year considerable investment was made in capital city infrastructure (particularly in Sydney) and in lighting optical fibre between Adelaide and Perth. When completed, these projects will provide a quantum upgrade to domestic bandwidth, particularly between the east and west coasts of Australia.

Investment in network enhancements during 2012 was assisted with funding under the National Research Network ("NRN") Program an initiative of the Australian Government conducted as part of the Super Science Initiative and financed from the Education Investment Fund. Federal funding of this nature greatly assists AARNet and its Members.

The investments referred to above will underpin the next generation of the AARNet network known as "AARNet4". AARNet4 is designed to meet the projected growth in requirements and demand for AARNet services from Members and, in particular, to:

(a) increase the capacity of the network to serve the growing needs of Members;

(b) increase the reach of the AARNet network within Australia;

(c) enhance the quality of network services and the level of network availability provided to Members;

(d) provide a platform for delivery of enhanced services in line with AARNet's Strategic Plan.

Planning and other preliminary work associated with the AARNet4 project is well advanced. The continued resilience and performance of the AARNet3 network enabled AARNet to defer purchasing equipment for AARNet4 from 2012 to 2013. This deferral allowed AARNet to progress activity on the international and domestic expansions referred to above, and also had a positive impact on AARNet's year end cash holdings.

Subscriptions, Contributions and Revenues

The Board have considered it prudent to adopt a new accounting policy for the recognition of revenues related to certain infrastructure projects (those which involve the construction of infrastructure and the associated delivery of services across that infrastructure). The change in policy and the rationale for the change are set out in note 1(c) to the financial statements. The financial effect this change has on the current year's results and on certain prior years' results is detailed in note 26 to the financial statements. The revenue figures quoted in this report reflect the adoption of that new policy.

Overall, AARNet's service revenues (for delivery of telecommunications services and infrastructure projects) for 2012 were $53,350,178 (2011: $55,230,724). Within this total, Telecommunications Revenues were $49,876,094 (2011: $50,992,534). The reduction in Telecommunications Revenues from 2011 results from fees paid to a third party to use further traffic capacity on that party's fibre cable system. AARNet pays these fees, then recovers the cost from certain Members and other Customers, such that Telecommunications Revenue includes the recoveries while Telecommunications Expenses include the offsetting cost. In 2012 these recoveries and costs were substantially lower than 2011 and, excluding the effect of these recoveries, Telecommunications Revenues for 2012 increased by 4.7% over 2011.

The underlying growth in service revenues (from both Members and Customers) exceeds the rate of increase in Members' access charges and subscription charges noted above. This reflects AARNet's strategy to expand services to Customers who are not Members and thus capture economies of scale for the benefit of Members.

Revenue from Infrastructure Construction Projects declined by 18% from the level generated in 2011. The reduction reflects the extent of resources devoted during 2012 to projects (primarily funded by the Commonwealth's NRN Program) which are developing AARNet's network (refer above). The focus on NRN projects resulted in a lower level of activity on customer infrastructure projects which is reflected in reduced infrastructure project revenues. However, amounts from the NRN Program totalling $7,505,320 were recognised as contributions during 2012.

Telecommunication and Other Expenses

Telecommunications expenses reduced to $17,671,653 in 2012 (2011: $18,862,753). The reduction reflects the third party costs and recoveries referred to above. Excluding the effect of those fees, telecommunications costs rose by 12.8%, a much faster rate than the rate of increase in related revenues. This increase was driven by the growing cost of traffic (particularly off-net commercial internet traffic) and the costs of increased leased capacity within the AARNet network.

Depreciation and Amortisation costs, for both the core AARNet network and infrastructure projects, were lower than in 2011. This reflects reduced depreciation charges as major network investments made some time ago become fully depreciated, however, this was partly offset by increased amortisation of the capitalised value of Indefeasible Rights to Use international traffic paths which flow from increased international capacity brought on stream in 2012 (refer to above).

Employee benefits expenses, both generally and in relation to infrastructure construction projects, increased during 2012 with part of the increase due to higher staffing levels than in 2011 (with persons recruited during 2011 receiving a full year's salary, on-costs and entitlements during 2012).

Administration costs are markedly higher than in 2011. However this is primarily due to the mark-to-market valuation of forward foreign exchange contracts used to hedge against adverse movements in the value of the Australian Dollar. The international capacity purchased by AARNet is typically priced in USD and, with additional international capacity commissioned during 2012, the board approved an increase in AARNet's foreign exchange hedging program. AARNet accounts for the movements in the value of the instruments used to hedge this exposure as an administrative cost (or gain). Without this cost, the increase in administration costs from 2011 to 2012 is 5.3%.

Accumulated Surplus and Reserves

In 2012 AARNet recorded a surplus (Net Income) of $15,339,470 (2011: $9,851,978). Note these figures also reflect the change in accounting policy described in notes 1(c) and 26 to the financial statements.

In the Board's view, it is prudent for AARNet to aim to generate a surplus in order that future investments in network capability and services may be funded without calling on the Members to contribute further equity to the company. Surpluses earned in recent years, aided by conservative financial management, have accumulated into significant holdings of cash and investments.

Surpluses earned by AARNet cannot (by virtue of the terms of AARNet's constitution) be distributed to the shareholders.

AARNet intends to use these accumulated funds to:

(a) finance future investments in
  - (i) infrastructure and equipment to expand the reach and capability of AARNet's network; and
  - (ii) technology to enhance the delivery of services AARNet delivers to Members and Customers.

(b) supplement members subscriptions and other income in future years; and

(c) defray part of the significant financial commitments in respect of non-cancellable operating leases (principally rights to use the traffic paths of fibre cable systems) which, at year end, exceeded $103m (refer note 2 to the financial statements).

In the short-term, the costs of the AARNet4 project will also be met, in part, by drawing on these accumulated funds.

Net Assets

Net assets at 31 December 2012 were $107,930,680 (2011: $92,297,468). The increase represents the Net Income for 2012 plus the change in value of available-for-sale financial assets during 2012.

Strategic Direction

During 2012 AARNet refined its Strategic Plan and has established the following areas of strategic focus:

(a) Delivering Australia's advanced research and education network;

(b) Growing the research and education community;

(c) Building Services Capability.

In addition, the Strategic Plan, also calls for AARNet to:

(d) Ensure financial sustainability; and

(e) Enable a creative, connected work environment.

Significant changes in the state of affairs

There were no significant changes in the state of affairs which have arisen since 31 December 2012 or since that have significantly affected or may significantly affect the results of those operations or the state of affairs in subsequent years.

Matters subsequent to the end of the financial year

Except for matters discussed under the headings 'Review of operations' and for the potential exemption from payroll tax discussed below, no other matter or circumstance has arisen since 31 December 2012 that has significantly affected or may significantly affect:

(a) AARNet's operations in future financial years;

(b) the results of those operations in future financial years; or

(c) AARNet's state of affairs in future financial years.

Likely developments and expected results of operations

AARNet expects that the rate of growth in network traffic will continue at significant levels during 2013, reflecting the historical trends experienced by the company.

AARNet is also considering making an application for exemption from payroll tax in certain of the states in which it operates. While there is no certainty that any such application would be successful, if exemptions were to be granted AARNet would benefit from a significant reduction in employment related costs.

