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**PARLIAMENT OF TASMANIA**

**LEGISLATIVE COUNCIL  
GOVERNMENT ADMINISTRATION COMMITTEE 'A'**

**INQUIRY INTO FORESTRY TASMANIA  
FINANCIAL PERFORMANCE**

**Members of the Committee:**

**Hon Rosemary Armitage MLC**

**Hon Ruth Forrest (Chair) MLC**

**Hon Vanessa Goodwin MLC**

**Hon Greg Hall MLC**

**Hon Paul Harriss MLC**

**Hon Jim Wilkinson MLC**

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## **ABBREVIATIONS LIST**

AASB	-	Australian Accounting Standards Board
AGAAP	-	Australian Generally Accepted Accounting Principles
AIFRS	-	Australian International Financial Reporting Standards
CSO	-	Community Service Obligation
EBIT	-	Earnings before interest and taxes
FTE	-	Full time equivalents
GBE	-	Government Business Enterprises
IGA	-	Inter-Governmental Agreement
PA	-	per annum
RFA	-	Regional Forest Agreement
SOC	-	State-Owned Companies
SOP	-	Statement of Principles
TCFA	-	Tasmanian Community Forest Agreement

## **EXECUTIVE SUMMARY**

**Note: This is a public report of the Committee that is intended to highlight some of the major concerns and challenges noted during the course of the Inquiry in relation to the financial performance of Forestry Tasmania. The issues covered in this report, particularly under terms of reference 1-3, should not be read as an exhaustive list of the issues relating to the financial performance of Forestry Tasmania and as such, the reader should also consider the reports completed by the Auditor-General, including the recent Special Report No.100.**

1. Government Administration Committee "A" (the Committee) was established by resolution of the Legislative Council and its operation is governed by Sessional Orders agreed to by the Council.
2. By resolution of 3 March 2011, the Committee determined to commence an Inquiry in relation to the financial performance of Forestry Tasmania.
3. In commencing the Inquiry, the Committee was concerned about the financial performance of Forestry Tasmania following a series of reports by the Auditor-General that confirmed amongst other things declining operating profits, poor cash flows and increasing superannuation liabilities.
4. The Committee was also concerned about the implications of extensions to the letter of comfort provided to Tascorp during 2010-11.
5. The Committee's aim in completing this report is to provide information to inform the Government and the public as to some of the major issues facing Forestry Tasmania and the appropriate actions that should be taken in the circumstances. The Committee intends that the report compliment the important work undertaken by the Auditor-General and that it should also

inform the work currently being completed as part of the strategic review of Forestry Tasmania.

6. The Committee had already noted a range of factors that were potentially impacting upon Forestry Tasmania's financial performance. The Committee's concerns included the decline in Forestry Tasmania's available markets (including exports), the impact of the global financial crisis, the impact of the Japanese tsunami and the unfavourable exchange rates facing Australian export industries.
7. In attempting to evaluate the financial performance of Forestry Tasmania over time, the Committee was concerned about the standard of public reporting undertaken by Forestry Tasmania. In particular, the Committee was concerned about the ability of the reader to be able to reasonably consider the financial performance and strategic direction of the organisation from the published information.
8. The Committee was concerned that Forestry Tasmania Management and the Board appeared to have failed to take adequate strategic action in a timely manner to address the decline in operating cash flows and market conditions.
9. In conducting the Inquiry, the Committee considered the issue of the ongoing profitability of Forestry Tasmania as a matter of importance but that their operating cash flow position was of more immediate concern.
10. The cash flow challenges noted include Forestry Tasmania's requirement to meet Community Service Obligations (CSO), the costs associated with their defined benefits superannuation liability and the effect of the annual revaluation of their biological assets on profit.

11. Cash flow challenges were noted to have also resulted from a high level of outstanding debtors. As at 4 July 2011 Forestry Tasmania were owed \$37 million, of which \$27 million was overdue. Some of these debts are well outside normal commercial payment terms, up to 101 days.<sup>1</sup>
12. In considering these challenges, the decision to undertake the Inquiry was also appropriate given the importance of a sustainable forest industry to the economy of Tasmania, which requires the prudent and sustainable management of the public forest assets.
13. A range of information was sought during the course of the Inquiry. The primary source of information was from Forestry Tasmania directly, either by means of written submission or by means of evidence at a series of hearing dates. The Committee also considered a range of information published by the Auditor-General as well as a small number of written submissions that were received.
14. At the commencement of the Inquiry, the Committee received a briefing from the Auditor-General on 13 April 2011. The Committee acknowledges and thanks the Auditor-General for his time and assistance with this Inquiry.
15. Although the Committee did not call for public submissions, a total of 6 parties made written submissions to the Inquiry. Some of the material was treated as *in-camera* evidence. This included written material from Forestry Tasmania themselves. Further information in relation to the submissions received is attached to the report at **Appendix A**.
16. The only witness requested to attend public hearings was Forestry Tasmania. Hearings were held at the following times and locations:

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<sup>1</sup> B.Gordon, *Transcript of Evidence, 4 July 2011*, p. 14

- a. 18 April 2011 – Parliament House Hobart
- b. 23 May 2011 – Parliament House Hobart
- c. 4 July 2011 – Parliament House Hobart

Further information about witnesses is attached to the report at **Appendix B**.

17. Further information in relation to the transcripts from the hearings can be found at **Appendix C** and at [www.parliament.tas.gov.au](http://www.parliament.tas.gov.au).
18. The Committee acknowledges that at the time the Inquiry was conducted, Forestry Tasmania was facing considerable pressure due to a range of uncertainties facing the industry.
19. From the outset of the Inquiry, the Committee found it a difficult task to obtain clear answers from Forestry Tasmania in relation to a range of questions put to them. They were reluctant to answer questions and provide appropriate documentation as expected.
20. Forestry Tasmania provided incremental information to the Committee, only after multiple requests to do so. In general terms, the Committee found that the majority of the information sought was straight forward financial information that would already have been readily available to them.
21. During the course of their evidence, the Committee also noted a tendency on the part of Forestry Tasmania to present a conflicting position in relation to whether they sought to be treated as a commercial enterprise or not.
22. Forestry Tasmania has not provided details of the costs of delivering CSO's in recent financial reporting.



23. The terms of reference for the Inquiry were to inquire into and report upon:
- a. The financial performance of Forestry Tasmania as reported in the Half Yearly Financial Report;
  - b. Actions taken by Forestry Tasmania to address the decline in operating cash flows previously reported and noted by the Auditor General;<sup>2</sup>
  - c. Factors impacting on the ongoing profitability of Forestry Tasmania;
  - d. Financial and operational implications of the recent restructure of Forestry Tasmania resulting in the abolition of the Mersey District.
24. In considering the terms of reference, the Committee also attempted to clarify the role the State Government had played in relation to the performance of Forestry Tasmania and the declining operating cash flow position of the organisation.
25. It appeared to the Committee at the commencement of the Inquiry that the Shareholder Ministers had taken a hands-off approach to the financial performance issues facing Forestry Tasmania.
26. The Committee noted from the outset of the Inquiry, that given the nature of the problems facing Forestry Tasmania, and particularly given the reports of the Auditor-General over the last three years, it was difficult to understand why the Government would have adopted such an approach in the circumstances.
27. In forming this initial view, it appeared to the Committee that there had been an absence of reports to Parliament other than the Auditor-General's Annual Reports, and most recently his Special Report, that would alert the Parliament

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<sup>2</sup> Auditor-General Report No.2 of 2010, Vol.3, p. 33-46

to the serious challenges faced by Forestry Tasmania in the current economic climate.

28. Although the Committee affirms in principle, the decision of the Government in recent months to undertake a strategic review of Forestry Tasmania, the Committee believes this decision to have been unreasonably delayed.
  
29. Following the commencement of the Inquiry, the Auditor-General tabled Special Report No.100 '*Financial and economic performance of Forestry Tasmania*'. The report was tabled in both Houses of the Tasmanian Parliament.

## **FINDINGS**

30. Forestry Tasmania's first years of operation were characterised by relative stability and impressive dividend payments to the State. This situation changed as gradually costs rose, returns diminished and assets were devalued. At the same time, export markets and prices became volatile, a problem exacerbated by currency values and political activism. While in the mid-2000s, Forestry Tasmania found these factors challenging, though manageable, by 2010 it was operating at a loss.
  
31. Forestry Tasmania appears to have adopted a reactive approach to risk. The Committee has found it to be questionable whether Forestry Tasmania has acted with sufficient strategic vision over time to address the challenges that have arisen within their business.
  
