Statutory Review of the *Forest Products Act 2000*

FINAL REPORT

Government of Western Australia

November 2006

Foreword

Hon Kim Chance MLC
Minister for Forestry

Statutory Review of the Forest Products Act

I have pleasure in presenting the report of the Review Committee established by you to conduct the statutory review of the *Forest Products Act 2000.*

This is the first review of the Forest Products Act since its commencement in November 2000. The first five years of operation of the Forest Products Commission were characterised by major reductions in jarrah and karri timber volumes, and consequently its principal revenue stream, following the Government's *Protecting our old growth forests* policy, and the resultant need for major restructuring within the native forest products industry.

In addition, it inherited the legacy of long-term contracts with poor commercial terms and, as a matter of Government policy, has been requested to develop its New Plantations program in low rain areas of the agricultural region, which is not commercial on the basis of wood products alone, but can contribute significantly to natural resource management and regional development objectives. Nevertheless, it has made significant progress in a number of areas, particularly in managing the shift from native forests to greater reliance on plantations.

This Review is a timely opportunity to take stock of the FPC and its operations and consider statutory or other changes which will improve its performance. The reasons for the creation of the FPC as a separate statutory authority remain today but changed operational and financial circumstances, and the benefit of five years experience, have led to the Review making a number of recommendations that it believes will improve the effectiveness of the FPC.

Two opportunities for public submission to the Review optimised the external input to the Review within its tight time constraints and ensured a comprehensive scope in the issues and views that were considered. I am confident that this process has made the review process more robust and relevant to the future of the forest products industry in Western Australia.

I would especially like to acknowledge the work of the independent reviewer, Mr Grahame Searle, whose considerable experience and expertise in statutory processes, corporate governance and review of statutory authorities, was vitally important to the Review. The other Review Committee members, too, brought vast collective experience from relevant Government sectors to the Review, and are to be commended for their commitment to the process and for taking a wide-ranging and open approach to the Review.

As a Committee, we would like to acknowledge the considerable efforts of Mr Keith Low as its Executive Officer. In addition, thanks go to Mr John Carruthers and Ms Kelly Whitfield, from the Department of Premier and Cabinet, for their very capable assistance to Mr Searle in the second stage of this Review.

The Review Committee would also like to particularly thank all the stakeholders who took the time to make submissions to the Review.

I commend the report to you for endorsement and implementation.

Hon Adele Farina MLC
Chair
Review Committee

Contents

Executive Summary

This report has found that the Forest Products Commission (FPC) should be retained and that its continued existence as a statutory authority is warranted as the most effective way to sustainably manage the State's forest products. Some changes would assist it to perform better and these are outlined in this report.

Since its creation in 2000, the FPC has not had an easy road to travel. It had a high level of inherited debt from its inception. It also inherited long-term contracts which committed it to selling forest products at less than commercial prices. Early in its operations, changes in Government policies greatly decreased the amount of forest products it was allowed to harvest, with a commensurate decrease in revenues. It has also made significant changes to its business model, increasing its revenue from plantations and decreasing its revenue from native forest.

As discussed in Chapter 1 of this report, the FPC is also obliged to meet the expense of working towards social and environmental benefits, while receiving very little special funding for such activities. This report recommends that the non-commercial activities of the FPC be retained, but with greater transparency on their extent and funding impact, to be reflected in its annual Statement of Corporate Intent. This will paint a clearer picture of the effect of these activities on the profitability of the FPC, and will also allow other funding to be sought for these activities, as appropriate.

Additionally, the Review's recommendation that the FPC should take on a lead agency function for the forest industry on behalf of Government is discussed in Chapter 1.

The profit made by the FPC is comparable with other state forestry bodies in Australia. There is room for improvement, however. In Chapter 2 of this report, recommendations are made which are intended to improve the FPC's financial performance. For example, when the FPC enters into future contracts for the supply of forest products, they should be structured so that commercial rates of return are achieved. The FPC should focus on improving its profit, return on capital and return on assets so that more commercial rates of return are achieved in future. A formal policy is recommended to help guide future debt management decisions and improve the FPC's dividend policy.

As discussed in Chapter 3 of this report, it is the opinion of the Review that the FPC's current statutory authority status is appropriate for a commercial enterprise and should be retained. In Chapter 4 of this report, the Review has noted that the FPC has put considerable thought into increasing the profitability of its programs and anticipates increased returns in the future. In Chapter 5 the review notes that the FPC has met competitive neutrality requirements.

The Review finds that strong mechanisms are in place to set standards in ecologically sustainable forest management and the protection of water resources. Adherence to these standards is of crucial importance to the FPC in performing its functions and is a feature that can be further developed. These issues are discussed in Chapter 6.

Chapter 7 of this report highlights that the relationship between the Department of Environment and Conservation (DEC) and the FPC is an area that requires improvement.