Environmental regulation

AARNet's operations are not adversely affected by any significant environmental regulation. AARNet believes its greenhouse gas emissions are substantially below the thresholds that are subject to the reporting requirements of either the *Energy Efficiency Opportunities Act 2006* and the *National Greenhouse and Energy Reporting Act 2007*.

Insurance for Officers

During the financial year, AARNet paid a premium of $17,424 (2011: $17,265) in respect of liability insurance for the company's Directors and Officers. The liabilities insured against are costs and expenses that may be incurred in defending civil or criminal proceedings that may be brought against the Directors and Officers in their capacity as Directors and Officers of AARNet, and any other payments arising from liabilities incurred by the Officers in connection with such proceedings, other than where such liabilities arise out of conduct involving a wilful breach of duty by the Directors or Officers or the improper use by the Directors or Officers of their position or of information to gain advantage for themselves or someone else or to cause detriment to AARNet. It is not possible to apportion the premium between amounts relating to the insurance against legal costs and those relating to other liabilities.

No known liability has arisen under these indemnities to the date of this report.

Agreement to indemnify Officers

Under the terms of its Constitution, AARNet provides indemnity to persons who are, or have been, an officer or auditor of AARNet, but only to the extent permitted by law and to the extent that the officer or auditor is not indemnified by Directors' and Officers' liability insurance maintained by AARNet. The indemnity is against liability incurred by that person as an officer or auditor of AARNet to another person and for costs and expenses incurred by the officer or auditor in defending such proceedings.

Separately, AARNet and each director of AARNet have entered into a Deed of Indemnity under which AARNet indemnifies each director against any liability:

a) to a third party (that is, other than to AARNet) unless the liability arises out of conduct involving a lack of good faith, and

b) for legal costs incurred in successfully defending civil or criminal proceedings or in connection with proceedings in which relief is granted under the *Corporations Act 2001*.

No known liability has arisen under these indemnities as at the date of this report.

Auditor

PricewaterhouseCoopers continues in office in accordance with section 327 of the *Corporations Act 2001*.

This report is made in accordance with a resolution of Directors.

Emeritus Professor GR Sutton AO
Director

Mr CM Hancock
Director

Melbourne
26th March 2013

Auditor's Independence Declaration

As lead auditor for the audit of AARNet Pty Limited for the year ended 31 December 2012, I declare that to the best of my knowledge and belief, there have been:

a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

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

This declaration is in respect of AARNet Pty Limited during the period.

Scott Walsh
Partner
PricewaterhouseCoopers

Sydney
26 March 2013

PricewaterhouseCoopers, ABN 52 780 433 757
Darling Park Tower 2, 201 Sussex Street, GPO BOX 2650, SYDNEY NSW 1171
DX 77 Sydney, Australia
T: +61 2 8266 0000, F: +61 2 8266 9999, www.pwc.com.au

This financial report covers AARNet as an individual entity. The financial report is presented in the Australian currency.

AARNet Pty Limited is a company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is:

AARNet Pty Limited
Level 2, Building 1, Binary Centre
3 Richardson Place
North Ryde NSW 2113

A description of the nature of AARNet's operations and its principal activities is included in the directors' report on pages 2 to 6, which is not part of this financial report.

Through the use of the internet, we have ensured that our corporate reporting is timely, complete, and available globally at minimum cost to AARNet. All press releases, financial reports and other information are available on our website: www.aarnet.edu.au

For queries in relation to our reporting please call (02) 9779 6968
or email accounts@aarnet.edu.au

Income statement

For the year ended 31 December 2012

	Notes	31 December 2012 $	31 December 2011 $
Telecommunications revenue	4	49,876,094	50,992,534
Infrastructure project construction revenue	4	3,474,084	4,238,190
Total services revenue	4	53,350,178	55,230,724
Other revenue:			
Interest	4	2,858,252	2,448,766
Dividends	4	197,977	53,795
Other income	4	443,044	198,034
Total - Other revenue		3,499,273	2,700,595
Contributions - National Research Network Program		7,505,320	-
Contributions - assets donated		-	1,019,153
Total revenue and income		64,354,771	58,950,472
Telecommunications expenses		(17,671,653)	(18,862,753)
Depreciation and amortisation - Telecommunications	5	(9,455,545)	(9,683,695)
Employee benefits expense - Telecommunications		(8,395,875)	(7,413,295)
Administration - Telecommunications		(7,586,345)	(5,801,683)
Infrastructure project construction		(1,836,242)	(2,942,158)
Depreciation and amortisation - Infrastructure projects	5	(1,680,768)	(2,468,252)
Employee benefit expense - Infrastructure Development Group		(1,755,499)	(1,353,320)
Administration - Infrastructure Development Group		(511,080)	(453,728)
Other expenses		(122,294)	(119,610)
Total expenses		(49,015,301)	(49,098,494)
Net income		15,339,470	9,851,978

The above income statement should be read in conjunction with the accompanying notes.

Refer to note 1(c) and note 26 for an explanation of the change in accounting policy and retrospective adjustments.

Statement of comprehensive income

For the year ended 31 December 2012

	31 December 2012 $	31 December 2011 $
Net income for the year	15,339,470	9,851,978
Movement in the fair value of available-for-sale financial assets	293,742	(195,465)
Other comprehensive income for the year, net of tax	293,742	(195,465)
Total comprehensive income for the year	15,633,212	9,656,513
Total comprehensive income for the year is attributable to:		
Owners of AARNet Pty Ltd	15,633,212	9,656,513

The above statement of comprehensive income should be read in conjunction with the accompanying notes.

Refer to note 1(c) and note 26 for an explanation of the change in accounting policy and retrospective adjustments.

Balance sheet

as at 31 December 2012

	Notes	31 December 2012 $	31 December 2011 $	31 December 2010 $
ASSETS				
Current assets				
Cash and cash equivalents	7	33,059,351	26,625,327	45,546,978
Trade receivables	8	15,431,241	15,610,140	13,859,539
Held-to-maturity investments	9	7,502,412	1,975,601	-
Accrued income	10	3,555,365	1,321,913	4,174,839
Derivative financial instrument		-	59,401	-
Total current assets		59,548,369	45,592,382	63,581,356
Non current assets				
Receivables	11	131,866	137,771	463,839
Available-for-sale financial assets	12	4,589,821	3,787,561	-
Held to maturity investments	13	14,418,274	18,897,366	-
Other financial assets – Non-controlling investment in Smart Services CRC Pty Limited		1	1	1
Property, plant and equipment	14	37,142,318	21,815,097	20,312,601
Intangible assets	15	55,893,929	52,264,422	47,480,087
Total non-current assets		112,176,209	96,902,218	68,256,528
Total assets		171,724,578	142,494,600	131,837,884
LIABILITIES				
Current liabilities				
Payables	16	9,560,443	3,121,117	5,988,016
Income in advance	17	34,130,317	31,038,488	28,187,868
Other liabilities		55,562	114,648	49,776
Interest bearing liabilities		-	-	1,425,692
Provisions	18	1,888,215	1,463,629	1,239,062
Derivative financial instrument		485,233	-	289,857
Total current liabilities		46,119,770	35,737,882	37,180,271
Non-current liabilities				
Provisions	19	414,113	384,589	278,579
Income in advance	21	16,692,050	14,074,661	11,738,079
Derivative financial instrument		567,965	-	-
Total non-current liabilities		17,674,128	14,459,250	12,016,658
Total liabilities		63,793,898	50,197,132	49,196,929
Net assets		107,930,680	92,297,468	82,640,955
EQUITY				
Contributed equity	22	39,039	39,039	39,039
Reserves		98,277	(195,465)	-
Retained earnings	23	107,793,364	92,453,894	82,601,916
Capital and reserves attributable to equity holders of AARNet		107,930,680	92,297,468	82,640,955
Total equity		107,930,680	92,297,468	82,640,955

The above balance sheet should be read in conjunction with the accompanying notes.

