Audit Opinion

The audits of the University and its controlled entities' financial statements for the year ended 31 December 2010 resulted in unqualified Independent Auditor's Reports, except for the UON Foundation Trust and Newcastle Innovation Limited.

I issued a qualified Independent Auditor's Report for UON Foundation Trust as I was unable to express an opinion as to whether the Trust had recorded all revenues received from donations and fundraising sources in its financial statements. This is common for entities with these sources of revenue, as it is impracticable for them to maintain effective systems of internal control over the receipt of such revenues until their initial entry in the financial records. My audit report for 31 December 2009 was similarly qualified.

At the date of finalising this report the audit of Newcastle Innovation Limited had not been completed. More detail is provided under the Newcastle Innovation comment below.

Unless otherwise stated, the following commentary relates to the consolidated entity.

Key Issues

New Campus

Last year, I recommended the University conduct a comparative cost benefit analysis of its proposal to build a new campus in Newcastle city. The University advised it has had an economic assessment of the project prepared. The University has also advised that its application for funding stage 1 of the project under the Commonwealth’s Structural Adjustment Fund was unsuccessful. Full funding for the project has not been sourced, although the University has been granted a parcel of land worth approximately $4.0 million and received a commitment of financial support from the State Government of $25.0 million. The University estimates it can presently contribute $40.0 million to the project. The estimated cost of stage 1 is $159 million, and the total project cost is $562 million.

The University has a very large site at Callaghan with good infrastructure, which may be capable of accommodating increases in student numbers. The University advised that other issues associated with student accommodation and car parking at a city centre campus have yet to be resolved. The University has advised that until funding is confirmed by the Commonwealth or State Governments, the project will not proceed.

Capital Works (Repeat Issue)

The University is planning capital expenditure of $102.3 million in 2011, $34.3 million of which will be funded by grants predominately from the Australian Government. The major components of the planned capital expenditure are: $80.5 million for buildings, $7.0 million on information technology projects and $14.8 million on plant and equipment.

The University has commenced a project to build additional student accommodation for up to 750 students on the Callaghan campus for an estimated cost of $85.0 million, which is to be funded through debt. The University expects the income from the additional accommodation will exceed the cost of funding this project over its life.

During 2010, the University spent $56.0 million on capital expenditure, with $24.6 million funded through grants, and the remaining $31.4 million funded through operational cash flows. The University estimates its backlog maintenance is $64.9 million ($62.3 million).

Last year, I recommended the University implement a total asset management plan to ensure assets are planned and managed efficiently and effectively. The University advised it is still in the process of developing such a plan.

The University was unsuccessful in obtaining funding from the Commonwealth’s Structural Adjustment Fund for Stage 1 of its proposed new campus in Newcastle city.
Impact of the Global Financial Crisis

The fair values of the University’s equity investments declined significantly during the global financial crisis. However, the value of equity investments at 31 December 2010 of $78.6 million, compared to $76.8 million in 2009 and $67.1 million in 2008, reflects the subsequent improvement in financial markets.

The University recorded operating surpluses of $36.6 million and $45.4 million in 2010 and 2009 respectively, compared to an operating loss of $366,000 in 2008. The major contributor to the loss was an impairment expense of $29.2 million, reflecting the decline in the value of equity investments at that time.

The global financial crisis also significantly impacted superannuation investment earnings and benefit valuations in 2008. As economic conditions improved through 2009, superannuation liabilities decreased from $234 million to $199 million at 31 December 2009. However, they have subsequently increased to $223 million at 31 December 2010, due to changes in key assumptions during 2010, resulting in an actuarial loss of $18.5 million.

Employment of Contractors (Repeat Issue)

I recommend the University create and maintain a single record of all contractors engaged.

The University should also periodically review the roles and responsibilities of its contractors to ensure:

- its reliance on contractors is not excessive
- use of a contractor instead of a permanent employee is appropriate
- contractors do not become de facto employees by virtue of being with the University for an extended period of time
- use of contractors continues to represent value for money.