Both entities have to work very closely together for matters such as fire management and harvest planning and this would be assisted by further clarification of respective roles and the development of formal dispute resolution arrangements.

The Review also suggests a number of changes to give the FPC greater certainty in its ability to access land for the harvesting of forest products. These matters are discussed in Chapter 8 and include a right to be consulted over land use changes, the ability to buy and sell land and the transfer of some fee simple plantation lands from the DEC to the FPC.

In Chapter 9, some legislative changes are outlined which should assist the FPC to perform its functions.

Chapter 10 of this report outlines an implementation plan so that the FPC can improve its operations. It establishes that a report on progress in addressing the recommendations of this report be made to the Minister by 1 February 2008.

Summary of Recommendations

Reason for the Review

There were three catalysts to the review of the FPC. The first was that Section 71 of the *Forest Products Act 2000* (the Forest Products Act) required it to be reviewed five years after its commencement, with this review to be completed within 12 months. The second catalyst to the review is Recommendation 24 of *"Government Structures for Better Results – The Report of the Taskforce Established to Review the Machinery of Western Australia's Government"* – known as *The Machinery of Government Taskforce* (Hicks *et al*, 2001). The taskforce reported within eight months of the inception of the FPC and, recognising this left insufficient basis for meaningful review, recommended that review of the organisation be delayed until 2005.

The third catalyst to the review was that an internal Treasury and Finance review of the FPC was commenced in 2005 but had not completed its deliberation before this statutory review was due to commence. To avoid duplication of effort, it was agreed that this review would utilise work already commenced and produce a single report.

Terms of Reference

In accordance with Section 71(2) of the *Forest Products Act 2000*, the review, will consider and have regard to –

(a) the effectiveness of the operations of the FPC
(b) the need for the continuation of the functions of the FPC
(c) any other matters that appear to the Minister to be relevant to the operation and effectiveness of this Act

For the purposes of this review, other relevant matters may include:

- the functions, activities and structure of the FPC to ensure consistency with relevant Government policies and priorities
- progress towards the achievement of all recommendations pertinent to the FPC arising from any relevant machinery of government reviews, functional reviews, or other recent reviews
- the extent of any overlap or duplication that may be occurring with other State Government agencies with closely related areas of responsibility
- opportunities for, and barriers to, improved policy coordination and collaborative planning and monitoring of service delivery across the State
- the most efficient and effective arrangements for collaborative delivery of services, and opportunities for cost savings
- the appropriateness and feasibility of incorporating the functions undertaken by the FPC into a department of State

The Terms of Reference relate only to administrative and organisational matters associated with the FPC and its functions, and specifically exclude consideration of relevant Government policy settings, including the Forest Management Plan.

Methodology

The statutory review is being conducted in accordance with a Review Plan that is consistent with the Department of the Premier and Cabinet guidelines for public sector reviews and which has been endorsed by the Minister for Forestry (the Minister) and the Minister for Public Sector Management.

The Minister in requesting this review established a Review Committee to conduct the review and advise the Minister accordingly. The Committee comprised the following members:

- Hon Adele Farina MLC, Member for South West Region (Chair)
- Mr Grahame Searle, Department of Land Information (Independent Reviewer)
- Dr Paul Biggs, General Manager, Forest Products Commission
- Mr Alex Rimkus, Department of Treasury and Finance
- Mr John Lightowlers, Department of Premier and Cabinet
- Mr Tony Jupp, Office of the Minister for Agriculture and Food; Forestry

In addition, Mr Keith Low from the FPC was the Executive Officer.

The Review of the FPC has included two opportunities for community consultation:

- in the first round of consultation, a request for submissions to the review was advertised, and letters were sent out to key stakeholders inviting comment;
- forty submissions were received from stakeholders and contributed to the development of the draft report which included some preliminary recommendations and options for discussion;
- members of the Review Committee met with a number of key stakeholders to discuss the draft report and relevant issues;
- advertisements appeared in the press calling for further comment on the draft report, allowing a response period of two weeks;
- comment on the draft report was also invited from groups and individuals who had made submissions in the first round; and
- thirty second-round submissions were received and taken into account in the development of this report which makes final recommendations.

The Minister's Review Report will be tabled in both Houses of Parliament in accordance with s71(3) of the Act, and will be published on the FPC website.

Background

Prior to the creation of the FPC in 2000, the Department of Conservation and Land Management (CALM) managed all aspects of Western Australia's forests, including conservation and the harvesting of timber. In October 2000 the Forest Products Act was passed by Parliament to separate the Government's commercial native forest management objectives from its conservation objectives.

The department previously known as CALM, now merged with the former Department of the Environment and called the Department of Environment and Conservation (DEC), retained its conservation role, and engages in land management practices to promote environmental matters such as natural heritage protection, biodiversity conservation and fire management.