Refer to note 1(c) and note 26 for an explanation of the change in accounting policy and retrospective adjustments.

Statement of changes in equity

For the year ended 31 December 2012

	Notes	31 December 2012 $	31 December 2011 $
Total equity at the beginning of the financial year		**92,297,468**	82,640,955
Changes in the fair value of available-for-sale financial assets, net of tax		**293,742**	(195,465)
Total comprehensive income for the year	23	**15,339,470**	9,851,978
Total recognised income and expense for the year		**15,633,212**	9,656,513
Total equity at the end of the financial year		**107,930,680**	92,297,468

The above statement of changes in equity should be read in conjunction with the accompanying notes.

Refer to note 1(c) and note 26 for an explanation of the change in accounting policy and retrospective adjustments.

Cash flow statement

For the year ended 31 December 2012

	Notes	31 December 2012 $	31 December 2011 $
Cash flows from operating activities			
Receipts from customers (inclusive of goods and services tax)		**71,637,845**	73,619,279
Payments to suppliers and employees (inclusive of goods and services tax)		**(42,212,090)**	(51,119,665)
		29,425,755	22,499,614
Interest paid		**(19)**	(106,984)
Net cash inflow (outflow) from operating activities	27	**29,425,736**	22,392,630
Cash flows from investing activities			
Payments for property, plant and equipment		**(14,290,640)**	(7,267,902)
Payments for intangible assets		**(10,198,574)**	(10,763,761)
Payments for available-for-sale financial assets		**(1,734,633)**	(4,371,605)
Payments for held-to-maturity investments		**(4,575,837)**	(23,894,644)
Proceeds from available-for-sale financial assets		**1,251,619**	334,203
Proceeds from held-to-maturity investments		**3,480,000**	3,000,000
Dividends received		**165,787**	53,795
Interest received		**2,910,566**	3,021,327
Net cash (outflow) inflow from investing activities		**(22,991,712)**	(39,888,588)
Cash flows from financing activities			
Payments of finance lease liabilities		**-**	(1,425,692)
Net cash outflow from financing activities		**-**	(1,425,692)
Net (decrease)/increase in cash and cash equivalents		**6,434,024**	(18,921,651)
Cash and cash equivalents at the beginning of the financial year		**26,625,327**	45,546,978
Cash and cash equivalents at end of year	7	**33,059,351**	26,625,328

The above cash flow statement should be read in conjunction with the accompanying notes.

1 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

This general purpose financial report has been prepared in accordance with Australian equivalents to International Financial Reporting Standards (AIFRS), other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Interpretations and the *Corporations Act 2001* as applicable for not-for-profit entities.

Early adoption of standards
AARNet has not early adopted any standards that have been issued but are not yet effective.

Historical cost convention
These financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and contributed assets at fair value, and the recording of held-to-maturity financial assets at amortised cost.

Critical accounting estimates
The preparation of financial statements in conformity with AIFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying AARNet's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 3.

(b) Foreign currency translation

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.

(c) Revenue recognition

Revenue from the provision of telecommunications services is recognised upon delivery of the services to the users.

Infrastructure construction revenue for projects where the infrastructure becomes the property of the customer is recognised in accordance with the percentage of completion method unless the outcome cannot be reliably estimated. Where the outcome of a contract cannot be reliably estimated, contract costs are recognised as revenue to the extent of costs incurred.

Revenue for projects which involve the construction of infrastructure and the subsequent delivery of services across that infrastructure, where the infrastructure becomes the property of AARNet (unless the project involves contributions of assets) is recognised over the period of the agreement for the provision of those telecommunications services. We refer to this style of arrangement as a Service Agreement (see further below).

Contributed assets (including the contribution of funds by government agencies or other persons to facilitate the construction of infrastructure for the AARNet network) are recognised at fair value when title and control of the asset passes or when the conditions to receive or retain funding are met.

Interest income is recognised as it accrues and dividends are recognised as revenue when the right to receive payment is established.

Amounts disclosed as revenue are net of any discounts allowed and taxes paid. Funds received in advance of the revenue recognition point, are recorded as a liability as income in advance.

Change in accounting policy
The policy of recognising income on Service Agreements over the period of the agreement represents a change from the policy adopted previously. Under the previous policy, AARNet recognised, as income, the full value of the infrastructure service component of the Service Agreement, at the point at which the service was available for use by the customer. One effect of this policy was that AARNet did not recognise any liability for the obligation to provide future services to customers in relation to the unexpired contracted portion of each Service Agreement. In the view of the directors, the growing value of Service Agreements (which began to be written during 2008) is now at such a point that it is no longer appropriate to continue such a policy (and, in particular, to continue to not recognise the related obligation to provide services which customers have already paid for).

Accordingly, AARNet has elected to change its accounting policy in the current year with respect to Service Agreements set out above with retrospective effect from 1 July 2008, being the commencement date of the previous policy.

The effect of adopting this revised policy is shown in note 26 to these financial statements. These financial statements are presented on the basis that the policy now adopted had been in place since 1 July 2008.

(d) Income tax

AARNet is exempt from income tax under Section 50-5 of the Income Tax Assessment Act 1997. AARNet's tax status was subject to review by the ATO during 2008, and its tax exempt status was confirmed.

(e) Leases

Leases of property, plant and equipment where AARNet, as lessee, has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the fair value of the leased property or, if lower, the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in other short-term and long-term payables. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the asset's useful life or over the shorter of the asset's useful life and the lease term if there is no reasonable certainty that AARNet will obtain ownership at the end of the lease term.

Leases in which a significant portion of the risks and rewards of ownership are not transferred to AARNet as lessee are classified as operating leases Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

(f) Impairment of assets

Assets that are subject to depreciation or amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. As a not-for-profit entity, value in use is calculated on the basis of the depreciated replacement cost, which represents the current replacement cost of an asset less, where applicable, accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired future economic benefits of the asset.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

The company has only one cash generating unit.

(g) Cash and cash equivalents

For cash flow statement presentation purposes, cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, and bank overdrafts.

(h) Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost, less provision for doubtful debts. Trade receivables are due for settlement no more than 30 days from the date of recognition.

Collectability of trade receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off. A provision for impairment of trade receivables is established when there is objective evidence that AARNet will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 60 days overdue) are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial. The amount of the provision is recognised in the income statement in other expenses.

(i) Investments and other financial assets

Classification

AARNet classifies its financial assets in the following categories: loans and receivables, held-to-maturity investments and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and, in the case of assets classified as held-to-maturity, re-evaluates this designation at each reporting date.

(i) Loans and receivables

Loans and 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 period which are classified as non-current assets. Loans and receivables are included in trade and other receivables (note 8) and other debtors (note 11) in the balance sheet.

(ii) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that management has the positive intention and ability to hold to maturity. If AARNet were to sell other than an insignificant amount of held-to-maturity financial assets, the whole category would be tainted and reclassified as available-for-sale. Held-to-maturity financial assets are included in non-current assets, except for those with maturities less than 12 months from the end of the reporting period, which are classified as current assets.