32. The Committee is concerned about the ongoing viability of Forestry Tasmania. The following findings are made from the evidence obtained during the course of the Inquiry:
  - a. The Shareholder Ministers are the Treasurer and the Minister for Energy and Resources;
  - b. It is not mandatory for Forestry Tasmania to publish an interim financial report;
  - c. Forestry Tasmania is to be commended for publishing an interim financial report, however the report released by Forestry Tasmania and considered by the Committee was inadequate and not in accordance with AASB standards;
  - d. It was difficult to obtain concise information from Forestry Tasmania about their operating cash flow position;
  - e. Forestry Tasmania provided an expected cash deficit position of \$3.156 million for the first six months of the 2010-11 financial year;

- f. Forestry Tasmania's operating cash position for 2010-11, as reported in the 2010-11 financial statement is recorded as a deficit of \$12.117 million;<sup>3</sup>
- g. Forestry Tasmania requires a minimum operating cash flow of \$20 million to cover capital expenditure;<sup>4</sup>
- h. Forestry Tasmania provided the Committee with a general indication of the steps being taken by them to address the decline in their cash flow position through cost savings measures. They failed to confirm their strategy of how the decline in cash flow would be addressed in terms of the growth and development of their business;
- i. The strategies employed and measures taken to reduce spending are unlikely to be adequate to generate a positive cash flow position in the short term;
- j. Cost savings should flow from the closure of the Mersey District;
- k. TCFA funds appeared to have been used to fund ordinary operations. These funds will need to be repaid at some stage in order to fund remaining TCFA obligations. Given the current state of Forestry Tasmania's operating cash flow, it is unclear how this will be achieved;
- l. In trying to understand the TCFA funding in the context of Forestry Tasmania's profitability, the Committee was unable to determine with confidence the accuracy of the accounting for the TCFA funds due to inconsistency in the reported figures provided to the Committee by Forestry Tasmania, in its Annual Reports, and reports of the Auditor-General;
- m. Funding to meet the statutory CSO costs was provided by Government to Forestry Tasmania until the 1998-99 financial year;

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<sup>3</sup> Forestry Tasmania, *op. cit.* p.5

<sup>4</sup> B.Gordon, *op. cit.*p.3

- n. The CSO statutory requirement does impose additional operating expenses on Forestry Tasmania that currently need to be met from within their existing operating budget;
- o. The Auditor-General has reported that Forestry Tasmania has historically provided a detailed breakdown of their CSO costs incurred. Forestry Tasmania did not provide a detailed breakdown of their CSO costs to the Committee, or publish these costs in their half yearly reporting or their recent annual financial reports.
- p. Forestry Tasmania state they are seeking Government funding to meet the cost of their CSOs. The Minister for Energy and Resources stated that he did not believe it was appropriate to support an application at this time in light of the current strategic review;<sup>5</sup>
- q. It is uncertain that an application has been made by Forestry Tasmania for CSO funding at the time of reporting;
- r. The payment of \$2.8 million pa in Local Government rates by Forestry Tasmania is an appropriate and legitimate liability in respect of the productive commercial forests under their management given their GBE status;
- s. A number of factors remain as threats to the operating position of Forestry Tasmania including the high Australian dollar, global markets, the uncertainty surrounding the SOP process, the IGA, superannuation liability and the debtor situation;
- t. The uncertainty related to the SOP and IGA will have implications for Forestry Tasmania given the potential further loss of productive native forest estates under their responsibility and their role in the management of non-productive native forest estates;
- u. The withdrawal of Gunns Limited from native forest harvesting has negatively impacted on Forestry Tasmania's revenue;
- v. Forestry Tasmania is exploring new markets for their products;

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<sup>5</sup> Auditor-General, *op. cit.* p.91

- w. As at 4 July 2011, Forestry Tasmania was owed \$37 million, of which \$27 million was overdue. Some of these debts are well outside normal commercial payment terms.
- x. Forestry Tasmania's debtor situation is exacerbating their cash flow challenges;
- y. Forestry Tasmania has taken steps to recover debts. However the current economic circumstances have caused difficulty for many forestry related businesses to pay. Forestry Tasmania is working with these debtors to recover the outstanding amounts;
- z. Forestry Tasmania has not received any direction from Government regarding their debt management;
- aa. Until the financial report of 2010-11, Forestry Tasmania has treated all unfunded defined benefit superannuation liability as non-operating expenses;
- bb. The Auditor-General has stated that Forestry Tasmania's unfunded defined benefit superannuation liability will continue to grow for at least another 5.5 years and it will require cash to fund retirements and pensions;
- cc. Without more detailed and relevant segment reporting by Forestry Tasmania, it will continue to be difficult to determine what sectors of their business are profitable or unprofitable.

## **RECOMMENDATIONS**

33. The Committee makes the following recommendations as a result of the Inquiry:

- a. The Government needs to work with the Forestry Tasmania Board to address the issue of the lack of an adequate cash surplus as a matter of urgency;
- b. Interim reporting be continued and in accordance with AASB consistent with Treasurer's Instruction GBE 08-52-05 which mandates AASB standards for year-end financial reporting undertaken by a GBE;
- c. The Forestry Tasmania Board urgently resolve the question of the strategic direction of the organisation with particular regard to:
  - i. The identification and pursuit of new and additional revenue streams;
  - ii. Debtor management;
  - iii. Clearly articulated actions to reduce spending;
  - iv. Funding of the current and emerging superannuation liability; and
  - v. Funding for and management of the CSOs.
- d. Forestry Tasmania more clearly report the income and expenditure of TCFA funds;
- e. Forestry Tasmania undertake comprehensive segment reporting, with consideration to commercial confidentiality, as part of their financial performance reporting;
- f. As recommended by the Auditor-General, legal advice be sought by Forestry Tasmania as a matter of urgency to resolve the question of the CSO funding between the Tasmanian Government and Forestry Tasmania;

- g. Forestry Tasmania provide a full break down of the CSO costs in their financial reporting;
- h. Forestry Tasmania respond in a more strategic and timely manner to emerging and actual threats to their operating cash position, resulting from factors including Government policy decisions, unfavourable exchange rates, the increased unfunded superannuation liability, market volatility and market conditions;
- i. Forestry Tasmania and the responsible Minister work towards compliance with the Treasury reform principles for the operation of GBEs. In particular, the Committee believes attention should be given to Principles 1, 2, 6 & 7 which state:
- *Principle 1: Shareholder Ministers exercise strategic control over Government businesses, consistent with their accountability to the Parliament and the public, to ensure the Government's broader policy objectives;*
  - *Principle 2: Shareholding Ministers set clear objectives for Government businesses outlining the core activities to be undertaken by the Government business, including any public policy objectives;*
  - *Principle 6: The Board and management of a Government business are to ensure that the business is managed in a way that is consistent with the expectations of the Government;*
  - *Principle 7: Government businesses are subject to appropriate public disclosure and reporting transparency in the interest of accountability to the Parliament and the community. Treasury is working with the Government businesses on implementation of the Report Principles with the initial focus on updating the Ministerial Charters and Statement of Expectations for all Government businesses.<sup>6</sup>*

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<sup>6</sup> Treasury, *op. cit.*



- j. That this Report be tabled at the next meeting of the Joint Standing Committee of Public Accounts.

## **A BRIEF HISTORY OF FORESTRY TASMANIA**

34. On 1 July 1994, Forestry Tasmania commenced operations. The former Forestry Commission had been disaggregated, with its functions separated into State forest management (Forestry Tasmania), private forest policy (Private Forests Tasmania), environmental regulation on State and private forests (Forest Practices Board) and forest policy (Department of Infrastructure, Energy and Resources).<sup>7</sup>
35. Its vision, as described in 1995, was that Forestry Tasmania '*will be an internationally competitive forest manager, with its operations based on sustainable, multiple use forest management and recognised for excellence in research, enterprise and forestry practices.*'
36. The Company's purpose, or mission, was described as being '*the sustainable production and delivery of forest goods and services for optimum community benefit using environmental best practice to create long-term wealth and employment for Tasmanians.*'<sup>8</sup>
37. The first year of operations involved a transition to corporatisation, which required new employee arrangements and a new Enterprise Agreement.<sup>9</sup> In terms of business prospects, there were no problems apparent. Forestry Tasmania's chair affirmed: '*Gains were made in profitability and wood production and there have been real increases in wood prices.*' The company had no debt and estimated it could fund its near-term capital expenditure and dividend-tax equivalent from internal sources.<sup>10</sup>

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<sup>7</sup> Forestry Tasmania, 'Sustainability Charter: Forest Management Plan 2008', p.56-57

<sup>8</sup> Forestry Tasmania Annual Report 1994-95, p.9.