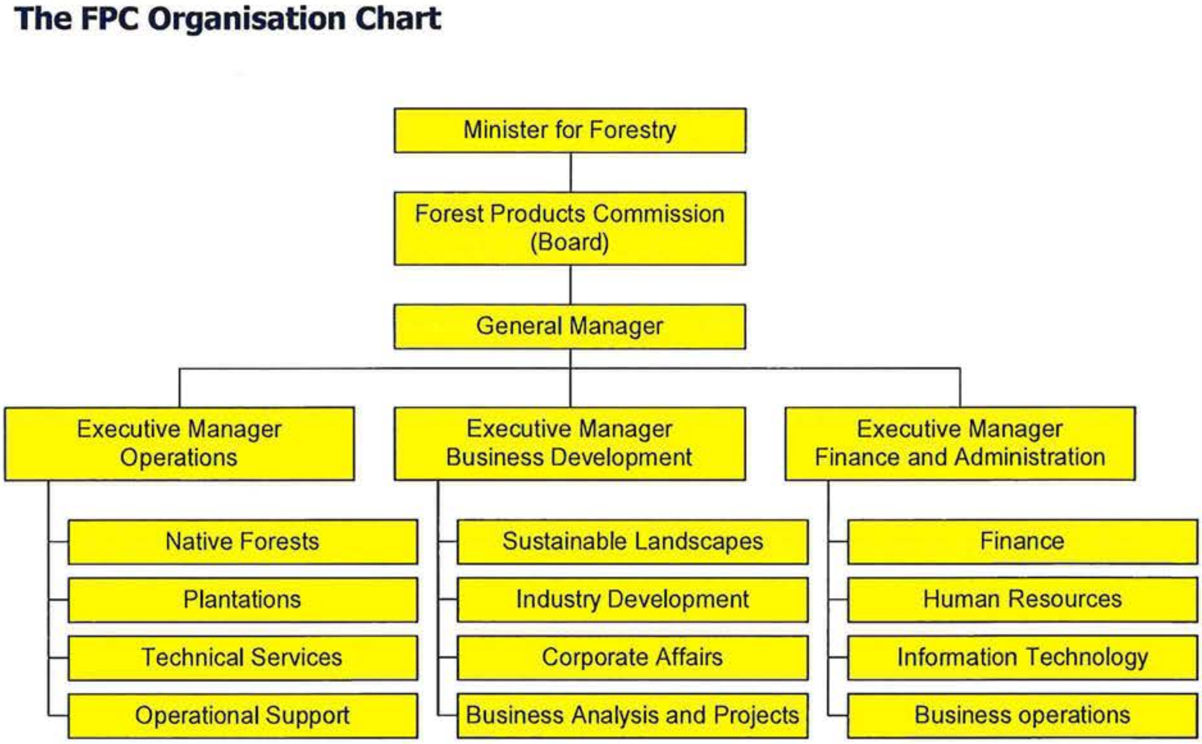
The Forest Products Act established the FPC, a statutory authority which took over the commercial functions of forest management. The FPC undertakes functions such as:

- harvesting and sale of forest products from State owned native forests and plantations;
- regenerating State owned native forests and plantations;
- promoting sustainable use of forest products from native forests;
- managing trees on farms in cooperation with farm owners;
- providing plantation management services to plantation investors;
- conducting research to maximise the value of forest products;
- consulting with the public and forest products industry on its operations; and
- providing advice to Government on forestry.

The FPC plays a role in managing a growing estate of tree farms for both public organisations and private sector investors on a fee for service basis. The FPC can also undertake activities which assist it to harvest forest products, such as constructing roads and engaging contractors. It sells forest products via contract, and must provide specific quotas of timber to various businesses under State Agreement Acts which were entered into to encourage investment in the timber industry.

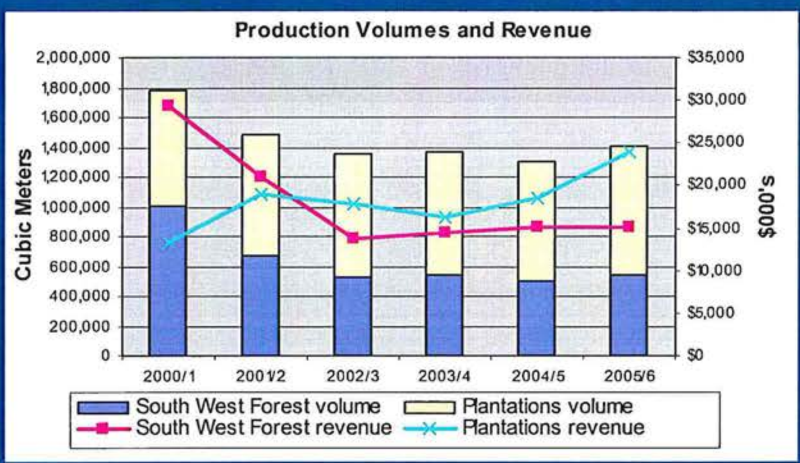
The FPC is responsible under its legislation for harvesting indigenous forest products in a sustainable manner. It is required to work closely with the DEC, through initiatives such as the development of the Forest Management Plan (FMP). The FMP is an important document, which establishes how the FPC may conduct its business in State forest or timber reserves. The FPC must adhere to the goals set in the FMP for such factors as biological diversity, productive capacity, socio-economic benefits and yields of specific trees.