(iii) Available-for-sale financial assets

Available-for-sale financial assets, comprising principally marketable equity securities, are non-derivatives that are either designated in this category or not classified in any other categories. They are included in non-current assets unless the investment matures or management intends to dispose of the investment within 12 months of the end of the reporting period.

Recognition and derecognition

Purchases and sales of financial assets are recognised on the date on which AARNet commits to purchase or sell the asset. Financial assets are derecognised when the rights to receive the cash flows from the financial assets have expired or have been transferred and AARNet has transferred substantially all the risks and rewards of ownership.

When securities classified as available-for-sale are sold, the accumulated fair value adjustments recognised in other comprehensive income are reclassified to profit or loss as gains and losses from investment securities.

Measurement
At initial recognition, AARNet measures a financial asset at its fair value plus transaction costs that are directly attributable to the acquisition of the financial asset.

Loans and receivables and held-to-maturity investments are subsequently carried at amortised costs using the effective interest method.

Available-for-sale financial assets are subsequently carried at fair value.

Impairment
AARNet assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

(i) Assets carried at amortised cost
If a held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, AARNet may measure impairment on the basis of an instrument's fair value using an observable market price.

(ii) Assets classified as available-for-sale
If there is objective evidence of impairment for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit and loss is removed from equity and recognised in profit and loss.

Impairment losses on equity instruments that were recognised in profit and loss are not reversed through profit and loss in a subsequent period.

If the fair value of a debt instrument classified as available-for-sale increases in a subsequent period and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

(j) Derivatives and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured to their fair value at each reporting date.

AARNet has entered into forward exchange contracts which are economic hedges for foreign currencies to be traded at a future date but do not satisfy the requirements for hedge accounting.

These contracts are fair valued by comparing the contracted rate to the current market rate for a contract with the same remaining period to maturity. Any changes in fair values are taken to the income statement immediately.

(k) Fair value estimation

The fair value of financial assets and financial liabilities are estimated for recognition and measurement or for disclosure purposes.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values due to their short-term nature. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to AARNet for similar financial instruments.

(l) Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation for all assets except contributed assets which are stated at fair value. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to AARNet and the cost of the item can be measured reliably.

Property, plant and equipment is depreciated using the straight-line method to allocate their cost, net of residual values, over their estimated useful lives, as follows:

>	Leasehold improvements	10 years
>	Office equipment	3 years
>	Leased communication assets	5 – 6 years
>	Leased office equipment	3 years
>	Communication assets	3 – 20 years
>	Software	2 – 3 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting 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 (note 1(f)).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

(m) Intangible assets

AARNet's intangible assets are indefeasible rights to use (IRU) capacity of traffic paths, which have been amortised from the date they were available for service and will continue to be amortised over the period of the right, which varies from 15 to 20 years. These are considered operating leases, and additions represent amounts paid as per the lease agreement.

(n) Trade and other payables

These amounts represent liabilities for goods and services provided to AARNet prior to the end of financial year which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

(o) Employee benefits

(i) Wages and salaries and annual leave

Liabilities for wages and salaries, including non-monetary benefits and leave entitlements expected to be settled within 12 months of the reporting date are recognised in other payables in respect of employees' services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled.

(ii) Other long-term employee benefit obligations

The liability for leave entitlements or other employee benefits which are not expected to be settled within 12 months after the end of the period in which the employees render the related service is recognised in the provision for employee benefits and measured as the present value of expected future payments to be made in respect of services provided by employees up to the end of the reporting period using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the end of the reporting period on national government bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

(p) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST except where the amount of GST incurred is not recoverable from the Australian Taxation Office (ATO). In these circumstances the GST is recognised as part of the cost of the acquisition of the asset or as part of an expense.

Receivables and payables (except accrued expenses) are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the ATO is included as a current asset or liability in the Balance Sheet.

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

(q) Provisions

Provisions for make good costs on leased premises are recognised when: AARNet has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

(r) New accounting standards and interpretations

AARNet has assessed the impact of new accounting standards and interpretations and did not identify any significant impact.

2 Commitments

(a) Expenditure commitments

	31 December 2012 $	31 December 2011 $
Commitments in relation to expenditure contracted for at the reporting date but not recognised as liabilities, payable:		
Within one year	11,937,524	6,681,109
Later than one year but not later than five years	4,471,209	3,010,568
Later than five years	741,543	77,000
	17,150,276	9,768,677

(b) Lease commitments – AARNet as lessee

(i) Non-cancellable operating leases

Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:		
Within one year	11,792,264	18,640,971
Later than one year but not later than five years	50,576,303	33,389,208
Later than five years	41,214,051	15,993,570
Commitments not recognised in the financial statements	103,582,618	68,023,749

3 Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity and that are believed to be reasonable under the circumstances.

Critical accounting estimates and assumptions

AARNet makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(i) Useful life of intangible assets

The Directors have assumed in the ordinary course of business that AARNet's customers will continue to use AARNet's services into the foreseeable future.

(ii) Useful life of assets

AARNet is an owner of a significant amount of assets and infrastructure. Estimates are made as to the useful life of these assets which can affect the amount of depreciation and amortisation expense during the year.

(iii) Infrastructure projects completion

AARNet estimates the percentage of each project complete at the Balance Sheet date and allocates revenues and expenses accordingly.

(iv) Assets at fair value

AARNet carries its available-for-sale financial assets at fair value with changes in the fair value recognised in reserves. It obtains market valuations at least annually.

AARNet carries contributed non-monetary assets at fair value. Fair value is based on management's estimate of the likely price it would have had to pay to acquire such assets supported by evidence where available from the relevant vendor.

4 Revenue

	31 December 2012 $	31 December 2011 $
Services revenue		
Telecommunications revenue	47,960,537	49,653,668
Infrastructure service fees	1,915,557	1,338,866
Infrastructure project construction revenue	3,474,084	4,238,190
	53,350,178	55,230,724
Other revenue		
Interest	2,858,252	2,448,766
Dividends	197,977	53,795
Other income	443,044	198,034
	3,499,273	2,700,595
	56,849,451	57,931,319

Refer to note 1(c) and note 26 for an explanation of the change in accounting policy and retrospective adjustments.

5 Expenses

	31 December 2012 $	31 December 2011 $
Depreciation		
Office equipment	946,445	776,666
Leasehold improvements	162,994	175,741
Communication assets	2,748,072	3,110,148
Software	68,935	90,915
Leased communication assets	573,085	2,019,051
Total depreciation	4,499,531	6,172,521
Amortisation		
Intangibles - Indefeasible Rights to Use traffic paths	6,636,781	5,979,426
Total amortisation	6,636,781	5,979,426
Total depreciation and amortisation	11,136,312	12,151,947
Finance costs		
Interest and finance charges paid/payable	19	1,777
Foreign exchange losses	94,864	523,160
Loss (gain) on forward exchange contracts	1,112,599	(349,258)
Loss on sale of available-for-sale financial assets	72,235	54,376
Loss on disposal of assets	1,923	41,780
Amortised interest expense	48,118	21,677
Rental expense relating to operating leases		
Minimum lease payments – premises	956,594	768,892
Superannuation expense	1,206,938	1,017,580

6 Financial risk management

AARNet's activities expose it to a variety of financial risks: market risk (including currency risk, interest rate risk and price risk), credit risk and liquidity risk. AARNet's overall risk management program focuses on liquidity and seeks to minimise potential adverse effects on the financial performance of AARNet. AARNet uses derivative financial instruments such as foreign exchange contracts to hedge certain risk exposures. AARNet uses different methods to measure different types of risk to which it is exposed. These methods include sensitivity analysis in the case of interest rate and foreign exchange risks and ageing analysis for credit risk.