<sup>9</sup> *Ibid*, p14-15

<sup>10</sup> *Ibid*, p.9

38. By the following year, the *'novelty of the new corporate approach was replaced with the harsh realities of operating as a profitable business in very difficult markets'* Managing Director Evan Rolley observed.<sup>11</sup> This was attributed largely to a slow domestic housing market and the Asian Financial Crisis affecting export markets, but meant finding operational efficiencies and deferring projects.<sup>12</sup>
39. In 1997, the commencement of the Regional Forest Agreement (RFA) meant Forestry Tasmania lost 57,000 hectares of harvestable forest. This was offset with compensation and an overall increase in valuation of the forest estate.<sup>13</sup> There was also some change to the executive structure with the creation of the new role of Chief Financial Officer and Secretary to the Board.<sup>14</sup>
40. Forestry Tasmania also opened its new headquarters in Hobart. In 1999, the financial results were *'disappointing'*, in the Chair's view, but reflected the realities of the commercial environment at the time, and notwithstanding, he believed *'the financial fundamentals of the business are sound.'*<sup>15</sup>
41. By 2000 the situation had improved as markets in South Korea, Indonesia, China and Japan were developed.<sup>16</sup> However, successive Forestry Tasmania annual reports continued to describe market conditions in terms such as difficult, challenging, and tough as well as noting the pressure this placed on their cashflow. Whilst Forestry Tasmania was able to retain its employees, it consciously sought to defer payments to suppliers until market conditions improved. Furthermore, to raise cash, Forestry Tasmania sold heavy plant and equipment items on a leaseback basis.<sup>17</sup>

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<sup>11</sup> Forestry Tasmania Annual Report 1995-96, p.15

<sup>12</sup> Forestry Tasmania Annual Report 1997-98, p.14; Forestry Tasmania Annual Report 1996-97, p. 14

<sup>13</sup> Forestry Tasmania Annual Report 1997-98, p.14

<sup>14</sup> Forestry Tasmania Annual Report 1998-99, p.9

<sup>15</sup> *Ibid*, p.11

<sup>16</sup> Forestry Tasmania Annual Report 1999-00, pp.6-9

<sup>17</sup> Forestry Tasmania Annual Report 2001-02, p.8

42. Forestry Tasmania also began to pursue tourism projects, as highlighted by the Tahune Airwalk and Scottsdale Forest Eco Centre projects.<sup>18</sup>
43. During the early 2000s there were also changes to accounting standards and methods. Specifically, asset revaluations that had been adjusted against equity were instead treated as revenue, which happened to add \$32.111 million into Forestry Tasmania's revenue stream in 2000-01.<sup>19</sup> Although, in 2003, the Directors expressed concern '*that the current methodology for valuation of native forests on our balance sheets needs further review.*'<sup>20</sup>
44. The following year the Directors re-issued a warning that due to anticipated changes to accounting standards this would mean new assumptions had to be made. The value of assets impacted on ascertaining asset performance or returns; this in turn impacted Forestry Tasmania's ability to know whether its long-term investments had been sensible.<sup>21</sup> The value of forest assets could also change unpredictably from year to year due to bushfires, with an expenditure impact associated with fire-fighting efforts.
45. Forestry Tasmania was provided with a capital structure review and the Board approved a revised capital structure. A forward borrowing program commenced to invest in items deemed to be revenue generating, such as roads and plantations, starting with the first borrowing of \$14 million.<sup>22</sup>
46. The financial year 2002-03 was reported as being a '*substantially improved year*' for Forestry Tasmania,<sup>23</sup> as was 2003-04.<sup>24</sup> Forestry Tasmania hinted that if it received a CSO payment, its profitability would be improved.<sup>25</sup>

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<sup>18</sup> Forestry Tasmania Annual Report 2000-01, p.6

<sup>19</sup> Auditor General Report No. 2 Vol. 2, 2001, p.114

<sup>20</sup> Forestry Tasmania Annual Report 2002-03, p.7

<sup>21</sup> Forestry Tasmania Annual Report 2003-04, p.8

<sup>22</sup> Forestry Tasmania, *op. cit.*, p.6

<sup>23</sup> Forestry Tasmania, *op. cit.*, p.6

<sup>24</sup> Forestry Tasmania, *op. cit.*, p.8

47. In 2005, the Tasmanian Community Forest Agreement (TCFA) resulted in additional reserves being added for conservation purposes, restrictions on clear felling and changed harvesting techniques.<sup>26</sup> The area of additional reserves was approximately 360,000 ha.<sup>27</sup>
48. Forestry Tasmania also found during this time that its operating costs were rising due to fuel prices and new environmental standards being applied to wood supply. The Board also expressed the view that it was being '*burdened*' by Forestry Tasmania's CSOs. Combined with the application of other government taxes, according to the Board, these factors were causing an '*ongoing dilution of Forestry Tasmania's future income cash stream,*' totalling \$7.6 million pa.<sup>28</sup>
49. The Board also noted in 2005 that there were '*a number of constraints*' (without naming them) that Forestry Tasmania had to absorb compared to the private sector. '*To make any comparison in financial terms, particularly for return on investment, it is important that these caveats on the management of State forests become more transparent.*'<sup>29</sup>
50. Due to a change in accounting standards from AGAAP to AIFRS in 2004-05, Forestry Tasmania's net assets decreased by \$134.480 million, although this did not impact on its cash position.<sup>30</sup>
51. In 2005-06, forest sales revenue decreased by \$30 million, due to the strong Australian dollar, freight costs and product boycotts.<sup>31</sup> In addition, Forestry

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<sup>25</sup> Forestry Tasmania, *op.cit*, p.8

<sup>26</sup> Forestry Tasmania Annual Report 2004-05, p.7

<sup>27</sup> Tasmanian Community Forest Agreement factsheet.

<sup>28</sup> Forestry Tasmania, *op. cit*, p.10

<sup>29</sup> Forestry Tasmania, *op. cit.*, p.11

<sup>30</sup> Auditor General Report No. 2 Vol. 2, 2006, pp. 17-18

<sup>31</sup> *Ibid*, p.14

Tasmania was receiving income to offset the TCFA funds which when excluded from earnings suggested that profit in 2006-07 was less than stated.<sup>32</sup>

52. Forestry Tasmania management assured the Auditor-General that TCFA money was being expended to cover costs incurred due to that agreement and made '*no net contribution to profit other than that spent on capital expenditure.*'<sup>33</sup>
53. Then ANZ Chief Economist Saul Eslake said in October 2006 that he estimated Forestry Tasmania had a market valuation of \$25 million, were it to be sold, due to its low returns.<sup>34</sup>
54. Forestry Tasmania embarked upon a new strategy of 'value-adding' within Tasmania (the processing of timber products within Tasmania prior to export), signified by the opening of two veneer mills by the Malaysian company Ta Ann in the Huon Valley and Circular Head.
55. The Tamar Valley Pulp Mill was envisaged to provide Forestry Tasmania with demand for wood supply, avoiding the need to export quantities of pulpwood from Tasmania as woodchips.<sup>35</sup> This would, to an extent, fill a void created by a downturn in the international woodchip market, due to high currency, high freight costs, and in Forestry Tasmania's view, a '*misinformation campaign*' perpetuated by environmental groups that was damaging market perceptions.<sup>36</sup>

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<sup>32</sup> Forestry Tasmania Annual Report 2006-07, p.48

<sup>33</sup> Auditor General Report No. 2 Vol. 2, 2007, p.19

<sup>34</sup> 'Forestry Tasmania Worth \$25m: Economist', *The Advocate*, 16 October 2006, p.13

<sup>35</sup> Forestry Tasmania, *op. cit*, p.15

<sup>36</sup> Forestry Tasmania, *op. cit*, p.9

56. However, it would increase reliance on Gunns Limited, which in 2008 accounted for 47% of Forestry Tasmania's forest sales. [Other major customers were Artec (17%) and Norske Skog Boyer (7%).]<sup>37</sup>
57. The initial wood supply agreement reached between Gunns Limited and Forestry Tasmania lapsed, with mill construction yet to commence, and was subsequently extended to November 2010.<sup>38</sup>
58. The 2006-07 Annual Report observed that the statutory requirement of providing sawlog volume of 300,000m<sup>3</sup> per annum '*reduces our ability to deliver a fully commercial financial performance.*'<sup>39</sup> The following year a further valuation of forest assets caused a \$73.889 million decrement. Earnings before interest and taxes (EBIT) and return on assets were disclosed as not being comparable to previous years due to more '*changes to accounting policies*', at least the second such change within a relatively short period.<sup>40</sup> Forestry Tasmania disclosed in 2008 that:
- The prime reasons for the decrease in the forest value can be attributed to change in prices, timing of wood flows (reflecting the Tasmanian Community Forest Agreement) and increased forest management costs, in particular the increased cost of pest control since the use of 1080 ceased on state forest.*<sup>41</sup>
59. Financial results diminished too. The Auditor-General observed:

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<sup>37</sup> Auditor General Report No. 2 Vol. 2, 2008, p.20

<sup>38</sup> 'Lifeline for Gunns', *Mercury*, 2 December 2008, p.1

<sup>39</sup> Forestry Tasmania, *op. cit.*, p.13

<sup>40</sup> Forestry Tasmania Annual Report 2007-08, p.5. See also p.22: "*Forestry Tasmania has changed its policy for accounting for the biological native forest asset class. In the period 1 July 2005 to 30 June 2007 this asset was accounted for under AASB 116 Property, Plant and Equipment on the basis that this asset was more in the nature of this asset class, as the driver of the change in value was not biological growth but other factors used in the valuation process. However, in reviewing this policy in 2007-08 the Board has determined that the native forest asset should now be accounted for under AASB 141 Agriculture, in line with the plantation biological asset.*"

<sup>41</sup> *Ibid.*, p.5

*Not surprisingly, as a result of its tight liquidity position, Forestry proposed no dividend for the 2007-08 financial year. It is also noted that no dividend was paid during 2007-08 in relation to the 2006-07 financial year. Improved operating profits and cash flows are required if Forestry is to return to paying dividends ... I am advised that management is developing longer-term strategies to maintain future sustainability.*<sup>42</sup>