The University does not maintain a single, complete and detailed listing of all contractors it has engaged during the year. It uses a decentralised approach to engage and record contractors.

The University was unable to provide the following information as at 31 December 2010:

- the cost of contractors engaged
- the number of contractors engaged
- the period of service of contractors engaged.

The retention of contract employees for extended periods may result in additional costs to the University. The University should review its practices relating to contractors to ensure they are appropriate to achieve desired outcomes and comply with employment related legislation.

Credit Cards (Repeat Issue)

I recommend the University:

- conduct a complete review of issued credit cards to determine whether all 1,001 employees who currently have credit cards actually need them
- review its credit card policy around the expenditure approval process, and consider reducing the time frame given to card holders for submitting documentation supporting the expenditure
- consider raising a receivable from relevant employees for expenditure incurred on corporate credit cards not acquitted and accounted for within 2 months of the statement date
- consider following up on and taking appropriate action for breaches of University credit card policy.

I have reviewed and raised concerns about the University’s credit card processes for several years. Total credit card expenditure during 2010, by the 1,001 employees with credit cards, was $19.0 million ($22.1 million).
During the year, 149 employees used their credit cards for personal expenditure totalling $68,060. Personal expenditure using a University credit card is considered to be a fraudulent transaction by the University and a breach of its policy, unless it is for emergency purposes only and reimbursed within 14 days. Last year, I recommended the University’s debtors system record personal expenditure on credit cards as receivables, subject to the University’s standard collection and recovery procedures. This would make the personal expenditure more visible and enable the University to effectively monitor and control it. The University did not implement this recommendation, but has recovered most personal expenditure by employing additional resources in the credit card section. An amount of $2,625 remained outstanding as at 31 December 2010.

The University’s internal analysis of credit card expenditure for a sample of cards covering the period from April to August 2010 identified the following instances of non-compliance with policy:

- 455 instances of incorrect account coding
- 759 instances where original tax invoices and receipts have not been attached to monthly statements
- 18 instances of possible asset purchases
- 232 instances of purchases greater than $1,000
- 158 instances of possible personal expenditure
- 301 other possible policy breaches.

The card holders are given up to two months to submit documentation supporting the expenditure. At the beginning of March 2011, 72 individuals had not submitted documentation for expenditure incurred up to 31 December 2010.

The University advised that credit card expenditure documentation is in most cases submitted directly to the Card Services team, and not to the authorising officer. As a result, authorising officer approval is based on quite limited substantiating information. This lack of review is an inherent weakness in the University’s internal control system. It also creates a significant risk of inappropriate personal and/or fraudulent expenditure occurring without being detected, e.g. due to incorrect coding.

During the year, 293 people had their credit cards suspended, and 46 were cancelled for not following policy requirements.

**Contract Separation Provision**

I recommend the University:

- implement a formal process to identify and record claims by contract employees for eligible payment. This will ensure adequate data is captured by Human Resources, allowing for the percentage of likely claims to be determined and used to more accurately calculate the contract separation provision
- monitor internal controls around HR processes and data capture to ensure compliance with the Workplace Agreements
- disclose the existence of potential liabilities from former employees under the contingent liabilities note.

In current Academic and General Staff Workplace Agreements, the University is required to make severance payments to contracted employees where they:

- are on their second or subsequent contract, and
- seek continued employment, but are declined by the University, or
- are replaced by another employee.

In any of these circumstances, the University is liable to pay the contracted employees severance pay at rates determined in the Workplace Agreements.
At 31 December 2010, the University provided $6.7 million for contract separation payments to certain contract employees, an increase of $5.9 million compared to 2009. In previous years, the provision was calculated at only 20.0 per cent of total estimated entitlements to reflect the number of likely claims. However, the University has found this basis of provisioning to be inadequate due to deficiencies in historical human resource data and processes, including failing to capture adequate evidence of employees seeking continued employment.

As a result, there may be a potential liability for former employees who sought continued employment on separation, but were not aware they were eligible for the payments. The University cannot reliably measure this potential liability.