Risk management is carried out by the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) under policies approved by the Board of Directors. The CEO and CFO identify, evaluate and hedge financial risks in close co-operation with AARNet's operating management. The Board provides principles for overall risk management, as well as policies covering specific areas, such as foreign exchange risk, and the use of derivative financial instruments.

(a) Market risk

(i) Foreign exchange risk (currency risk)

AARNet operates internationally and is exposed to foreign exchange risk arising from currency exposures, primarily with respect to the USD, and to a smaller extent, to the EUR.

AARNet holds foreign currency and enters into foreign exchange contracts to manage foreign exchange risk.

Foreign exchange risk arises from future committed expenditure. The risk is measured using sensitivity analysis and cash flow forecasting.

AARNet's risk management policy is to hedge at least 60% of anticipated short-term cash flows (mainly for the purchase of capacity from the US) in USD. AARNet currently has monthly requirements in excess of USD0.5m, primarily for the purchase of capacity from the USA to Australia and for equipment purchases. These requirements are expected to rise over time.

At year end, AARNet held USD0.96m (AUD1.00m) in USD denominated bank accounts and EUR0.02m (AUD0.03m) in a EUR denominated bank account as part of its strategy to minimise the financial effects of foreign currency fluctuations. AARNet's Board monitors the company's hedging strategy on a continuing basis.

Sensitivity

At 31 December 2012, had the AUD weakened/strengthened by 10% against the USD and the EUR with all other variables held constant, AARNet's net income for the year would have been $189,000 lower/$$287,000 higher (2011: $18,000 higher/$248,000 higher), mainly as a result of foreign exchange losses/gains on translation of USD and EUR denominated cash at bank. Equity would have changed by the same amounts as net income had the AUD weakened/strengthened by 10% against the USD.

(ii) Cash and held-to-maturity investments (interest rate risk)

Cash

AARNet's exposure to changes in interest rates is to the extent of its cash at bank and on deposit. At 31 December 2012, if interest rates had changed by -/+1% (100 basis points) from year-end rates with all other variables held constant, Net Income for the year would have been $321,000 lower/higher (2011: $152,000 lower/higher), as a result of higher/lower interest income from cash and cash equivalents. The 2011 sensitivity is lower as a lesser value was held in cash securities in that year. Total equity would have changed by the same amounts.

Held-to-maturity investments

At 31 December 2012, if interest rates had changed by -/+1% (100 basis points) from year-end rates with all other variables held constant, Net Income for the year would have been $140,000 lower/higher (2011: $114,000) as a result of higher/lower interest income from held to maturity investments. Equity would have changed by the same amounts.

(iii) Available-for-sale assets (price risk)

Available-for-sale financial assets are comprised predominately of equities listed on the ASX. At 31 December 2012, had the ASX uniformly been -/+1% higher/lower with all other variables held constant, Total Comprehensive Income for the year would have been $46,000 higher/lower (2011: $38,000) as a result of higher/lower income from available-for-sale financial assets.

(iv) Summarised sensitivity analysis

The following table summarises the sensitivity of AARNet's financial assets and financial liabilities to interest rate risk, foreign exchange risk and other price risk.

6 Financial risk management (cont.)

31 December 2012	Carrying amount	Interest rate risk				Foreign exchange risk				Other price risk			
		-100bps		+100bps		-10%		+10%		-1%		+1%	
		Profit	Equity	Profit	Equity	Profit	Equity	Profit	Equity	Profit	Equity	Profit	Equity
	$	$	$	$	$	$	$	$	$	$	$	$	$
Financial assets													
Cash and cash equivalents	33,059,344	(320,992)	(320,992)	320,992	320,992	(43,656)	(43,656)	167,538	167,538	-	-	-	-
Accounts receivable	13,804,672	-	-	-	-	-	-	-	-	-	-	-	-
Held-to-maturity investments, term deposits	5,000,000	(50,000)	(50,000)	50,000	50,000	-	-	-	-	-	-	-	-
Held-to-maturity investments, floating rate notes	9,000,000	(90,000)	(90,000)	90,000	90,000	-	-	-	-	-	-	-	-
Available-for-sale financial assets	2,111,825	-	-	-	-	-	-	-	-	(45,898)	(45,898)	45,898	45,898
Other assets	147,279	-	-	-	-	-	-	-	-	-	-	-	-
Accrued income	3,555,365	-	-	-	-	-	-	-	-	-	-	-	-
Derivative financial instrument	-	-	-	-	-	-	-	-	-	-	-	-	-
Financial liabilities													
Derivative financial instrument	1,053,197	-	-	-	-	117,053	117,053	(95,771)	(95,771)	-	-	-	-
Trade payables	5,648,516	-	-	-	-	(28,512)	(28,512)	23,328	23,328	-	-	-	-
Other liabilities	4,249,931	-	-	-	-	-	-	-	-	-	-	-	-
Total increase/ (decrease)		(460,992)	(460,992)	460,992	460,992	44,885	44,885	95,095	95,095	(45,898)	(45,898)	45,898	45,898

6 Financial risk management (cont.)

31 December 2011	Carrying amount	Interest rate risk				Foreign exchange risk				Other price risk			
		-100bps		+100bps		-10%		+10%		-1%		+1%	
		Profit	Equity	Profit	Equity	Profit	Equity	Profit	Equity	Profit	Equity	Profit	Equity
	$	$	$	$	$	$	$	$	$	$	$	$	$
Financial assets													
Cash and cash equivalents	26,625,327	(151,903)	(151,903)	151,903	151,903	9,098	9,098	255,062	255,062	-	-	-	-
Accounts receivable	13,976,509	-	-	-	-	-	-	-	-	-	-	-	-
Held-to-maturity investments	11,400,000	(114,000)	(114,000)	114,000	114,000	-	-	-	-	-	-	-	-
Available-for-sale financial assets	3,787,561	-	-	-	-	-	-	-	-	(37,876)	(37,876)	37,876	37,876
Other assets	150,752	-	-	-	-	-	-	-	-	-	-	-	-
Accrued income	1,321,913	-	-	-	-	-	-	-	-	-	-	-	-
Derivative Financial Instrument	59,401	-	-	-	-	6,170	6,170	(5,049)	(5,049)	-	-	-	-
Financial liabilities													
Trade payables	1,447,613	-	-	-	-	2,307	2,307	(1,888)	(1,888)	-	-	-	-
Other liabilities	1,505,213	-	-	-	-	-	-	-	-	-	-	-	-
Total increase/ (decrease)		(265,903)	(265,903)	265,903	265,903	17,575	17,575	248,125	248,125	(37,876)	(37,876)	37,876	37,876

6 Financial risk management (cont.)

(b) Credit risk

Credit risk arises from AARNet's holdings of cash and cash equivalents, term deposits, corporate bonds and loan notes, shares, hybrid securities and derivative financial instruments. Further credit risk arises from credit exposures to customers in the form of outstanding receivables and committed transactions.