60. In 2009 Forestry Tasmania reported that its financial position was ‘robust’ notwithstanding the global financial crisis.<sup>43</sup> Nonetheless, cashflow remained a problem and the Auditor-General estimated that Forestry Tasmania had utilised \$2.965 million of TCFA funds for operating expenses outside that agreement, which would need replacing at a future date.<sup>44</sup>
61. There was no dividend recommended for 2008-09.<sup>45</sup> Debt collection days slowed to 65 days (more than double the benchmark 30 days) due to the late payment of a number of large invoices effecting a slower than usual payment cycle.<sup>46</sup>
62. In 2010, however, Forestry Tasmania’s finances encountered trouble: There was a decrease in operating revenue (from \$182.952 million in 2008-09 to \$162.277 million in 2009-10) and return on assets decreased from 1.1% to 0.3%.<sup>47</sup> Essentially, Forestry Tasmania was generating negative cash from its operating activities, a situation the Auditor-General described as ‘... *not sustainable*’.<sup>48</sup>

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<sup>42</sup> Auditor-General, *op. cit.*, p.18

<sup>43</sup> Forestry Tasmania Annual Report 2008-09, p.8

<sup>44</sup> Auditor-General Report No. 2 Vol. 2, 2009, p.19

<sup>45</sup> *Ibid.*, p.20-21

<sup>46</sup> *Ibid.*, p.21-22

<sup>47</sup> Forestry Tasmania Annual Report 2009-10, p.4

<sup>48</sup> Auditor-General Report No. 2 Vol. 3, 2010, p.44



63. The balance sheet was also affected by a change to forest asset valuation, although this did not affect Forestry Tasmania's cash position. The 2009-10 Annual Report stated:<sup>49</sup>

*The independent valuation conducted by Sewall determined that no positive 'commercial in use' value could be attributed to forest land given the constraints applied under the Forestry Act. In addition, title for this land rests with the Crown, not with Forestry Tasmania. Based on this information, the Directors have impaired the forest land asset to a zero carrying value as at 30 June 2010,*

64. Forestry Tasmania was also facing problems due to the gradual disappearance of its traditional market in Japan and the need to replace the old with the new.

*We primarily developed the [marketing] strategy in response to the shift in market conditions in Japan, which for the past 30 years was the major destination for Tasmanian woodchips. However, as the pulp and paper mills in Japan age, Japanese investment in this infrastructure is now heading offshore to China, where the same quality products can be produced more competitively.<sup>50</sup>*

65. The Auditor-General recommended that Forestry Tasmania change the way its financial statements are to be presented in the future to improve public understanding of its operations.<sup>51</sup>

66. At the December 2010 Government Business Enterprise (GBE) hearings, Forestry Tasmania acknowledged that although trading conditions led to negative cash flow from operations in the 2009-10 financial year, profitability had recovered in the six months since and the situation had much improved.<sup>52</sup>

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<sup>49</sup> *Ibid*, Appendix 1, p.27

<sup>50</sup> *Ibid*, p.8

<sup>51</sup> Auditor-General, *op. cit*, p. 9 and Auditor-General, *op. cit*, p.33-34

<sup>52</sup> House of Assembly GBE Committee, *Transcript of Evidence*, 1 December 2010, p. 25

67. Staff numbers have decreased overall since Forestry Tasmania's establishment. Forestry Tasmania's first Annual Report for the 1994-95 reporting year noted a full time equivalent (FTE) figure of 622 as at 30 June 1995. FTEs have subsequently declined over time. In 2009-10, there were 461 FTEs reported.

68. The July 2011 Special Report No.100 completed by the Auditor-General succinctly explained the development and changes in Forestry Tasmania's operating environment since its establishment in 1994.<sup>53</sup>

*The forestry business is cyclical in nature and exposed to changes in trading conditions and to the strength of local and world economies. The nature of Forestry's business changed significantly over the 16 years to 30 June 2010. ...*

69. Matters of particular historical impact on the financial performance of Forestry Tasmania were decisions of Government to remove the provision of CSO type funding, Forestry Tasmania's decision to sell its plantation assets requiring it to return \$40 million to the State and entering into the RFA and the TCFA resulting in a reduction in the native forest estate available to generate income.

70. Forestry Tasmania's financial situation is particularly difficult, being faced with declining revenues, relatively high fixed costs including CSO type costs, a decline in the available productive native forests, particularly since 2000, with an increase in obligations for management of non-productive forests, declining operating cash flows, long periods between investments in plantation development and a return on investment, declining local and world markets, an increasing Australian dollar, increasing defined benefit superannuation obligations and uncertainty regarding its CSOs.

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<sup>53</sup> Auditor-General, *op. cit.*, p.2

*...We formed the view that expectations of Forestry, and the environment in which it operates, changed fundamentally over the period July 1994 to June 2010 but that its business and funding model did not keep pace with these changes. This conclusion is supported by the fact that the most recent Ministerial Charter was issued in 1999.*

*Forestry is endeavouring to deal with these matters but may not be able to do so without financial assistance from the State Government. For example, based on current levels of cash flow, Forestry will find it difficult to fund its defined benefit superannuation obligations.<sup>54</sup>*

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<sup>54</sup> Auditor General Special Report No. 100, 'Financial and economic performance of Forestry Tasmania', July 2011, p.2-3

## **THE FINANCIAL PERFORMANCE OF FORESTRY TASMANIA AS REPORTED IN THE HALF YEARLY FINANCIAL REPORT**

71. The decision to commence the Inquiry was in part based upon the information contained in the report published by Forestry Tasmania entitled '2011 HY *Financial Results and Outlook*' (the interim report).
72. Forestry Tasmania commenced interim reporting for the operating period 1 July – 31 December 2010, following requests to do so from Members of the Legislative Council and recommendations made by the Auditor-General.
73. Forestry Tasmania indicated during the course of the Inquiry that they had received guidance from the Department of Treasury and Finance that supported the necessity to commence interim reporting.
74. Forestry Tasmania indicated that the guidance was for all GBEs and was therefore not limited to their organisation. The guidance was in relation to an expectation on the part of the Government that GBEs act in a similar corporate manner to an ASX listed company.
75. Mr Gordon noted during the course of his evidence that:

*Treasury issued a guideline that said GBEs and SOCs should try to act in accordance with ASX guidelines - that is, act as if they were listed entities in terms of reporting finances. As you would be aware, a listed company would normally produce its six-monthly financial results and may or may not issue profit guidance at the same time.<sup>55</sup>*

but that in respect of the expectation that Forestry Tasmania would do so that:

*the entities in other States would not do six-monthly statements. Quite a few of them are government departments so they do not*

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<sup>55</sup> B.Gordon, *Transcript of Evidence*, 18 April 2011, p.1

*have standard accounting practices, they do not have normal company accounting practices.*<sup>56</sup>

76. The Committee was unable to identify a specific Treasury Instruction to enforce such an interim reporting requirement. Given Forestry Tasmania was the only GBE to have completed an interim report, the Committee concluded the undertaking was likely to have been voluntary rather than a requirement.
77. The Committee noted during the course of Forestry Tasmania's evidence that there was a general reluctance on their part to produce a full set of accounts as part of an interim report.
78. The reasons for the reluctance included concerns related to issues of commercial in-confidence information, that similar forestry organisations in other jurisdictions do not produce interim reports, the unaudited status of the report, the resources required by Forestry Tasmania to complete the report and because of concerns with unreasonable conclusions that may be drawn from an interim report that did not cover the full 12 month reporting period of their operations, given the nature of their business.
79. Mr Gordon noted in relation to the ability of Forestry Tasmania to have the interim report audited that:
- There appears to be no head of power or authority to have those accounts audited by the Auditor-General so that is why that has not been done and also it is the first time we have done it.*<sup>57</sup>
80. Whilst Forestry Tasmania is to be commended in principle for the decision to publish an interim financial report in addition to their mandatory annual reporting obligations, the report published by Forestry Tasmania was found by

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<sup>56</sup> *Ibid*, p.2

<sup>57</sup> *Ibid*, p.1

the Committee to be of little benefit to the reader and in general terms, not to an appropriate standard.

81. The Committee agreed with the comments of Mr Gordon at hearing that there was a lot of work to be done on the reporting and that he was seeking feedback from stakeholders in relation to the report.
82. The Committee found the interim report was more akin to a company newsletter than a financial report. The Committee found the interim report failed to provide basic information that the reader may use to gain an objective understanding of the financial performance of Forestry Tasmania.
83. The interim report did not conform to Australian Accounting Standards Board (AASB) standards, which would be a reasonable benchmark given that the full year financial reports are to be prepared in accordance with AASB standards as per the Treasurer's Instruction GBE 08-52-05.
84. The Committee noted that some basic information was provided in the interim report which included:
  - a. A restructure of Forestry Tasmania was underway to reduce operating costs by measures such as a reduction in the workforce, by seeking funding to meet CSOs, amalgamation of the Mersey District and negotiating a higher stumpage price;
  - b. An increase in revenues from forest sales over the six month reporting period;
  - c. Reductions in the workforce to 350 underway;
  - d. An increase in operating expenses over the six month period;
  - e. An increase in operating profit over the six month period;
  - f. A general outlook of uncertainty.

