

Forestry Corporation of NSW (trading as Forestry Corporation)

Audit Opinion

Unqualified audit opinions were issued on the Forestry Corporation of NSW's (trading as Forestry Corporation) and its controlled entity's 30 June 2013 financial statements.

The following comments are for the consolidated entity, unless otherwise stated.

Compliance with Treasury's Early Close Procedures

During the year, NSW Treasury issued TC 13/01 'Mandatory early close procedures for 2013'. This Circular aimed to improve the quality and timeliness of agencies' annual financial statements.

The Forestry Corporation performed the procedures, with the exception of four major financial statement line items in the financial statements. However, this process helped them submit financial statements by an earlier due date. In 2013-14, Forestry Corporation plans to bring forward the valuation of biological assets to 28 February 2014 to assist them in meeting early close requirements in full.

The early close procedures also resulted in improvements to the quality of the financial statements as evidenced by no reported misstatements in 2012-13 compared to 2011-12.

Operational Snapshot

Forestry Corporation:

- manages 1.8 million hectares of native forests, 230,000 hectares of softwood and 35,000 hectares of hardwood plantations across the State
- made a profit after tax of \$7.2 million (\$74.4 million loss in 2011-12) in 2012-13. Total revenue was \$310 million and expenses for the year were \$280 million.

Key Issues

Corporatisation

On 1 January 2013, the Forestry Commission of New South Wales was corporatised under the *Forestry Act 2012*, with a corporate name of Forestry Corporation of New South Wales (Forestry Corporation). Forestry Corporation is a State owned corporation and the nature of the business and business relationships largely remain the same, while the governance structures have changed. In March 2013, a Board of Directors was established consisting of four independent members, one executive director along with two subcommittees chaired by the independent Board members.

On 22 April 2013, pursuant to the Treasurer's Order and the *Forestry Act 2012*, employees and their related liabilities were transferred to Forestry Corporation from the Forestry Commission Division and the Department of Primary Industries. The process of registering the Enterprise Bargaining Agreement under Federal Legislation delayed the transfer of employees to April 2013.

Forestry
Commission
was
corporatised on
1 January 2013

Internal Audit Activities

Recommendation

Forestry Corporation should develop a three year internal audit plan with sufficient activity each year to provide an appropriate control environment for the organisation.

Forestry Corporation had limited internal audit activities during 2012-13

Internal audit activities during 2012-13 were limited. Management changed its original internal audit plan for the year from six to two internal audits and completed only one during the year. Management advised that uncertainty around the process for the agency's corporatisation and its governance structure contributed to the reduction in internal audit activity. However, the reduced level of activity may not have been sufficient to provide an appropriate control environment to mitigate operational and financial risks of the organisation over that period.

Performance Issues

Fire Management Plans

Forestry Corporation is not meeting one of its two key performance indicators. In 2012-13, unfavourable weather conditions, such as strong winds and lightning strikes resulted in destruction of 137 hectares (12 hectares in 2011-12) of softwood plantations.

Only one of the Forestry Corporation's two key fire management targets was achieved

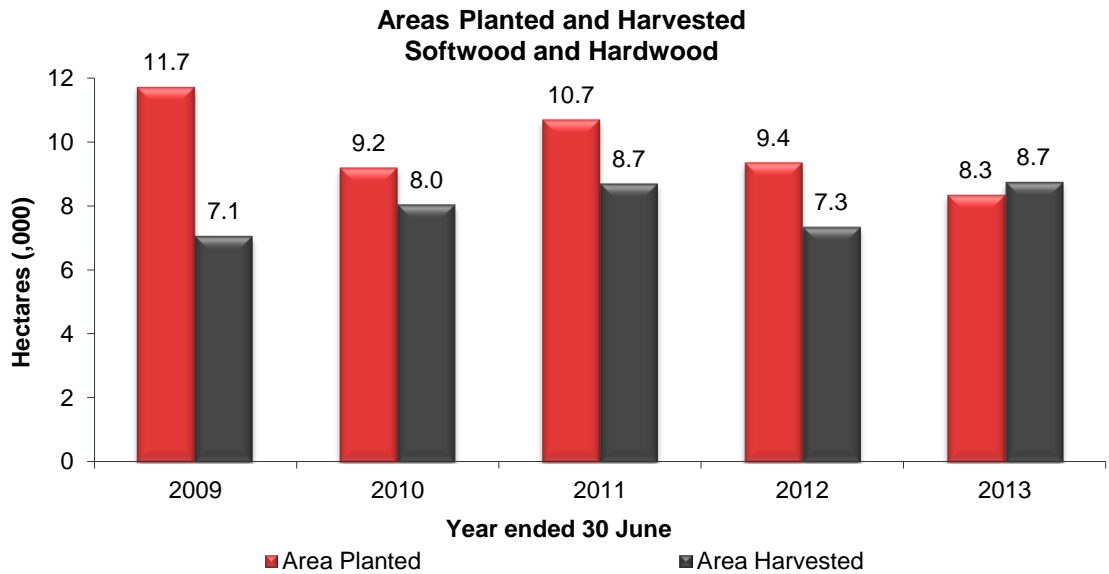
Key performance indicator	Target	Actuals
Planted forests burnt by wildfire	One hectare per incident maximum	In 11 fire incidents the number of hectares of planted forests burnt exceeded one hectare
Native forest area burnt by wildfire	< 2 %	1.89 % of native forests

Source: Forestry Corporation (unaudited).