**Other Information**

I identified opportunities to improve accounting and internal control procedures at the University and its controlled entities and have reported them to management.

The University has advised it is taking action on the issues I have raised.

**Financial Information**

The consolidated financial information includes the financial reports of the University and its controlled entities.

**Abridged Statements of Comprehensive Income**

<table>
<thead>
<tr>
<th>Year ended 31 December</th>
<th>Consolidated</th>
<th>Parent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2010</td>
<td>2009</td>
</tr>
<tr>
<td></td>
<td>$'000</td>
<td>$'000</td>
</tr>
<tr>
<td>Australian Government grants</td>
<td>242,236</td>
<td>245,030</td>
</tr>
<tr>
<td>Higher Education Contribution Scheme</td>
<td>94,503</td>
<td>89,072</td>
</tr>
<tr>
<td>Fees and charges</td>
<td>90,767</td>
<td>79,782</td>
</tr>
<tr>
<td>Other</td>
<td>118,715</td>
<td>108,523</td>
</tr>
<tr>
<td><strong>Total Revenue</strong></td>
<td><strong>546,221</strong></td>
<td><strong>522,407</strong></td>
</tr>
<tr>
<td>Employee benefits and on-costs</td>
<td>303,973</td>
<td>271,698</td>
</tr>
<tr>
<td>Depreciation and Amortisation</td>
<td>40,403</td>
<td>38,997</td>
</tr>
<tr>
<td>Impairment of available for sale assets</td>
<td>22</td>
<td>66</td>
</tr>
<tr>
<td>Other</td>
<td>162,323</td>
<td>166,229</td>
</tr>
<tr>
<td>Deferred expense – superannuation</td>
<td>2,945</td>
<td>--</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td><strong>509,666</strong></td>
<td><strong>476,990</strong></td>
</tr>
<tr>
<td><strong>Surplus</strong></td>
<td><strong>36,555</strong></td>
<td><strong>45,417</strong></td>
</tr>
</tbody>
</table>

**Other Comprehensive Income**

- Gain on revaluation of land and buildings | 17,709 | 68,173 | 17,709 | 68,173 |
- Gain/(loss) on value of available for sale financial assets | (1,024) | 10,549 | (1,027) | 10,472 |
- Other expense | (40) | (111) | -- | -- |

**Total Other Comprehensive Income** | **16,645** | **78,611** | **16,682** | **78,645** |

**Total Comprehensive Income** | **53,200** | **124,028** | **48,355** | **118,941** |

Note: 2009 figures will not agree to the figures reported in Volume 2 of the 2010 Auditor-General’s Report, due to reclassification of prior year figures in the 2010 financial statements of the University.

Fees and charges increased by 15.0 per cent due to an increase in the number of students from 21,913 in 2009 to 23,372 in 2010 and fee rises of approximately five per cent.
Employee benefits rose due to an increase in the number of staff, salary increments and a pay increase of approximately three per cent during the year.

Deferred superannuation expense increased due to a $2.9 million write off of a receivable that had been recognised for the SANCS superannuation scheme. The Australian Government has indicated it will not fund SANCS superannuation liabilities.

**Abridged Statement of Financial Position**

<table>
<thead>
<tr>
<th>At 31 December</th>
<th>Consolidated</th>
<th>Parent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2010</td>
<td>2009</td>
</tr>
<tr>
<td></td>
<td>$'000</td>
<td>$'000</td>
</tr>
<tr>
<td>Current assets</td>
<td>190,815</td>
<td>167,249</td>
</tr>
<tr>
<td>Non-current assets</td>
<td>1,084,312</td>
<td>1,022,497</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>1,275,127</strong></td>
<td><strong>1,189,746</strong></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>106,117</td>
<td>93,983</td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td>239,882</td>
<td>219,835</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td><strong>345,999</strong></td>
<td><strong>313,818</strong></td>
</tr>
<tr>
<td><strong>Net Assets</strong></td>
<td><strong>929,128</strong></td>
<td><strong>875,928</strong></td>
</tr>
</tbody>
</table>

Note: 2009 figures will not agree to the figures reported in Volume 2 of the 2010 Auditor-General’s Report, due to reclassification of prior year figures in the 2010 financial statements of the University.