85. A number of key and important pieces of financial information remained unclear or missing from the interim report, including:
- a. A statement of comprehensive income;
  - b. A balance sheet or a statement of financial position;
  - c. A statement of cash flows;
  - d. A statement of changes in equity;
  - e. A lack of segment reporting other than some reference to their tourism operations;
  - f. There is no indication of the current cash flow position or cash flow forecast for the year;
  - g. With reference to points d. and e. at paragraph 79, the comments contained within the report appear to be at odds with the first six months of trading whereby three/six months had been reported to have zero export sales;
86. The Committee also noted there was no explanatory information in relation to business changes which would have been helpful to the reader including:
- a. The report refers to '*strong demand for whole log exports*' but does not provide information including the percentage of total export products;
  - b. The report makes reference to '*Chinese demand strong – prices rising*' but fails to indicate what the prices were for, and what contracts had been signed in support of this position;
  - c. There was no separation of CSO costs so that the reader may understand what the costs to Forestry Tasmania are said to be in relation to the stated obligations;
  - d. What the amalgamation of the Mersey District would mean for Forestry Tasmania in terms of their operations;

- e. What impact the reduction in the full time equivalent figure would have in terms of operations;
  - f. Why CSO funding has not been sought prior to 2011 given the emphasis CSO was said to have had on the profitability of the business over a number of preceding years;
  - g. How Forestry Tasmania intends to negotiate a higher stumpage price in the future;
  - h. How Forestry Tasmania is intending to prepare for a possible further transition out of native forest harvesting.
87. In considering the issue of interim reporting, the Committee noted the requirement placed upon GBEs to complete quarterly reporting to the responsible Minister in accordance with Treasurer's Instruction GBE 08-57-05<sup>58</sup> – **Appendix D**.
88. The Committee could not support the rationale provided by Forestry Tasmania about why an interim report could not be produced on the basis of the resources required to do so in light of the work required to comply with GBE 08-57-05<sup>59</sup>.
89. The Committee also found that internal reporting was required to the Forestry Tasmania Board in order for the Board to make informed decisions about the strategic operation and performance of Forestry Tasmania that contained information that would assist with external reporting of this nature.
90. The Committee noted the importance of providing the broader community with up to date financial information in relation to the performance of Forestry Tasmania in light of the comments expressed in the Auditor-General's Report

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<sup>58</sup> Treasurer's Instruction, *Quarterly Reports No. 08-57-05*, under Section 114 of *Government Business Enterprises Act 1995*

<sup>59</sup> *Ibid*



No.2 of 2010, Volume 3 and in response to general community interest and concern in relation to the management of public forest assets.

91. The Committee concluded that acceptable interim financial reporting standards could be achieved by GBEs in Tasmania including by Forestry Tasmania.
92. The Committee noted Treasury Newsletter Volume 12, Number 1 of July 2011 in which '*Operation of Government Businesses – reform principles*' – **Appendix D** is discussed and in particular noted the following Principles as most relevant:
- a. *Principle 6: The Board and management of a Government business are to ensure that the business is managed in a way that is consistent with the expectations of the Government;*
  - b. *Principle 7: Government businesses are subject to appropriate public disclosure and reporting transparency in the interest of accountability to the Parliament and the community. Treasury is working with the Government businesses on implementation of the Report Principles with the initial focus on updating the Ministerial Charters and Statement of Expectations for all Government businesses.*<sup>60</sup>

### **Segment Reporting**

93. The Committee makes the following general comments in relation to the issue of segment reporting which should also be considered more broadly in the context of Forestry Tasmania's annual reporting.

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<sup>60</sup> treasury@.tas – Newsletter, Volume 12, No. 1 July 2011

94. The Committee found that the lack of segment reporting by Forestry Tasmania has the effect of making it impossible to determine which aspects of the company's business are profitable or unprofitable.
  
95. Whilst full public disclosure of some of Forestry Tasmania's business sectors is unnecessary due to commercial confidentiality, greater segment reporting is nonetheless needed.

**ACTIONS TAKEN BY FORESTRY TASMANIA TO ADDRESS THE  
DECLINE IN OPERATING CASH FLOWS PREVIOUSLY REPORTED  
AND NOTED BY THE AUDITOR GENERAL**

96. Prior to the commencement of this Inquiry, the Auditor-General had previously reported his concerns to Parliament on a number of occasions in relation to the financial performance of Forestry Tasmania. This included his report entitled *Volume 3 – Government Business Enterprises, State Owned Companies and Superannuation Funds 2009-10* as well his Annual Reports.
97. Since the commencement of this Inquiry, the Auditor-General has also presented to both Houses of Parliament *Special Report No.100 Financial and economic performance of Forestry Tasmania*.
98. The Committee noted from the Volume 3 report that:
- It is not sustainable for Forestry to generate negative cash from its operating activities, a situation management and the Board must address. Management are keenly aware of this position and are monitoring operations closely. We are advised that management is developing longer term strategies to maintain future cash flows.<sup>61</sup>*
99. Based in part upon the findings of the Auditor-General, the Committee was seeking to obtain a clear picture of the strategies being put in place by Forestry Tasmania to address the decline in their cash flow position.
100. The Committee found it to be a difficult task to obtain clear information in relation to the actions taken by Forestry Tasmania apart from a broad overview of some cost reduction strategies they had recently put in place.

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<sup>61</sup> Auditor-General, *op. cit*, p.44

101. The Committee had anticipated that Forestry Tasmania would have provided a detailed strategic overview that would have included information in relation to cost reduction, revenue and other initiatives. This did not occur and instead, some general cost savings initiatives were discussed.

### **Cost Reduction Strategies**

102. Forestry Tasmania indicated one key strategy in reducing their operating costs was the reduction in their full time equivalent (FTE). The target set was a reduction from approximately 550 to 350 and that this had been an ongoing strategy for some time.

103. Other than the amalgamation of the Mersey District into the Bass and Murchison Districts, which was associated with '*substantial one-off redundancies*'<sup>62</sup> and which is discussed further under term of reference 4, Mr Gordon noted that:

*It would be a reasonably even spread of reductions over the last three and a half years.*<sup>63</sup>

104. Forestry Tasmania also noted that they had negotiated with various staff for a reduction to part-time hours.

105. The cost savings of the overall reduction in salaries was put at \$5.8 million.<sup>64</sup>

106. Forestry Tasmania advised the Committee that they were aiming for a significant reduction in their property rental overheads, which included a reduction in rent for their head office in the order of \$700,000 pa<sup>65</sup> by means of

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<sup>62</sup> B.Gordon, *op. cit.* p.10

<sup>63</sup> *Ibid*, p.8

<sup>64</sup> B.Gordon, *op. cit.*, p.7

<sup>65</sup> *Ibid*, p.8

a downscaling of their head office building through the introduction of new tenancies.

107. In relation to the costs associated with renting their headquarters, Mr Gordon claimed that Treasury, as the landlord, had not been charging market based rental prices.<sup>66</sup>
108. Other cost saving initiatives in relation to their buildings included the sale of office buildings and depots in regional centres such as Triabunna, Strahan and Geeveston. Forestry Tasmania noted the challenges associated with disposing of buildings due to the restricted nature of the market for commercial property in these areas.
109. Forestry Tasmania advised the Committee that the amalgamation of the Mersey District had meant the closure of the Stoney Rise building. The rental cost of the facility was put at approximately \$250,000 pa<sup>67</sup>, with an estimated cost saving of approximately \$125,000 pa in rental accommodation as a result of the closure.
110. Forestry Tasmania noted that efficiencies had been made in relation to the decision to commence a lease-back program for their vehicle fleet although the savings were noted to be minimal. Further reductions were anticipated from a fleet migration to diesel vehicles.
111. Costs savings were also intended to be made through the non-replacement of infrastructure. In particular, this related to the non-essential repair of roads, bridges and other infrastructure. The Committee noted the effect this may have in relation to the management of access to a range of important localities and their associated infrastructure.

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<sup>66</sup> B.Gordon, *op. cit*, p.8

<sup>67</sup> *Ibid*, p.11

112. Other measures noted by Forestry Tasmania to reduce costs within the organisation included:

- a. Closure of the Forestry Tasmania library;
- b. Change to Voice-Over-Internet-Protocol (VOIP) telephone system;
- c. Reduction in the Community Assist program from \$100,000 pa to \$80,000 pa;
- d. Reduction in research FTEs resourcing through natural attrition;
- e. Lease out of Tarkine Forest Adventures;
- f. Cost minimisation strategy for Maydena Adventure Hub and improving the profit result for the Tahune Airwalk through increasing yields and reducing costs;
- g. Competitive tendering for electricity costs;
- h. Reduction in costs for regeneration burning.<sup>68</sup>

113. Overall, the cost reduction measures were estimated at:

*between \$5 million and \$7 million in the people costs and another \$1 million or so in the smaller operating cost type things that we have made and there are still some of those to work through.*<sup>69</sup>

### **Other strategies to address cash flow**

114. The Auditor-General expressed concerns about the debt position of Forestry Tasmania as having had a negative impact on their cash flow position due to the longer timeframes for debts to be paid.