In terms of bank deposits and derivative financial instruments, AARNet deals principally with major Australian banks. In terms of investments in equities, hybrids loan notes and bonds, AARNet has an approved investment policy which stipulates minimum ratings or other criteria for investment funds. Investments in such securities also follow recommendations from a licensed investment advisor.

AARNet's principal customers are Australian Universities and the CSIRO, who are also its shareholders. Other, non-shareholder, customers are typically government funded or partly government funded institutions. AARNet also minimises credit risk by invoicing for services in advance for a significant portion of its income.

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash available to meet the needs of the business.

Management monitors rolling forecasts of AARNet's liquidity on the basis of expected cash flow. AARNet's Board periodically considers longer range financial forecasts (5+ years) and these are provided to the Board during the normal course of its deliberations. The Board also considers the expenditure commitments disclosed in note 2.

(d) Fair value measurements

The fair value of financial assets and financial liabilities must be estimated for recognition and measurement or for disclosure purposes.

As of 1 January 2010, AARNet Pty Ltd has adopted the amendment to AASB 7 *Financial Instruments: Disclosures* which requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

(a) quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1)

(b) inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) (level 2), and

(c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (level 3)

AARNet holds forward exchange contracts which are valued at fair value under level 2 methodology.

7 Current assets – Cash and cash equivalents

	31 December 2012 $	31 December 2011 $
Cash at bank and in hand (AUD)	18,564,813	6,433,201
Cash at bank (USD and EUR)	994,031	1,160,097
Deposits at call - all denominated in AUD	13,500,507	19,032,029
	33,059,351	26,625,327

(a) Cash at bank and on hand

Cash at bank and on hand are held at interest rates varying between 0.05% and 3.60% (2011: 0.15% and 4.13%). During the year, cash at bank and on hand is transferred to term deposits.

(b) Deposits at call

Interest bearing deposits at call attracted interest rates between 3.50% and 6.00% (2012: 4.25% and 6.00%). These deposits have an average maturity of 67 days.

(c) Bank guarantee and credit facilities

AARNet has a $2,000,000 Bank Guarantee Facility provided by the National Australia Bank. AARNet has provided bank guarantees for $239,380 for the AARNet Sydney office, $84,977 for the AARNet Brisbane office, and $60,000 for the AARNet Melbourne office. AARNet had an unsecured credit card facility totalling $200,000 during the year.

8 Current assets – Receivables

	31 December 2012 $	31 December 2011 $
Trade receivables	13,804,672	13,976,509
Other debtors	147,279	150,752
Prepayments	1,479,290	1,482,879
	15,431,241	15,610,140

As of 31 December 2012, no trade receivables are impaired or considered uncollectable. No amounts have been outstanding for more than 90 days. The other amounts relate to a number of customers for whom there is no history of default, and it is expected that these amounts will be received when due.

(a) Other debtors

These amounts generally arise from transactions outside the usual operating activities of AARNet. Interest is not normally charged.

(b) Fair value

Due to the short-term nature of these receivables, their carrying amount is assumed to approximate their fair value.

9 Current assets – Held-to-maturity investments

	31 December 2012 $	31 December 2011 $
Bonds	2,502,412	895,601
Term deposits	5,000,000	1,080,000
	7,502,412	1,975,601

10 Current assets – Accrued Income

	31 December 2012 $	31 December 2011 $
Infrastructure projects	2,921,447	428,551
Other	351,208	558,338
Interest on cash and cash equivalents and held-to-maturity investments	282,710	335,024
	3,555,365	1,321,913

11 Non-current assets – Receivables

	31 December 2012 $	31 December 2011 $
Other debtors	109,877	33,787
Prepayments	21,989	103,984
	131,866	137,771

(a) Fair values

The fair value of non-current receivables is materially the same as their carrying amounts.

(b) Credit risk

There is no concentration of credit risk with respect to current and non-current receivables, as AARNet has a small number of low credit risk customers. See note 6.

12 Non-current assets – Available-for-sale financial assets

	31 December 2012 $	31 December 2011 $
Equity securities	2,111,826	1,805,261
Bonds	2,477,995	1,982,300
	4,589,821	3,787,561

13 Non-current assets – Held-to-maturity investments

	31 December 2012 $	31 December 2011 $
Bonds	13,418,274	17,397,366
Term deposits	1,000,000	1,500,000
	14,418,274	18,897,366

14 Non-current assets – Property, plant and equipment

	Leasehold improvements $	Office equipment $	Leased communication assets $	Communication assets $	Software $	Total $
At 1 January 2011						
Cost	1,700,997	1,854,433	14,966,979	25,709,785	695,265	44,927,459
Accumulated depreciation	(744,050)	(823,449)	(12,930,651)	(9,563,398)	(553,310)	(24,614,858)
Net book amount	956,947	1,030,984	2,036,328	16,146,387	141,955	20,312,601
Year ended 31 December 2011						
Opening net book amount	956,947	1,030,984	2,036,328	16,146,387	141,955	20,312,602
Additions	314,830	1,727,846	1,111,615	4,562,503	-	7,716,795
Disposals	(41,780)	-	-	-	-	(41,780)
Depreciation charge	(175,741)	(776,666)	(2,019,051)	(3,110,148)	(90,915)	(6,172,520)
Closing net book amount	1,054,257	1,982,165	1,128,892	17,598,743	51,040	21,815,097
At 31 December 2011						
Cost	1,935,241	3,582,279	16,078,594	30,272,289	695,265	52,563,668
Accumulated depreciation	(880,984)	(1,600,114)	(14,949,702)	(12,673,546)	(644,225)	(30,748,571)
Net book amount	1,054,257	1,982,165	1,128,892	17,598,743	51,040	21,815,097

	Leasehold improvements $	Office equipment $	Leased communication assets $	Communication assets $	Software $	Total $
Year ended 31 December 2012						
Opening net book amount	1,054,257	1,982,165	1,128,892	17,598,743	51,040	21,815,097
Additions	60,014	161,454	-	19,487,240	119,969	19,828,677
Disposals	-	(1,923)	-	-	-	(1,923)
Depreciation charge	(162,994)	(946,445)	(573,085)	(2,748,072)	(68,935)	(4,499,533)
Closing net book amount	951,277	1,195,250	555,807	34,337,911	102,073	37,142,318
At 31 December 2012						
Cost	1,995,255	3,740,674	16,078,594	49,759,529	815,234	72,389,286
Accumulated depreciation	(1,043,978)	(2,545,424)	(15,522,787)	(15,421,618)	(713,161)	(35,246,968)
Net book amount	951,277	1,195,250	555,807	34,337,911	102,073	37,142,318

15 Non-current assets – Intangible assets

	Indefeasible right to use capacity of traffic path $	Total $
At 1 January 2011		
Total payments	78,873,572	78,873,572
Accumulated amortisation on a straight line basis	(31,393,485)	(31,393,485)
Net book amount	47,480,087	47,480,087
Year ended 31 December 2011		
Opening net book amount	47,480,087	47,480,087
Additions	10,763,761	10,763,761
Amortisation charge	(5,979,426)	(5,979,426)
Closing net book amount	52,264,422	52,264,422
At 31 December 2011		
Total payments	89,637,333	89,637,333
Accumulated amortisation on a straight line basis	(37,372,911)	(37,372,911)
Net book amount	52,264,422	52,264,422
Year ended 31 December 2012		
Opening net book amount	52,264,422	52,264,422
Additions	10,266,288	10,266,288
Amortisation charge	(6,636,781)	(6,636,781)
Closing net book amount	55,893,929	55,893,929
At 31 December 2012		
Total payments	99,903,621	99,903,621
Accumulated amortisation on a straight line basis	(44,009,692)	(44,009,692)
Net book amount	55,893,929	55,893,929

During the year, additions to intangible assets totalled $10,266,288. These additions were the result of recognising further payments for Indefeasible Rights to Use traffic paths.