The FPC Organisation Chart



The FPC has not achieved the commercial results that were expected. Many factors have contributed to this, such as the Government's *Protecting Our Old Growth Forests* policy and the *Forest Management Plan 2004-2013* (FMP), which diminished the timber yield available to the FPC. The policy, which was fully implemented through the FMP in 2004, reduced native forest stumpage revenue by more than 50% from 2000 levels and also required the FPC to focus heavily on restructuring the native forest industry. **Figure 1** shows the significant fall in native forest volumes and revenue, and the consequential changes in FPC's orientation towards plantations

FIGURE 1 – MOVEMENTS IN TIMBER PRODUCTION



In addition, the more stringent ecologically sustainable forest management standards introduced with the FMP, required that considerable resources be applied to adapting procedures, and training staff and contractors, to ensure compliance.

The FPC is also not a textbook Government Trading Enterprise, in that it cannot simply focus on making profit. Instead, its legislation binds it to considering economic, social and environmental objectives - often called the 'triple bottom line'. Many of its programs aim towards having positive outcomes on the economy and society through providing employment, while also having environmental advantages. Such programs can be seen as attempts to balance extremely complex objectives. There are many groups with a keen interest in forests and plantations, such as those representing workers in the forestry industry and groups with a specific focus on conservation. Each group tends to have its own view of which element of the 'triple bottom line' is of the highest priority. Perhaps this makes it inevitable that the FPC will attract criticism for compromising some part of the equation.

Key Issues

1. Non-Commercial Objectives

The draft report came to a preliminary finding that *"If the outcome of this review is that both commercial and non-commercial functions are retained by the FPC, then the extent and funding of its non-commercial role should be clear and transparent."* This proposal received a very high degree of stakeholder support:

> *"There should be clear delineation between commercial and non-commercial functions of the lead forestry agency and non-commercial functions should be appropriately defined and funded."*

> *"The proposal that the extent and funding of the FPC's non-commercial functions be clear and transparent is supported."*

The following case study is an example of a program undertaken by the FPC which has a mix of commercial and non-commercial benefits.

1.1 Case study: New Plantations

An example of an initiative of the FPC's which has non-commercial benefits is the New Plantations program. It has a mix of economic, social and environmental objectives, which means that it lends itself readily to criticism on a variety of fronts. For example, feedback was received that said the program's lack of commerciality was a drain on other parts of the FPC's business, while other criticisms argued that it did not effectively address salinity or that some of the tree species planted, particularly Maritime Pine, are unsuitable for the climatic conditions in the agricultural areas.

It is important that these matters be considered in the appropriate context based on an understanding of the background to the program and a holistic view of its position and value in terms of public policy.

The New Plantations program can be traced back to October 1996 when Cabinet gave in-principle approval to the objective of establishing a 500,000 hectare Maritime Pine estate in the intermediate rainfall (400-600 mm) zone of the agricultural region. More specifically, it authorised the FPC (then CALM), in consultation with the (then) State Salinity Council, to undertake a commercial Maritime Pine (*Pinus pinaster*) afforestation program of up to 150,000 ha on private land over 10 years.

The background to this approval included CALM's intended withdrawal from the well established bluegum (*Eucalyptus globulus*) plantation industry in the high rainfall (>600 mm) zone, the recommendation in the impending State Salinity Action Plan for establishment of three million hectares of deep rooted perennials, and the need for a timber resource to offset the planned liquidation of Maritime Pine plantations on the Gnangara Mound.

In November 1996 the *Western Australian Salinity Action Plan* made the planting of deep-rooted perennials a fundamental component of salinity control and proposed a target of 3 million hectares requiring public and private investment of $3 billion over 30 years. Commercial tree crops, including Maritime Pine, would contribute 750,000 ha (25 per cent) to the total.

The Salinity Strategy, released in March 2000, again gave priority to commercial, deep rooted perennials, especially tree crops, as a means of managing water discharge, one of three strategic approaches to salinity. The continuation of the Maritime Pine program in the 400-600 mm rainfall zone was noted as a specific contribution to the strategy.