Softwood and Hardwood Plantations

On average, hectares planted exceeded the number of hectares harvested during the past five years. Forestry Corporation planted 7,835 hectares of softwood during 2012-13 which was below its target of 8,064 hectares. Management advises that the budget for plantations was reduced due to lower timber sales in the Softwoods Division. This along with dry soil conditions resulted in lower hectares being planted during 2012-13.

Hectares planted and harvested during each of the last five years were:

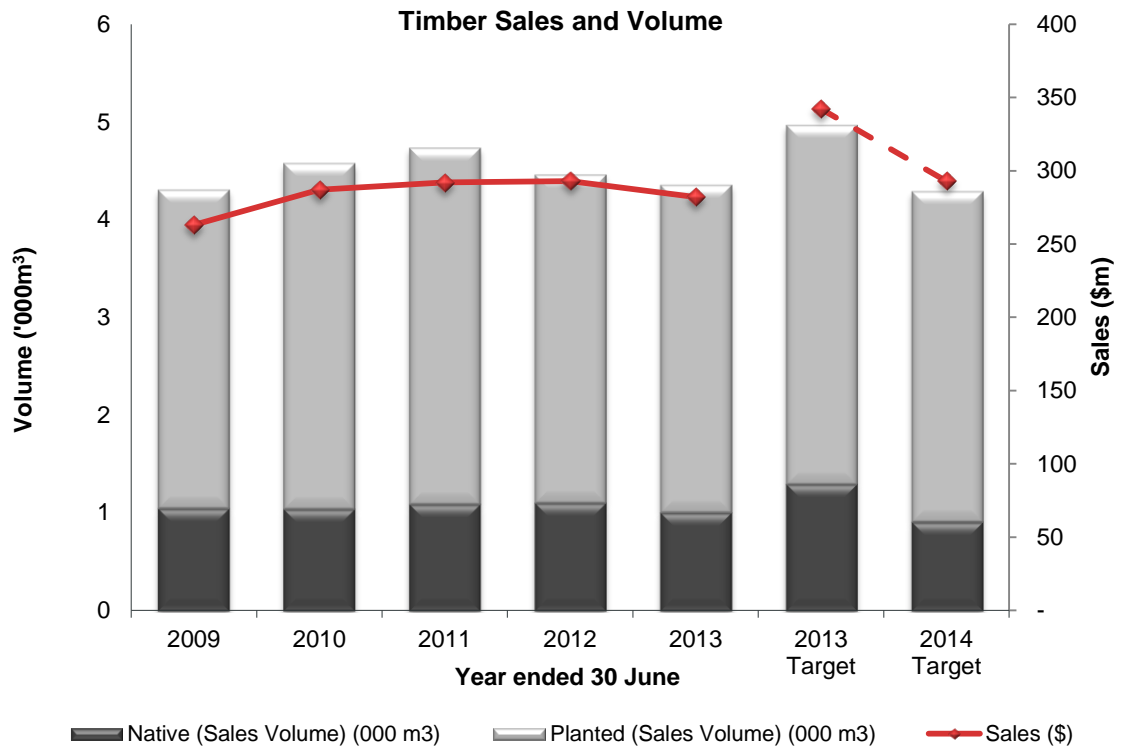


Source: Forestry Corporation (unaudited)

Timber Sales and Volume

Forestry Corporation did not meet its sales revenue or volume targets during 2012-13. Reduced volume and sales to major customers are predominantly due to the weak housing construction and renovating markets, and the change in the mix from individual housing to multi-unit dwellings. Cheaper imports, due to the high dollar value, also adversely affected timber sales.

Forestry Corporation had reduced sales in 2012-13, due to the weak housing construction and renovation markets



Source: Forestry Corporation Annual Report and Statement of Corporate Intent (unaudited).

Financial Performance

The following table compares Forestry Corporation's performance against the financial targets in its Statement of Business Intent:

Year ended 30 June	2013 Target	2013 Actual	2012 Actual
Operating profit before tax (OPBT) (\$'000)	36,039	18,611	10,723
Dividend (\$'000)	17,700	9,119	5,254
Income tax equivalent (expense)/benefit (\$'000)	(10,812)	2,723	2,488
OPBT to revenue (%)	10.4	6.0	3.4
OPBT to average assets (%)	1.9	1.0	0.6
OPBT to total equity (%)	3.2	1.7	1.0
Total Liabilities to total equity (%)	70.9	70.5	83.5

Note: OPBT excludes forest revaluation adjustment, capital grants and superannuation fund movement.