115. In response to this concern, Forestry Tasmania advised the Committee that they had implemented a program to pursue overdue accounts, and that this had

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<sup>68</sup> Forestry Tasmania tabled document 'Additional costs saving/revenue measures'

<sup>69</sup> B.Gordon, *op. cit*, p.9

met with some success. However, as at 4 July 2011, Forestry Tasmania were owed \$37 million, of which \$27 million was overdue. Some of these debts are well outside normal commercial payment terms, up to 101 days.<sup>70</sup>

116. Forestry Tasmania advised they were also rigorously monitoring cash levels on a day to day basis and that they had sufficient liquidity to meet their debts as they fall due.<sup>71</sup>

117. The Committee also sought to clarify the status of and use of TCFA funding and the acquittal of funds as a means of addressing the declining cash flow position. In particular, the Committee was concerned about the funds spent each year and the balance of the 'unspent' funds in terms of the ability of Forestry Tasmania to meet future TCFA obligations such as fertilising, pruning and thinning.

118. In explaining the management of TCFA funding Dr Drielsma noted:

*As part of the arrangement, the understanding was that for every hectare of plantation established there would be \$6,000 acquitted. In essence, we have put that into our bank account and then we look after that plantation for the rest of its life. Part of that \$6,000 stays as revenue in advance because we only draw it down and expend it as we do the pruning and the fertilising over time and some of that will emerge over a 15 or 20 year period as we incur the subsequent costs. As far as the external acquittal of the Government is concerned, we have acquitted that once we have established the hectare of plantation.<sup>72</sup>*

119. After multiple requests to do so, Forestry Tasmania did provide the Committee with information in relation to the receipt, acquittal and spending of the TCFA

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<sup>70</sup> B.Gordon, *Transcript of Evidence*, 4 July 2011, p.14

<sup>71</sup> Forestry Tasmania Submission tabled 23 May 2011, p.4

<sup>72</sup> Dr. Drielsma, *Transcript of Evidence*, 18 April 2011, p.14

funds and amount of remaining unspent funds. The Committee found the information provided was inconsistent in respect of the information provided in Forestry Tasmania's Annual Reports, information provided to the Committee and the Auditor-General's Annual Reports. In most cases the variations were not large but the inconsistency of the accounting data is of concern to the Committee.

120. The Committee noted the unspent TCFA funds appeared to have been used to fund ordinary operations. It was unclear to the Committee whether this was an acceptable practice under the terms of the TCFA funding but noted the comments of the Auditor-General:

*Management are aware that money 'withdrawn' as at 30 June 2009 needs to be replaced and expended on TCFA specified activities and regularly manage the overall cash position of the organisation on this basis. In the absence of TCFA funds, Forestry would need the flexibility provided by a working overdraft.<sup>73</sup>*

121. The Committee concluded the funds would need to be repaid at some stage in order to fund remaining TCFA obligations. Given the current state of Forestry Tasmania's operating cash flow, this appeared to the Committee to be a difficult undertaking.

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<sup>73</sup> Auditor-General, *op. cit.* p.19



## **FACTORS IMPACTING ON THE ONGOING PROFITABILITY OF FORESTRY TASMANIA**

122. The Committee sought to obtain clarification from Forestry Tasmania about some of the major factors that in their opinion were impacting upon their ongoing profitability.
123. The Committee found it difficult to obtain concise information from Forestry Tasmania about their operating cash flow position. A figure was eventually obtained during the third date of hearings, which confirmed a deficit of \$3.156 million for the first six months of 2011.<sup>74</sup> The Committee found the forecast was for a further decline at the end of the financial year with Forestry Tasmania acknowledging a cash deficit for the full year.
124. The 2010-11 Financial Statements released on 29 August 2011 disclosed, in the Statements of Comprehensive Income, a loss from operating activities of \$3.339 million, and after taking into account net finance costs, joint venture income, costs attributed to non-commercial forest zones and income tax benefit, the loss disclosed (before other items) was \$12.09 million.
125. The Committee established that the minimum operating cash flow required to cover capital expenditure was \$20 million.<sup>75</sup>
126. The Committee also considered a range of other material including financial reports and reports from the Auditor-General in considering the factors impacting upon profitability.

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<sup>74</sup> Forestry Tasmania Hansard, *op. cit.* p.2

<sup>75</sup> Forestry Tasmania Hansard *op. cit.* p.3

127. Some of the major issues noted by Forestry Tasmania as impacting upon their ongoing profitability included:

- a. CSO liability;
- b. Local Government rates liability;
- c. The high Australian dollar;
- d. Uncertainty surrounding the Statement of Principles (SOP) and the future of native forest operations more generally in Tasmania;
- e. Gunns Limited decision to exit native forest activity;
- f. Outstanding debts;
- g. Superannuation liability;
- h. The value of net assets.

128. With regard to the impact of these challenges Mr Gordon stated:

*At the moment, for example, we have the twin challenge of Gunns shutting four of its woodchip export mills, and an agreement between parties and Forestry Tasmania about the moratorium on some coupes. At the same time, Ta Ann's demand for peeled veneer billets has been running high, so we have to do a whole lot of scheduling in the coupes that produce mostly rotary veneer billets and sawlogs. From those same coupes we are maximising export log production because at the moment there is a very, very limited pulpwood market while ever Gunns have got those export facilities shut. Once the export facilities reopen, we will change all the scheduling and all the margin analysis will also change.<sup>76</sup>*

129. Mr Gordon went on to clearly state the serious situation Forestry Tasmania faced at this time with the possibility of a full shut down of all harvesting activities. He stated:

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<sup>76</sup> B.Gordon, *op. cit.* p.13

*We had a choice, probably three months ago, between shutting down all our harvesting activities - and shutting down most of our customers - or undertaking a substantial rescheduling exercise to maximise sawlog rotary veneer and export billet recovery, which is what we have done. There is a short-term cost in that, in that we have to build roads, and we have to reschedule. Every time you move a contract it costs money. If we had not made that decision, the alternative would probably be everyone shutting down.*<sup>77</sup>

### **Community Service Obligations (CSO)**

130. Forestry Tasmania made repeated reference to CSOs during the course of their evidence as having a significant impact upon their ongoing profitability. Forestry Tasmania last received CSO funding in the 1997-98 financial year.<sup>78</sup>
131. The Committee found CSOs to be a broad term in that it included a *'function, service or obligation'*<sup>79</sup> and that direct obligations were imposed upon the GBEs in accordance with the *Government Business Enterprise Act 1995*.
132. The Auditor-General found that in the case of Forestry Tasmania, CSOs were imposed upon them under s10 of the *Forestry Act 1920* and that in his opinion, there was no discretion in these obligations being met.<sup>80</sup>
133. According to Forestry Tasmania's interim report the cost of delivering CSOs was put at \$4.809 million for the 2011 half year, although no breakdown of the figure was given in the report.

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<sup>77</sup> *Ibid*, p.14

<sup>78</sup> Forestry Tasmania Hansard, *op. cit.* p.22

<sup>79</sup> Section 59 of *Government Business Enterprises Act 1995*

<sup>80</sup> Auditor-General, *op. cit.* p.90

134. A confirmed figure for the full cost of delivering CSOs for the full financial year has not historically been reported by Forestry Tasmania, including for the most recent 2010-11 Annual Report.
135. The Auditor-General has noted, that given Forestry Tasmania had historically provided a detailed breakdown of their CSO costs incurred, it was unclear why they were unable to publicly produce similar information for their recent Annual Reports. As they were seeking funding for the cost of their CSOs and consistently chose to raise this as a cost impact upon their cash flow position, CSO information would need to be reported.<sup>81</sup>
136. The Committee sought clarification as to whether Forestry Tasmania had applied to the Tasmanian Government for funding to meet their CSOs. Forestry Tasmania indicated to the Committee that they had made an application in early 2011 but had not received a response at the time of their evidence.<sup>82</sup> An application had apparently not been made prior to that time on the basis that 'Up until 2008 we did have money'.<sup>83</sup>
137. Mr Gordon noted in relation to CSO funding that:

*We expect that application to be dealt with in accordance with the GBE Act which says it should be dealt with and if the costs are genuine costs incurred then they should be funded. There will obviously be a debate about that. The alternative is for us to cease doing those things which is difficult because we are caught in the squeeze, because the Forestry Act requires us to manage these areas under good public policy for conservation and for other uses and we believe we should be funded for it.*<sup>84</sup>

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<sup>81</sup> *Ibid*, p.91

<sup>82</sup> B.Gordon, *op. cit*, p.22

<sup>83</sup> *Ibid*, p.22

<sup>84</sup> *Ibid*, p.22-23

138. The Committee sought clarification as to the status of the application for CSO funding from the Minister for Energy and Resources.
139. The Minister provided a written response on 29 August 2011 which confirmed that whilst Forestry Tasmania *'has written to me seeking support to apply to the Treasurer for Community Service Obligation (CSO) funding'* that he did not believe it was appropriate for Forestry Tasmania to make application for funding at this time in light of the current strategic review.
140. The Committee noted with concern, the discrepancy in position between the Minister and Forestry Tasmania in relation to the question of whether the correspondence was in fact an application for CSO funding or simply a request for support from the Minister.
141. The Auditor-General was also of the opinion that an application had been made in that he stated *'We note that Forestry has, in recent weeks, made formal application for Community Service Obligations to be funded'*.<sup>85</sup>
142. The Committee was unable to determine why Forestry Tasmania would not have made application for CSO funding prior to the current financial year in light of the stated impact on their cash flow position and given the opportunity to do so under the terms of Treasury Instruction GBE 13-114-04 *Community Service Obligations*<sup>86</sup> – **Appendix D**.
143. The Committee did however question the ability of Forestry Tasmania to be able to clearly demonstrate the cost of that CSO liability independent of their other business costs, as it appeared many costs claimed as CSO related were

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<sup>85</sup> Auditor-General, *op. cit*, p.94

<sup>86</sup> Treasurer's Instruction, *Community Service Obligations No. 13-114-04*, under Section 114 of *Government Business Enterprises Act 1995*

in fact integral to the operation of their business in any event. An example of this was the resources within Forestry Tasmania for fire fighting services.