In June 2002, the Government Response to the Salinity Taskforce report noted $27 million for commercial forestry plantings by the FPC as part of its contribution to the fight against salinity, and made the development of economically viable new salinity management options by (then) CALM, the FPC, and the then Department of Agriculture a top priority for funding. Additional research and development for commercial woody species for wood products (CALM, the FPC) was made Priority 2.

The *Action Plan for Treefarming in Western Australia*, released in September 2002, reiterated that plantations were an integral part of the Government's overall environmental strategy focused on salinity and other major environmental issues. It proposed co-ordinated action to match tree species with soil and rainfall and in locations conducive to commercial development and processing. Maritime Pine was proposed as a target species for the Mid-West and Esperance "cells" where it was best suited to significant areas of sandy soils.

However, the Action Plan also broadened the scope of commercial tree planting options and proposed that other species, including eucalypt sawlogs, Radiata Pine, WA sandalwood and oil mallees, could be considered where they were more suited to prevailing soil and climatic conditions in the cells. As a result Maritime Pine is now down to 61 per cent of new plantings, with eucalypt sawlog species up to 27 percent and sandalwood up to over 7 per cent. Similar trends are expected to continue.

The *State Sustainability Strategy* (September 2003) committed to actively support the *Action Plan for Tree Farming in Western Australia* in order to retain viable rural communities, cater for production of sawlogs to offset declining yields from native forests, and for carbon credits. It also noted the importance of plantations in realising opportunities for bioenergy production.

Western Australia's *Regional Development Policy*, launched in November 2003, identified plantation timber crops and associated new industries as important contributors to diversified regional economies and enhanced regional investment.

The *Western Australian Greenhouse Strategy*, released in September 2004, foreshadowed ongoing Government investment in plant-based carbon sinks linked to Government policies and strategies such as the *Action Plan for Tree Farming* and the *State Sustainability Strategy*.

Commercial plantations in the agricultural regions have consistently been affirmed as an important component of government policy for the last decade, not only for timber production but as part of the response to salinity issues in agricultural areas, as well as other environmental benefits and a range of socio-economic outcomes based on industry and regional development.

The FPC's New Plantations program reflects this and has broadened in scope in recent years, using a small suite of other species in addition to Maritime Pine where they were more suited to the conditions in targeted areas.

Maritime Pine

Maritime Pine was first trialled on the South West coastal plain at the start of last century. These trials showed that the Leirian strain from Portugal was best suited to WA conditions. Later trials also validated the superiority of Leiria trees for growth rate and wood quality, as well as having reasonable but variable form. Since 1942, only Maritime Pine of Leirian origin has been used for plantations in WA. In 1959, a breeding program was commenced to improve stem and branching form in the Leirian race and the first seed orchards were established in 1966. From 1971, all Maritime Pine plantings have been of orchard origin. Large gains in vigour, stem and branch form have resulted from this program.

Trials on the coastal plain, and in the glasshouse, had shown the Leirian strain was better able to tolerate drought conditions than the Landes and Corsican strains. There was also considerable variation within the Leirian breeding population for tolerance to drought which could be exploited. There has been a breeding program for Maritime Pine that has produced continuous improvement in growth, stem form and branch development. While much of this work has concentrated on developing trees that were suitable for the conditions on the coastal plain, plots were established further north of Perth and Maritime Pine has been planted in arboreta and plots extensively in the medium rainfall zone.

With the original 1996 initiative to develop the Maritime Pine Project as part of Western Australia's Salinity Action Plan, the available plantings of Maritime Pine in the medium rainfall zone were assessed to determine likely growth rates, and to develop a detailed site selection system based on an understanding of the climate and soil requirements of Maritime Pine. This work, the subject of a doctoral thesis[1], has allowed the further modification of the interim site selection guidelines, developed at the commencement of the program, that were based on the FPC's knowledge of how Maritime Pine performed generally in southern Western Australia.

The development of silvicultural systems to enhance the tolerance of annual summer drought and periodic severe annual drought conditions by Maritime Pine dates back to the 1970's with the development of the so called 'Silviculture 70' plantation management systems for both Radiata and Maritime Pine plantations.

[1] Ritson, P., 2004. Growth, yield and carbon sequestration of *Pinus pinaster* established on farmland in south-western Australia. PhD thesis, School of Forest and Ecosystem Science, University of Melbourne, 293 pages.

Research to further develop the silvicultural systems and the genotypes suitable for the medium rainfall zone had commenced prior to the development of the Maritime Pine Program. This work has continued as a priority in the last decade and has resulted in the refinement of the site selection, silvicultural management and genomes available for the program.

Key silvicultural issues have been to develop systems that balance the need to deliver hydrologic benefits from the tree planting program with the water requirements of the trees to ensure that the plantation systems are sustainable. The key issues being addressed in the breeding program are further improvement of the drought tolerance of Maritime Pine and the development of strains that are less prone to poor stem form on some sites where the initial water and nutrient availability is high.