Forestry Corporation did not achieve most of its financial targets during 2012-13. Management advised that revenue was \$38 million lower than the target due to the weak market conditions. Since most targets are dependent on achieving the target for timber sales, failure to achieve sales resulted in not meeting other targets. However, there was improvement in profitability compared to 2012 due to reduced operating expenses.

Financial Information

Abridged Statement of Comprehensive Income

Year ended 30 June	Consolidated		Parent	
	2013 \$'000	2012 \$'000	2013 \$'000	2012 \$'000
Forest sales	281,678	293,204	281,678	293,204
Other revenue	28,660	25,857	28,660	25,857
Total revenue	310,338	319,061	310,338	319,061
Expenses from operations	196,722	213,816	196,722	213,816
Personnel services expenses	64,414	143,404	60,875	150,609
Other expenses	18,626	22,447	18,626	22,447
Total expenses	279,762	379,667	276,223	386,872
Profit/(loss) before fair value adjustment	30,576	(60,606)	34,115	(67,811)
Loss on fair value of forests	26,077	16,304	26,077	16,304
Profit/(loss) before tax	4,499	(76,910)	8,038	(84,115)
Income tax benefit	2,723	2,488	2,723	2,488
Profit/(loss) after tax	7,222	(74,422)	10,761	(81,627)
Other comprehensive income				
Revaluation of property, plant and equipment	--	55,053	--	55,053
Superannuation actuarial gains/(losses)	26,315	(7,205)	22,776	--
Income tax expense on other comprehensive income	(6,832)	(15,885)	(6,832)	(15,885)
Total other comprehensive income	19,483	31,963	15,944	39,168
Total comprehensive income/(expense)	26,705	(42,459)	26,705	(42,459)

Personnel services costs reduced by 55.1 per cent because of a significant reduction in superannuation expenses from last year. Up to 22 April 2013, the gain or loss from the defined benefit superannuation was reflected in personnel services costs, as the personnel services were purchased from the Department of Primary Industries. In 2011-12, a superannuation loss of \$68.1 million increased personnel service costs.

The superannuation gain in 2012-13 was mainly due to an increase in the discount rate used to calculate the present value of the superannuation liability from 3.1 per cent to 3.8 per cent and improved investments returns increasing the assets of the fund.

The \$26.1 million fall in the value of forests was mainly due the increase in the discount rate from 8.4 per cent in 2011-12 to 8.5 per cent in 2012-13, unfavourable market conditions in one region due to saw mills closing down, and uncertain export markets for pulp. Planned harvesting from difficult terrains that are located far from the mills also increased the future expected costs.

Abridged Statement of Financial Position

At 30 June	Consolidated		Parent	
	2013 \$'000	2012 \$'000	2013 \$'000	2012 \$'000
Current assets	123,898	120,721	123,898	120,721
Non-current assets	1,796,285	1,831,125	1,796,285	1,831,125
Total assets	1,920,183	1,951,846	1,920,183	1,951,846
Current liabilities	94,205	110,950	94,205	110,950
Non-current liabilities	699,915	777,318	699,915	777,318
Total liabilities	794,120	888,268	794,120	888,268
Net assets	1,126,063	1,063,578	1,126,063	1,063,578

The majority of the non-current assets is property, plant and equipment of \$1.1 billion (\$1.1 billion at 30 June 2012) of which 91 per cent is Crown land. Non-current assets also include plantations valued at \$657 million (\$680 million in 2011-12). Native forests are still at nil value (nil). Discounted cash flows are based on projected future wood volume flows over 100 years for native forests and 35 years for planted forests.

Number of employees with excessive leave reduced by 20 per cent

Forestry Corporation management is monitoring annual leave and reduced the number of employees with excessive leave from 82 to 66 at 30 June 2013. However, the average amount of annual leave held by each of those with excessive leave remained the same as for last year at 49 days.

The \$94.1 million decrease in total liabilities was mainly due to a decrease in liabilities for superannuation schemes and a net deferred income tax liability.

Forestry Corporation Activities

Forestry Corporation of New South Wales is a statutory State owned corporation constituted by the *Forestry Act 2012*. Its principal objectives are:

- to be a successful business and, to this end:
 - to operate at least as efficiently as any comparable businesses
 - to maximise the net worth of the State's investment in the Corporation
- to have regard to the interests of the community in which it operates
- to contribute towards regional development and decentralisation
- where its activities affect the environment, to conduct its operations in compliance with the principles of ecologically sustainable development contained in section 6 (2) of the *Protection of the Environment Administration Act 1991*
- to be an efficient and environmentally sustainable supplier of timber from Crown-timber land and land owned by it or otherwise under its control or management.

For further information on Forestry Corporation, refer to www.forestrycorporation.com.au.

Controlled Entity

The following controlled entity has not been reported on separately as it is not considered material by size or nature of its operations to the consolidated entity.

Entity Name	Website
Forestry Commission Division	*

* This entity has no website.