144. The Committee was surprised that Forestry Tasmania was unable to produce clear information in relation to the CSO costs given their repeated reference to the impacts of this type of obligation on their profitability.

145. The Committee also noted the position of the Auditor-General in relation to CSOs when he stated:

*The exercise of these functions by Forestry is not discretionary and Forestry should seek legal advice to clarify its position as to its responsibilities and whether or not costs it incurs in providing these functions are Community Service Obligations.*<sup>87</sup>

### **Local Government Rates Liability**

146. Forestry Tasmania made reference on various occasions to their obligation to pay rates to Local Government as being a significant cost factor impacting upon their cash flow position. Forestry Tasmania indicated that they paid \$2.8 million to Local Government.<sup>88</sup>

147. There was no apparent reason put forward by Forestry Tasmania as to why they should not be liable for the payment of rates and the Committee concluded that it was an appropriate liability in respect of the productive commercial forests under their management and given their GBE status.

148. The Committee recognised the importance of rates paid by organisations such as Forestry Tasmania to the financial viability of regional Councils and in turn, the services provided to those communities. Given Forestry Tasmania had

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<sup>87</sup> Auditor-General, *op. cit.* p.94

<sup>88</sup> Forestry Tasmania, *op. cit.*

been required to pay rates for some years now, the Committee could not understand why Forestry Tasmania continued to refer to this cost to their business as an additional cost burden rather than seeking to adjust their business model accordingly. As the Auditor-General found in Special Report No.100:

*... that the business taken over by Forestry in 1994, and the environment in which it operated at that time, differs from the situation faced by it at 30 June 2010. The funding and business model applied has not kept pace with these changes.<sup>89</sup>*

### **The Australian Dollar**

149. Forestry Tasmania referred to the high Australian dollar as impacting upon the profitability of their operation.

150. The Committee noted that Forestry Tasmania would be in a similar position to other export forest industries in Australia in the current circumstances and noted the challenges associated with maintaining a competitive advantage.

151. The Committee believed this to be a significant and ongoing risk to Forestry Tasmania's operations in respect of their capacity to be internationally competitive, whilst achieving any form of profitability for their international operations.

152. The Committee concluded the exposure to the fluctuating Australian dollar supported the need to grow the domestic market for Forestry Tasmania and the expansion of further initiatives in downstream processing opportunities in Tasmania.

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<sup>89</sup> Auditor-General, *op.cit.* p.3

## **The Statement of Principles (SOP), the Tasmanian Forests Inter-Governmental Agreement (IGA) and the impact of additional forest reserves**

153. Forestry Tasmania referred to the uncertainty surrounding the forestry SOP process and noted they were not a party to the negotiations.

154. This was noted to be of particular concern to Forestry Tasmania given the declining productive native forest estates under their responsibility, whilst at the same time balancing their role in the management of non-productive native forest estates.

155. Mr Gordon noted from an historical perspective that:

*If large areas of production forests had not been taken out of production and put into reserves, we would have quite a different cash flow on the balance sheet. In practice, areas were taken out of productive forest, and we were paid some compensation by the State and Federal Governments for the asset that was lost, but there was no compensation for the cash flow that was lost. It is bit like when the Government compulsorily acquires your house and they pay you compensation. But they say you cannot live in the house for 20 years when you build the new one. The asset was taken out of production but there was no income stream to substitute for the lost production of wood capacity.<sup>90</sup>*

156. Forestry Tasmania noted the challenges associated with placing productive state forests into reserves. In particular, it was noted that although compensation may be paid for reserves and that in the past, plantation reserves were established, this had an immediate effect on the cash flow of the business and there would be no return on investment within the plantation for at least 25 years.<sup>91</sup>

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<sup>90</sup> B.Gordon, *Op. cit*, p.4

<sup>91</sup> B.Gordon, *op. cit*, p.27



157. On 9 August 2011, the Tasmanian and Commonwealth Governments signed the Tasmanian Forests Inter-Governmental Agreement (IGA). Whilst the IGA refers to possible compensation for contracts that cannot be fulfilled following the decision to place 430,000 hectares into an immediate reserve system, the Committee concluded the agreement had the potential to have significant impacts upon the viability of Forestry Tasmania under its current operating model.

158. Another issue associated with the current processes was the effect on the valuation of the forest estate. Dr Drielsma noted:

*They have given us a valuation this year of \$206 million, which is a reduction of about 31 per cent. So, already we are seeing the direct impact of the uncertainty created by that process, on the value of our forest estate.<sup>92</sup>*

159. The Committee noted from the 2010-11 financial report, that the value of the biological asset was now \$231.577 million<sup>93</sup>

### **Gunns Limited Exit from Native Forest Industry**

160. Forestry Tasmania noted the impact of Gunn's commercial decision to exit the native forest industry in Tasmania:

*Our largest customer, Gunns, was driving down the road in their car and some of the more extreme environmental groups shot out their tyres and they ran over the rest of our customers, and then us. That is what has happened. I think the market for sustainably-managed forest products is still quite strong.<sup>94</sup>*

and that

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<sup>92</sup> Dr. Drielsma, *Transcript of Evidence, 4 July 2011*, p.25

<sup>93</sup> Forestry Tasmania Stewardship Report 2010-11, p.32 (Annual Report)

<sup>94</sup> B.Gordon, *op. cit*, p.4

*I think Gunns' brand has been badly damaged by ENGO campaigns overseas. A bit like the one we saw this morning from a new anti-forestry group, targeting Harvey Norman for using sustainably-managed Australian forest products instead of using imported products from non-sustainable forests. As a result of that, there has been a substantial impact on not just Forestry Tasmania, but nearly all of its customers. The impact of that, I think, will go away once there is some certainty back in the market.*<sup>95</sup>

161. Forestry Tasmania indicated that they were seeking new export markets to counter the loss of Gunns Limited from the native forest industry.

162. Mr Gordon also noted in relation to the closure of Gunns Limited chip exporting mills earlier this year that:

*Until the uncertainty surrounding those facilities is cleared up, we are going to have the same uncertainties we've had. The effect on Forestry Tasmania is that many of our customers are in even more financial difficulty than we are.*<sup>96</sup>

163. The Committee noted that the strategy of placing such a degree of reliance on contracts with one major customer in Tasmania had ultimately exposed Forestry Tasmania to risks that may have otherwise been avoided in the circumstances through having a more diversified customer base.

## **Debtors**

164. Forestry Tasmania noted the total amount owed by their debtors at 4 July 2011 as being approximately \$37 million and that they have a debt management plan in place for relevant debtors.<sup>97</sup>

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<sup>95</sup> *Ibid*

<sup>96</sup> *Ibid*, p.5

<sup>97</sup> B.Gordon, *op. cit*, p.16

165. Forestry Tasmania noted their average age for outstanding debts as having continued to increase over recent months to 101 days as at 4 July 2011.<sup>98</sup>
166. The Committee noted the fact that the debtor situation was exacerbating the cash flow situation and that Forestry Tasmania had concluded they would need to take appropriate action to address the situation if circumstances did not improve.
167. The Committee noted the major factors impacting upon the short term debtor situation as being the closure of the Triabunna woodchip mill and the decision of Gunns Limited to exit the native forest industry.
168. The Committee noted the consequence of this development as meaning a number of Forestry Tasmania customers had been unable to sell their wood residue from their operations, which was a vital component of their cash flow in order to remain profitable enterprises.
169. Forestry Tasmania has taken steps to recover this debt, however in the current economic reality facing many forestry related businesses, many are unable to pay and have been placed on long term payment plans.
170. The Committee also noted the significant debt owed to Forestry Tasmania by Gunns Limited and that they are the major debtor under management. A significant portion of this debt is currently in dispute.
171. Forestry Tasmania has not received any direction from Government regarding their debt management with the Minister for Energy and Resources stating that:

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<sup>98</sup> *Ibid*, p.14

*Management of debtors is a commercial matter to be managed by the Forestry Tasmania Board and management in the context of obligations under the Forestry Act 1920 and the Government Business Enterprises Act 1995.<sup>99</sup>*

172. The Committee noted the difficult position that Forestry Tasmania was currently facing regarding the management of their debtors and their need to balance their cash flow objectives with maintaining ongoing customer contracts. As a result of the downturn in the industry, some debts are not being paid as they fall due. The Committee noted that Forestry Tasmania appears to have taken a long term debt management strategy.