16 Current liabilities – Payables

	31 December 2012 $	31 December 2011 $
Trade payables and accruals	9,560,443	3,121,117

Trade payables and accruals are expected to be paid within 30 days.

17 Current liabilities – Income in advance

	31 December 2012 $	31 December 2011 $
Infrastructure projects	6,080,427	7,952,876
Other	1,052,335	1,436,137
Infrastructure service fees	2,566,038	-
Subscriptions	24,431,517	21,649,475
	34,130,317	31,038,488

Refer to note 1(c) and note 26 for an explanation of the change in accounting policy and retrospective adjustments.

18 Current liabilities – Provisions

	31 December 2012 $	31 December 2011 $
Employee benefits	1,888,215	1,463,629

19 Non-current liabilities – Provisions

	31 December 2012 $	31 December 2011 $
Employee benefits	197,702	165,146
Make good on leased premises	216,411	219,443
	414,113	384,589

(a) Movements in provisions

Movements in each class of provision during the financial year, other than employee benefits, are set out below:

	Make good on leased premises $	Total $
2012		
Non-current liabilities – Provisions		
Carrying amount at start of year	219,443	219,443
Reduction in provision recognised	(3,032)	(3,032)
Carrying amount at end of year	216,411	216,411

	Make good on leased premises $	Total $
2011		
Non-current liabilities – provisions		
Carrying amount at start of year	174,454	174,454
Additional provision recognised	44,989	44,989
Carrying amount at end of year	219,443	219,443

20 Non-current liabilities – Retirement benefit obligations

Superannuation plan

Contributions for certain of AARNet's employees are held by the UniSuper Defined Benefit Division (the DBD) which is a defined benefit plan under Superannuation Law, but is considered to be a defined contribution plan under Accounting Standard AASB 119.

As at 30 June 2012 the assets of the DBD in aggregate were estimated to be $2,010.8 million in deficiency of vested benefits. The vested benefits are benefits which are not conditional upon continued membership (or any factor other than leaving the service of the participating institution) and include the value of indexed pensions being provided by the DBD.

As at 30 June 2012 the assets of the DBD in aggregate were estimated to be $906.8 million in deficiency of accrued benefits. The accrued benefits have been calculated as the present value of expected future benefit payments to members and indexed pensioners which arise from membership of UniSuper up to the reporting date.

The vested benefit and accrued benefit liabilities were determined by the Fund's actuary, Russell Employee Benefits, using the actuarial demographic assumptions outlined in their report dated 15 November 2012 on the actuarial investigation of the DBD as at 30 June 2012. The financial assumptions used were:

	Vested benefits p.a.	Accrued benefits p.a.
Gross of tax investment return – DBD pensions	5.85%	7.50%
Gross of tax investment return – commercial rate indexed pensions	3.40%	3.40%
Net of tax investment return – non pensioner members	5.25%	5.25%
Consumer Price Index	2.75%	2.75%
Inflationary salary increases short-term (2 years)	5.00%	5.00%
Inflationary salary increases long-term	3.75%	3.75%

Assets have been included at their net market value, i.e. allowing for realisation costs.

The Defined Benefit Division as at 30 June 2012 is therefore in an "unsatisfactory financial position" as defined by SIS Regulation 9.04. An "unsatisfactory financial position" for a defined benefit fund is defined as when 'the value of the assets of the Fund is inadequate to cover the value of the liabilities of the Fund in respect of benefits vested in the members of the Fund'. The Actuary and the Trustee have followed the procedure required by Section 130 of the SIS Act when funds are found to be in an unsatisfactory financial position.

The actuary currently believes, in respect of the long-term financial condition of the Fund, that assets as at 30 June 2012, together with current contribution rates, are expected to be sufficient to provide for the current benefit levels for both existing members and anticipated new members if experience follows the "best estimate" assumptions.

Clause 34 was initiated following both the December 2008 and December 2011 actuarial investigation and it has again been initiated following the 30 June 2012 actuarial investigation.

AARNet is not legally obliged to make additional contributions to the DBD in respect of any deficiency within the DBD. Accordingly, no provision has been made in AARNet's accounts for any potential shortfall in the DBD.

21 Non-current liabilities – Income in advance

	31 December 2012 $	31 December 2011 $
Infrastructure service fees	10,153,415	-
Infrastructure projects	2,935,315	10,707,994
Other	3,603,320	3,366,667
	16,692,050	14,074,661

Refer to note 1(c) and note 26 for an explanation of the change in accounting policy and retrospective adjustments.

22 Contributed equity

	31 December 2012 Shares	31 December 2011 Shares	31 December 2012 $	31 December 2011 $
Fully paid	78	78	39,039	39,039
	78	78	39,039	39,039

(a) Movements in ordinary share capital:

Date	Details	Number of shares	$
1 January 2011	Opening balance	78	39,039
31 December 2011	Balance	78	39,039
1 January 2012	Opening balance	78	39,039
31 December 2012	Balance	78	39,039

Holders of ordinary shares are entitled to one vote per share on resolutions put before the members. Holders of ordinary shares are not entitled to dividends and have no right to receive any distribution during a winding up.

23 Retained earnings

Retained earnings
Movements in retained earnings were as follows:

	31 December 2012 $	31 December 2011 $
Balance 1 January	92,453,894	82,601,916
Net income for the year	15,339,470	9,851,978
Balance 31 December	107,793,364	92,453,894

24 Key management personnel and related party disclosures

(a) Directors

The following persons were Directors of AARNet during the financial year:

(i) Chairman – non-executive

Emeritus Professor GR Sutton AO (appointed 1 January 2012)

(ii) Executive Directors

Mr C Hancock, CEO

(iii) Non-executive Directors

Mr KBR Adams (resigned 14 May 2012)

Professor MN Barber

Mr OJ Barrett

Mr P Campbell (resigned 28 November 2012)

Professor L Kristjanson (appointed 1 January 2012)

Mr P Nikoletatos

Mr N Poole

Mr JF Rohan

Dr I Tebbett (appointed 14 May 2012)

Emeritus Professor MS Wainwright AM

Professor I Young AO (appointed 1 January 2012)

(b) Key management personnel

The key management personnel are those who had authority and responsibility for planning, directing and controlling the activities of AARNet, directly or indirectly, during the year. The remuneration for key management personnel including directors is as follows:

	31 December 2012 $	31 December 2011 $
Short-term employee benefits	1,731,422	1,784,850
Post-employment benefits	176,996	162,635
	1,908,418	1,947,485

(c) Other transactions with key management personnel

A director, Prof M Wainwright, is Chair of Smart Services CRC Pty Ltd. AARNet owns one share and makes in-kind contributions to this company. In 2011, Mr C Hancock was appointed a Director of this company.