As can be seen from this background, there is significant research and development supporting the FPC's Maritime Pine program. Questions over the suitability of Maritime Pine for the medium rainfall zone of the agricultural region, due largely to the limited previous plantings in the area, are to be expected. This is not an unusual circumstance for new plantation programs.

However, the performance of plots and arboreta that have been established in the zone in the past provide an initial basis for confidence in the program. Constraining the planting zone to areas with suitable soil and climate characteristics is seen as an important factor in ensuring that the plantations are sustainable. Further improvement can be expected from ongoing breeding programs and the sustainability of Maritime Pine plantations in the zone will also be supported by silvicultural systems aimed at achieving the right balance between water table control and water availability for trees.

In considering the value of the FPC's New Plantations program, several basic points relating to the 'triple bottom line' need to be recognised:

1. The program has economic importance, as it will be difficult for Western Australia to grow or even maintain its structural timber plantation estate in the South West given the level of competition for land and water use in that region. For Western Australia to keep its existing forest-based industries, or preferably grow them, alternative areas such as low rainfall sites may need to be closely evaluated.

2. The program has ecological importance as it is widely accepted that deep-rooted perennials will play an important part in the State's response to the salinity issue. If public funding is to be expended on establishment of deep-rooted perennial species it will be most efficiently used if there is a revenue stream from the plantings. The revenue will also make it more viable for farmers to transfer some of their land from traditional crop/stock options to plantations. However, commercial plantations have never been intended as the sole solution to salinity in the agricultural zone. A reflection of this is that the Strategic Tree Farming Project is receiving just $64 million of a total of $316 million being spent in Western Australia under the National Action Plan for Salinity and Water Quality. The remainder is being spent on other tree planting, engineering and catchment management initiatives.

3. The program has social importance, as commercial plantations offer potential for critical regional development based on forest or associated industries, as has occurred in the Great Southern over the last decade.

1.2 Quantifying the FPC's non-commercial roles

When the FPC puts its resources behind programs with a mix of commercial and non-commercial benefits, it is clear that this represents some degree of financial cost to the organisation. What is not clear is the extent to which these programs represent an 'opportunity cost', compared to the money that might have been made if financial considerations were paramount. Most of the cost of these programs is borne by the FPC, which diminishes its profit and the dividend it pays to Government. Some stakeholders have been critical of how much various programs have cost, while others criticise the FPC's low profitability, without acknowledging the benefits arising from its non-commercial roles.

To help clarify the FPC's financial situation and allow analysis of how well non-commercial outcomes are being delivered, the Review is of the opinion that a cost should be ascribed to all of the FPC's non-commercial activities. This will allow clear recognition to be given to the impact they have on profit and dividend levels, and allow appropriate funding to be sought.

The Forest Products Act establishes that the FPC must prepare an annual Statement of Corporate Intent, in which it must report on the extent of their Community Service Obligations (CSO's), their costs and the source of the funding or compensation for these activities.

At present, the FPC receives some CSO funding, to cover interest on non-commercial debt. However, other marginally commercial or non-commercial roles ("non-commercial functions") that the FPC undertakes in supporting positive social and environmental goals do not receive CSO funding, although they could qualify to do so. This is at least in part because the boundaries between commercial and non-commercial functions of the FPC are not well defined. A first step towards gaining appropriate CSO funding will be to describe the FPC's non-commercial activities.

The following table provides an indicative summary of the types of non-business activities included or recommended to be included as statutory functions or likely to be expected of the FPC by Government, including an expanded 'lead agency' role for forest-based industries in Western Australia. This issue is discussed further in section 1.3.

Table 1: Potential non-commercial activities for the FPC

Category	Activity	Description
Sustainability Strategy	Delivery of NAP program	Resources to provide oversight, liaison and delivery of the Strategic Tree Farming initiative through the NAP.
	90 day credit terms	Cost of providing extended 90 day payment terms to native forest customers negotiated as part of industry rationalisation under old growth forest policy.
Research and Development	End-use timber research	Supporting downstream processing industries, researching timber applications in furniture and other high-value end uses.
	Strategic Tree Farming research and development	R&D activities aimed at developing new species and systems for low rainfall areas underpinning NAP's Strategic Tree Farming initiative.
Lead Agency	Forestry policy and stakeholder management	Supporting ministerial office through public relations, Ministerial Advisory Committees, industry forums, ministerial enquiries and media.
	Industry development and support	Activities undertaken in supporting the industry including formulation of industry development strategies and policy development.
	Industry leadership	FPC role in performing forest industry leadership role. Executive and Commission engagement in industry leadership and government policy implementation.
	Private Forestry Development Committees	Direct financial support to Private Forestry Development Committees (PFDCs).

In the past the FPC has spent in the order of $4 million per annum from retained revenue on the types of activities included in this table. It is estimated that additional lead agency responsibilities related to policy advice across the whole forest industry may amount to a further $250,000–$500,000 per annum.