173. Forestry Tasmania provided information to the Committee in relation to their debtors as part of their *in-camera* evidence to this Inquiry. As part of the public evidence, Mr Gordon noted:

*We have taken advice from people who undertake company analysis, about the state of particular customers – we have done that a few times – but generally we know our customers reasonably well and what their capacity to pay is.<sup>100</sup>*

### **Superannuation Liability**

174. The Committee noted during the course of the Inquiry, the impact of superannuation liabilities upon the profitability of Forestry Tasmania. The Committee heard that the short term liability had increased due to the restructure of the organisation, resulting in a number of separations. Mr Gordon noted that:

*What has happened in the last three and a half to four years is that we will have gone from 530 people in January 2007 and we will have 350 or fewer at 30 June 2011. So there is a one-off hit you get and,*

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<sup>99</sup> Committee correspondence from Minister for Energy and Resources dated 29 August 2011

<sup>100</sup> B.Gordon, *op. cit.*, p.15

*again, the way the scheme works is if someone retires and takes a lump sum, we are required to fund that in cash within 14 days of getting the notice from RBF.*<sup>101</sup>

175. Forestry Tasmania noted that payments for the superannuation and redundancy payments had been made from an investment account known as their superannuation account. The Committee noted the account had substantial draw-downs and as of July 2011 had a balance of approximately \$7.147 million from a balance of \$13.666 million as noted in the last annual report.<sup>102</sup>

176. The Committee agreed with the previous comments of the Auditor-General when he stated:

*It is likely that Forestry's unfunded defined benefit superannuation obligations will continue to grow for at least another 5.5 years and it will require cash to fund retirements and pensions.*<sup>103</sup>

177. The Committee noted that in the last financial year, Forestry Tasmania was required to pay \$6 million to fund benefits when its operating cash flow was negative \$6 million. In light of additional redundancies related to spending cuts, this funding requirement will increase in the coming financial year.<sup>104</sup>

178. The Committee also noted the comments of the Auditor-General that Forestry Tasmania currently accounted for the costs of defined benefits superannuation differently to other GBEs or State Owned Companies (SOC) in that they reported all costs as non-operating expenses. Forestry Tasmania

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<sup>101</sup> B.Gordon, *op. cit.* p.7

<sup>102</sup> Forestry Tasmania Hansard, *op.cit* p.5-6

<sup>103</sup> Auditor-General, *op. cit.* p.7

<sup>104</sup> Forestry Tasmania Hansard, *op. cit.* p.6

acknowledged that had they accounted for this expense in the same way that other GBEs have, their operating profit would have been further impacted.<sup>105</sup>

179. Forestry Tasmania has amended the presentation method applied to the defined benefits superannuation liability in their financial report of 2010-11 to be consistent with that of other GBEs and SOCs in the disclosure of related operating and non-operating expenses.
180. Furthermore, the Committee noted from a comparison of annual reports from the Tasmanian energy GBEs who hold significant unfunded defined benefit superannuation, that Forestry Tasmania's liability was large in terms of its total debt and required a very large percentage of operating cash flow to service the needs of pension and lump sum beneficiaries.
181. Other factors noted by the Committee as affecting Forestry Tasmania's ongoing profitability included declining revenues, high fixed costs, the Japanese earthquake and tsunami, and changes in the pulpwood market.

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<sup>105</sup> Committee correspondence from Forestry Tasmania dated 14 June 2011 in response to questions.

**FINANCIAL AND OPERATIONAL IMPLICATIONS OF THE RECENT  
RESTRUCTURE OF FORESTRY TASMANIA RESULTING IN THE  
ABOLITION OF THE MERSEY DISTRICT**

182. Information was obtained during the course of the Inquiry in relation to the rationalisation of district operations through the abolition of the Mersey District into the Bass and Murchison Districts.
183. According to material tabled by Forestry Tasmania during the course of the Inquiry, the following savings had been made in relation to the decision:
- a. 19 FTE redundancies and one early retirement costing \$831,000, but saving \$916,000 pa in annual salaries with staffing levels to be reduced by 50 by the end of the financial year;
  - b. Flow on effects including a reduction in vehicles saving approximately \$10,000 pa.<sup>106</sup>
184. Forestry Tasmania also noted the abolition of the Mersey District was estimated to bring savings in building rental of approximately \$125,000 pa.<sup>107</sup>
185. Forestry Tasmania noted that the Mersey District had lost \$1 million last financial year and that the share of timber sales declined markedly over recent years. In general terms, they believed the decision to reduce the number of districts from five to four to have been a good commercial decision and that there were no serious downsides to the closure.<sup>108</sup>

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<sup>106</sup> Forestry Tasmania, *op. cit.*

<sup>107</sup> B.Gordon, *op. cit.*, p.11

<sup>108</sup> Forestry Tasmania, *op. cit.*

## **AUDITOR-GENERAL – SPECIAL REPORT NO.100 - FINANCIAL AND ECONOMIC PERFORMANCE OF FORESTRY TASMANIA**

186. The Committee has made reference to the work of the Auditor-General throughout this report and has noted his concern in relation to the financial performance of Forestry Tasmania.

187. Following the commencement of the Inquiry, the Auditor-General released his Special Report No. 100 - *Financial and economic performance of Forestry Tasmania*.

188. Although the report goes into a range of broader concerns than considered in detail as part of this Inquiry, as would be expected of an audit report, the Committee endorses the report of the Auditor-General and believes that significant action is now required by Government.

189. The Committee has noted the comments of the Minister for Energy and Resources in the House of Assembly on 6 July 2011 in response to questioning in relation to the Auditor-General's report when he stated:

*The member who asked the question can be reassured that the Government does understand that we need to work with Forestry Tasmania to continue to restructure the business.*<sup>109</sup>

190. The Committee was unable to identify additional public records that would confirm a Government position in relation to the future of Forestry Tasmania.

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<sup>109</sup> House of Assembly Hansard, *Transcript, 6 July 2011*, p.16



## Appendix A

### Submissions and documents received and taken into evidence

<i>No.</i>	<i>Description</i>	<i>Date</i>
1	Naomi Edwards *	18/04/11
2	Dr Louise Crossley	18/04/11
3	Environment Tasmania	18/04/11
4	Forestry Tasmania*	23/05/11
5	Construction Forestry Mining & Energy Union	09/05/11
6	Mr Peter Godfrey	09/05/11

**A TOTAL OF SIX SUBMISSIONS WERE RECEIVED. SOME MATERIAL WAS TREATED AS *IN-CAMERA* EVIDENCE.**

\* Supplementary documents provided in addition to major submission.

## **Appendix B**

### **Witnesses**

- |          |         |   |
|----------|---------|---|
| 18/04/11 | 10.59am | Parliament House, Hobart<br>Forestry Tasmania |
|          |         | - Mr Bob Gordon                               |
|          |         | - Dr Hans Drielsma                            |
|          |         | - Ms Sue Shoobridge                           |
| 23/05/11 | 3.06pm  | Parliament House, Hobart<br>Forestry Tasmania |
|          |         | - Mr Bob Gordon                               |
|          |         | - Ms Sue Shoobridge                           |
|          |         | - Mr Ken Jeffreys                             |
| 04/07/11 | 2.31pm  | Parliament House, Hobart<br>Forestry Tasmania |
|          |         | - Mr Bob Gordon                               |
|          |         | - Dr Hans Drielsma                            |
|          |         | - Ms Sue Shoobridge                           |

## **Appendix C**

### **Transcripts of public hearings**

Friday 18 April 2011  
Monday 23 May 2011  
Monday 4 July 2011

Committee Room 2, Parliament House, Hobart  
Committee Room 2, Parliament House, Hobart  
Committee Room 1, Parliament House, Hobart

## Appendix D

### Key Documents

- Treasurer's Instruction, *Community Service Obligations No. 13-114-04*, under Section 114 of *Government Business Enterprises Act 1995*
- Treasurer's Instruction, *Quarterly Reports No. 85-57-05*, under Section 114 of *Government Business Enterprises Act 1995*
- Auditor-General – Special Report 100 - Financial and economic performance of Forestry Tasmania - July 2011
- Treasury Newsletter - treasury@.tas - Volume 12, No. 1 July 2011
- Forestry Tasmania interim report titled '*2011 HY Financial Results and Outlook*'
- Forestry Tasmania Stewardship Report 2010-11 (Annual Report)

These documents are available on the public record and can be located at the following websites:

[www.treasury.tas.gov.au](http://www.treasury.tas.gov.au)

[www.tenders.tas.gov.au](http://www.tenders.tas.gov.au)

[www.audit.tas.gov.au](http://www.audit.tas.gov.au)

[www.forestrytas.com.au](http://www.forestrytas.com.au)

Signed this            day of September Two Thousand and Eleven.

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Hon. Ruth Forrest MLC  
Committee & Inquiry Chair