A director, Mr P Nikoletatos, is Vice President of the Council of Australian University Directors of Information Technology (CAUDIT) to which AARNet provides payroll bureau services. AARNet receives no consideration for this activity.

A director, Mr OJ Barrett, was a consultant to the firm Minter Ellison Lawyers during 2011. Minter Ellison has provided legal services to AARNet for several years on normal arm's length commercial terms and conditions.

	31 December 2012 $	31 December 2011 $
Amounts recognised as expense		
Legal fees	534,641	461,027

Other directors represent and hold offices at certain of AARNet's shareholders. AARNet provides services to these shareholders on arm's length terms.

25 Remuneration of auditors

(a) Audit services

	31 December 2012 $	31 December 2011 $
PricewaterhouseCoopers Australian firm		
Audit of financial reports	192,900	187,000
Other services		
Audit of regulatory returns	8,750	8,500
Audit of special purpose reports	22,700	17,900
Accounting advice	-	15,000
Total remuneration for audit and other services	224,350	228,400
Taxation services		
Taxation services	29,850	-
Other services		
Other	5,195	7,395
Total remuneration of PricewaterhouseCoopers Australia	259,395	235,795

26 Effect of Change in Accounting Policy

The company has adopted a revised accounting policy for the recognition of revenue (Infrastructure Service Fees) on certain infrastructure projects, refer note 1(c).

The revised policy has been adopted with retrospective application to 1 January 2008. The effect of adopting the revised policy on the financial results and financial position previously reported for the years ended 31 December 2010 and 2011 is as shown in the tables below:

Effect on prior years Income Statement and Statement of Comprehensive Income

	Original $	Increase/ (Decrease) $	Restated $
2010			
Telecommunications revenue	45,087,459	808,844	45,896,303
Infrastructure project construction revenue	9,583,397	(5,551,514)	4,031,883
Total services revenue	54,670,856	(4,742,670)	49,928,186
Net income	13,451,548	(4,742,670)	8,708,878
Total comprehensive income	13,451,548	(4,742,670)	8,708,878
2011			
Telecommunications revenue	49,653,668	1,338,866	50,992,534
Infrastructure project construction revenue	8,158,117	(3,919,927)	4,238,190
Total service revenue	57,811,785	(2,581,061)	55,230,724
Net income	12,433,039	(2,581,061)	9,851,978
Total comprehensive income	12,237,574	(2,581,061)	9,656,513

Effect on prior years Balance Sheet

	Original $	Increase/ (Decrease) $	Restated $
2010			
Current liability: Income in advance	27,228,366	959,502	28,187,868
Non-current liability: Income in advance	6,258,164	5,479,915	11,738,079
Total liabilities	42,757,512	6,439,417	49,196,929
Retained earnings	89,041,333	(6,439,417)	82,601,916
Net assets and Total equity	89,080,372	(6,439,417)	82,640,955
2011			
Current liability: Income in advance	29,547,433	1,491,056	31,038,489
Non-current liability: Income in advance	6,545,239	7,529,422	14,074,661
Total liabilities	41,176,655	9,020,478	50,197,133
Retained earnings	101,474,372	(9,020,478)	92,453,894
Net assets and Total equity	101,317,946	(9,020,478)	92,297,468

The effect on the financial results for the year ended 31 December 2012 and the financial position as at 31 December 2012 is as shown below:

Current year Income Statement and Statement of Comprehensive Income under prior policy

	Original $	Increase/ (Decrease) $	Restated $
2012			
Telecommunications revenue	47,960,537	1,915,557	49,876,094
Infrastructure project construction revenue	9,088,616	(5,614,532)	3,474,084
Total service revenue	57,049,153	(3,698,975)	53,350,178
Net income	19,038,445	(3,698,975)	15,339,470
Total comprehensive income	19,332,187	(3,698,975)	15,633,212

Current year Balance Sheet under prior policy

	Original $	Increase/ (Decrease) $	Restated $
2012			
Current liability: Income in advance	31,564,279	2,566,038	34,130,317
Non-current liability: Income in advance	6,538,635	10,153,415	16,692,050
Total liabilities	51,074,445	12,719,453	63,793,898
Retained earnings	120,512,817	(12,719,453)	107,793,364
Net assets and Total equity	120,650,133	(12,719,453)	107,930,680

Refer to note 1(c) for an explanation of the change in accounting policy.

27 Reconciliation of net income to net cash inflow from operating activities

	31 December 2012 $	31 December 2011 $
Net income for the year	15,339,470	9,851,978
Depreciation and amortisation	11,136,313	12,151,947
Contribution income	-	(1,019,153)
Dividend income	(197,977)	(53,795)
Interest received	(2,910,567)	(3,021,327)
Net (gain)/loss on sale of available-for-sale financial assets	(25,504)	54,376
Amortised interest expense	48,119	21,677
Net (gain) loss on sale of non-current assets	1,923	41,780
Decrease (increase) in trade receivables	99,220	(2,067,231)
Decrease (increase) in accrued income	(2,201,262)	2,852,926
Decrease (increase) in prepayments	85,584	642,698
Increase (decrease) in derivative financial instruments	1,112,599	(349,258)
Increase (decrease) in trade payables	833,576	(2,251,651)
Increase (decrease) in other operating liabilities	(59,086)	64,872
Increase (decrease) in provisions	454,110	285,588
Increase (decrease) in income received in advance	5,709,218	2,606,142
Net cash inflow (outflow) from operating activities	29,425,736	19,811,569

Directors' declaration 31 December 2012

In the directors' opinion:

(a) the financial statements and notes set out on pages 9 to 29 are in accordance with the *Corporations Act 2001*, including:

   (*i*) complying with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements, and

   (*ii*) giving a true and fair view of AARNet's financial position as at 31 December 2012 and of the performance for the financial year ended on that date.

(b) there are reasonable grounds to believe that AARNet will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the directors.

Emeritus Professor GR Sutton AO
Director

Mr CM Hancock
Director

Melbourne
26th March 2013

Independent auditor's report to the members of AARNet Pty Ltd

For the year ended 31 December 2012

pwc

Report on the financial report

We have audited the accompanying financial report of AARNet Pty Limited (the company), which comprises the balance sheet as at 31 December 2012, and the income statement, the statement of comprehensive income, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

Our procedures include reading the other information in the Annual Report to determine whether it contains any material inconsistencies with the financial report.

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

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

Auditor's opinion

In our opinion the financial report of AARNet Pty Limited is in accordance with the *Corporations Act 2001*, including:

(*i*) giving a true and fair view of the company's financial position as at 31 December 2012 and of its performance for the year ended on that date; and

(*ii*) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*.

PricewaterhouseCoopers

PricewaterhouseCoopers

Scott Walsh
Partner

Sydney
26 March 2013

PricewaterhouseCoopers, ABN 52 780 433 757
Darling Park Tower 2, 201 Sussex Street, GPO BOX 2650, SYDNEY NSW 1171
DX 77 Sydney, Australia
T: +61 2 8266 0000, F: +61 2 8266 9999, www.pwc.com.au

Head Office
AARNet Pty Ltd
Level 2, Building 1
3 Richardson Place
North Ryde NSW 2113

Postal Address
GPO Box 1559
Canberra ACT 2601
ABN 54 084 540 518

T: +612 6222 3530
F: +612 6222 3535
inquiries@aarnet.edu.au
www.aarnet.edu.au