Additional requirements may arise from this review. Notably, the simple recommendation that the definition of "forest product" apply to all land, rather than just "public land", is likely to increase the scope of a range of the FPC's statutory functions, such as research and development or industry development, that may be non-commercial in nature. The recommendation that the FPC take a lead agency role for the forest products industry is also expected to leave scope for additional non-commercial functions.

The likelihood that its responsibilities will expand only serves to strengthen the need to effectively use the Strategic Development Plan and Statement of Corporate Intent process to accurately identify and value the extent of the FPC's non-commercial role.

The expectations of government of the non-commercial activities that the FPC enters into, and the cost of meeting them, can be expected to vary over time. The most effective means of dealing with this, and Government is aware of the cost of funding of non-commercial functions, is for the matter to be subject to separate consideration in development of the FPC's Statement of Corporate Intent each year.

A description in the Statement of Corporate Intent of the non-commercial tasks which government expects the FPC to do would:

- provide clear direction to the FPC on the activities it should undertake;
- allow the FPC to respond to Government priorities in a flexible way; and
- provide transparent separation of commercial and non-commercial functions for the FPC and its stakeholders.

The source of funding for these non-business activities in the annual schedule should also be clearly defined in the Statement of Corporate Intent, whether these are:

1. funded as a direct CSO;
2. paid for by the FPC by way of reduced profit and/or dividend to Government; and
3. paid for by a combination of 1 and 2.

To work out the cost of its non-commercial programs the FPC should set a minimum return on investment it seeks to achieve. Where initiatives fail to meet this return on investment due to desirable non-commercial benefits, this information should be included in the Statement of Corporate Intent.

For example, the FPC's involvement in plantations under the National Action Plan are not based on any investment analysis against a set minimum return on investment (i.e. hurdle rate) that reflects the risks involved and an appropriate commercial rate of return. Moreover, the difference between minimum commercial returns based on hurdle rates and actual returns are not identified or accounted for as a community service obligation. As a guide, a commercial hurdle rate might be in the vicinity of 12-13% (for example a 5.63% risk free rate based on the 10-year Commonwealth Government Bond rate at 1st September 2006, plus a market risk premium of say 7%). Alternately, they should at least cover the FPC's weighted average cost of capital of 10.55% (i.e. its real, pre tax cost as at 30 June 2006).

Figure 2 shows the internal rates of return from recent National Action Plan investments, highlighting the fact that expected returns from many investments other than sandalwood, are only marginally higher than the real risk free rate of 3.11% (i.e. the 10-year Government bond rate at 1st September 2006 adjusted for inflation) and well below the FPC's weighted average cost of capital.

Figure 2 – NAP Internal Rates of Return

Plantings	**Real Expected Return** (i.e. excluding inflation)
Pinus pinaster, Midwest	3.41%
Pinus pinaster, South Coast	4.04%
Eucalyptus saligna, Darkan	5.16%
Eucalyptus Sawlog, Dryland	2.56%
Eucalyptus saligna, South Coast	5.16%
Total Return (excluding Sandalwood)	**3.93%**
Sandalwood	10.58%
Overall Return	**5.49%**

This not only means that similar returns could be achieved by investing the money in risk-free Government bonds, but also that the organisation is not meeting the normal expectations of the suppliers of capital and has no real financial coverage (cushion) from which to meet the likely costs of the inherent high risks involved in long-term tree farming (e.g. storms, fire, drought, pests, changing weather patterns, poor harvest, variances in anticipated rotation times etc). While the FPC may well decide to invest in these sorts of initiatives as part of its commitment to a triple bottom line, it should nevertheless apply the discipline of a commercial investment analysis, quantifying the cost of lower rates of return and including them as community service obligations in its annual Statement of Corporate Intent.

Finding 1.2a: The FPC does not quantify the cost of lower rates of return associated with its non-commercial activities or identify them as community service obligations.

Finding 1.2b: The FPC should retain responsibility for non-commercial activities, but with more transparency related to their extent and funding impact. This should include, for each non-commercial activity:

- a full description
- the full cost
- the 'opportunity cost', compared to commercial rates of return
- the funding source
- the impact on profit and dividend levels

Recommendation 1:
That the FPC retains responsibility for non-commercial activities and includes a full description of these in its annual Statement of Corporate Intent, identifying their cost, funding source and impact on the financial performance of the organisation.

1.3 The FPC as a Lead Agency for the Forest Products Industry

At the regional level the forest products industry has the potential to be a significant contributor, both economically and socially. This is already the case in the South West and the Great Southern, and there are plantation and other developments that are expected to provide growth in the Mid-West, the Wheatbelt, Goldfields-Esperance, and Kimberley.