Current assets increased due to additional investments in term deposits resulting from the operating surplus in 2010. Non-current assets increased due to asset additions of $52.2 million and a revaluation of property, plant and equipment, which increased asset values by $17.7 million.

Current liabilities increased by $12.1 million primarily due to increases in the contract separation provision and the actuarially advised long service leave liability.

**University Activities**

The University is constituted under the *University of Newcastle Act 1989*. It mainly:

- provides educational and research facilities, having particular regard to the needs of the Hunter Region, the Central Coast and surrounding areas
- encourages the dissemination, advancement, development and application of knowledge
- provides courses of study and carries out research to meet the needs of the community
- confers degrees, including Bachelor, Master and Doctor, and awards diplomas and certificates.

For further information on the University, refer to [www.newcastle.edu.au](http://www.newcastle.edu.au).
Controlled Entities

Probiotic Health Pty Limited, a subsidiary of Newcastle Innovation Limited, was voluntarily liquidated on 30 August 2010. The company obtained an exemption from The Treasury from preparing a financial report as at 31 December 2010.

Newcastle Innovation Limited

Newcastle Innovation’s financial statements, and the audit thereof, had not been finalised at the time of this report. As a result of incorrect revenue recognition policies, I believe the company’s revenue and expenses have been overstated by a maximum of $4.5 million for 2010 and a maximum of $5.1 million for 2009. The impact on the overall results and net assets of the company for both years is nil and I do not consider the amounts material to the University’s consolidated financial statements.

I am currently working with management to resolve this issue so the financial statements and audit can be finalised.

UON Foundation Trust

I recommend Internal Audit findings be considered and actioned as necessary.

Internal Audit identified and reported several issues in papers presented to the February 2011 meeting of the Audit and Risk Management Committee. The papers identified that, in the view of the internal auditors, the Foundation had fallen short of its original objectives and that risks existed around its revenue raising activities. The papers recommended a review of the Foundation and a revision of its targets to ensure they are within achievable ranges, for presentation to and approval by the University Council. The University advised this has not occurred.

UON Singapore Pte Ltd

UON Singapore has an agreement with a partner entity in Singapore to share course fee revenue. Under the agreement, UON Singapore’s share of course fee revenue decreases as student numbers enrolled in a course increase, subject to certain enrolment number ‘trigger points’.

On 20 April 2011, the company received a letter from the partner entity requesting payments totalling SGD $907,000 for student fees for the period from 2008 to 2010. The claim is based on an interpretation of the relevant clause in the agreement. UON Singapore strongly disputes the basis and quantum of the claim, and will instruct legal counsel to contest and refute it. UON Singapore management has had preliminary legal advice from the University Counsel that the claim is unlikely to succeed if challenged at law, and is now seeking external independent legal counsel to confirm this. As settlement is uncertain at this stage, the claim has been recognised as a contingent liability by UON Singapore.

UON Singapore paid a SGD $500,000 dividend to the University of Newcastle on 29 March 2010. In December 2010, UON Singapore received a 5.82 per cent fixed interest loan of SGD $1.0 million from the University of Newcastle to offset any adverse cash flow implications. The loan is to be repaid by 31 December 2012.
The following controlled entities have not been reported on separately as they are not considered material by their size or the nature of their operations to the consolidated entity.

<table>
<thead>
<tr>
<th>Entity Name</th>
<th>Website</th>
</tr>
</thead>
<tbody>
<tr>
<td>UON Foundation Trust</td>
<td>*</td>
</tr>
<tr>
<td>UON Services Limited</td>
<td><a href="http://www.uonservices.org.au">www.uonservices.org.au</a></td>
</tr>
</tbody>
</table>

* This entity does not have a website.