It also interacts strongly with other industry and community sectors such as agriculture, mining, infrastructure, environment, tourism and local government.

The industry is multi-faceted in nature, with reliance on both native forests and plantations, mature industries sectors mixed with developing ones, and with primary, secondary and tertiary production components. Additionally, by the very nature of its primary resource, with rotation lengths measured in decades, the forest industry works routinely with long planning cycles that contrast strongly with many other industries. This contrast is perhaps most evident in farm forestry where tree crops are mixed with traditional annual crops and bring an added complexity to farm planning.

Submissions to the review provided a strong indication that the forest industries in Western Australia want a lead Government agency with responsibility for comprehensive policy and strategic development across all industry sectors.

This lead role has not been specifically catered for since the Forest Products Act commenced operation in November 2000. The FPC has been limited in this respect by the scope of its legislation, as well as its capacity to fund such activities from retained revenue. While it has undertaken some functions that would normally be done by a lead agency, particularly in areas such as business development and provision of policy advice to Government, these have been limited by the above factors, as have other possible functions such as community education.

Significantly, important contributors to the forest industry, such as bluegum plantation growers and the emerging farm forestry sector, together with the processing industries that are associated with them, have had little access to 'lead agency' services. The farm forestry sector, in particular, strongly advocated the need for a lead agency in submissions to the review.

Given the importance of the forest industries in contributing to the various sustainability objectives of government, there is substantial basis for the provision for a lead agency with responsibility for industry policy and related advice to Government. This role should be comprehensive in scope, extending to all sectors of the industry, and include a coordination role within government to ensure forest industry policies are appropriately aligned with other related policies and with all-of-government objectives.

Delivery

In the discussion of structural options in its Draft Report, the Review gave substantial consideration to the delivery of the lead agency role, and particularly of independent policy advice to government. As well as several in-principle observations of the Review which related to the inherent difficulties of the FPC, as a commercial entity, providing policy advice to government, this consideration acknowledged the perceptions of bias and conflict of interest that were reflected in a number of first-stage submissions to the Review.

Upon further consideration, however, it is apparent that alternative models are equally or more difficult to sustain, for several reasons.

While the FPC may not have comprehensive knowledge of downstream industries, it has the best across-the-board knowledge within government. Industry stakeholders strongly advocated for the FPC to fulfil the lead agency role.

The limitation on the FPC resources available for lead agency activities is recognised, but it is equally the case that similar resources would be required elsewhere in government if the role is to be carried out at all. The Review has proposed a model which would allow the FPC to transparently scope and fund its non-business activities.

The perception of conflict of interest appears greater than the reality because the extent of competition between the FPC and the private sector is relatively low. It is virtually a monopoly supplier of native timber, has withdrawn from the plantation pulpwood (bluegum) sector, and its farm forestry business model is based largely on working in conjunction with private growers/investors. While an argument can be made that it competes in the softwood plantation sector in the South West, the Review has observed elsewhere that the principal forces constraining the sector, relate to pricing mechanisms, and competition for land and water use. The competitive impact of the FPC's involvement in the emerging sandalwood plantation business won't be apparent within the next decade. In the context of the perception of bias, the Review also notes that s.66 of the Act allows the Minister to establish relevant advisory committee, thus providing an alternative mechanism for independent advice.

The Review accepts that the FPC is well exposed to broader government policy directions and well equipped to understand how forest industry and broader policy objectives are best aligned. Further, it is of the view that a small forest industry policy unit within a department, separate from the FPC, would have considerable difficulty in maintaining the level of technical and associated expertise required to provide effective advice to government or industry.

Given these considerations the Review believes that the lead agency role, including policy advice to government can most effectively be delivered by the FPC.

Finding 1.3: There should be provision for the delivery of lead agency functions for the forest products industry within government. The most effective delivery of these functions is through the FPC.

There exists a legislative provision for alternative advice from advisory committees to the Minister.

Recommendation 2:
That the FPC provide lead agency functions for the forest products industry on behalf of Government

1.4 Industry Development

The Review reported in its Draft Report that, in response to a submission, it had considered whether the FPC should be responsible for disbursement of industry assistance funding to the forest products industry currently made by the Department of Industry and Resources (DoIR) under the *Industry and Technology Development Act 1998*. However, it is of the view that, in addition to the prospect of perceived conflict of interest, this is a specialist task best retained by the DoIR, with assistance from the FPC.

2. Commercial Operations

Section 12 of the *Forest Products Act 2000* requires the FPC to endeavour to make a profit while ensuring the long-term viability of the forest products industry and applying the principles of ecologically sustainable forest management to operations in native forests. This section of the report examines the commercial operations of the FPC in terms of its:

- financial (profit) performance
- staffing and labour costs
- observed volatility of its financial statements
- stumpage rates under long term state agreements
- current dividend policy

2.1 Financial performance

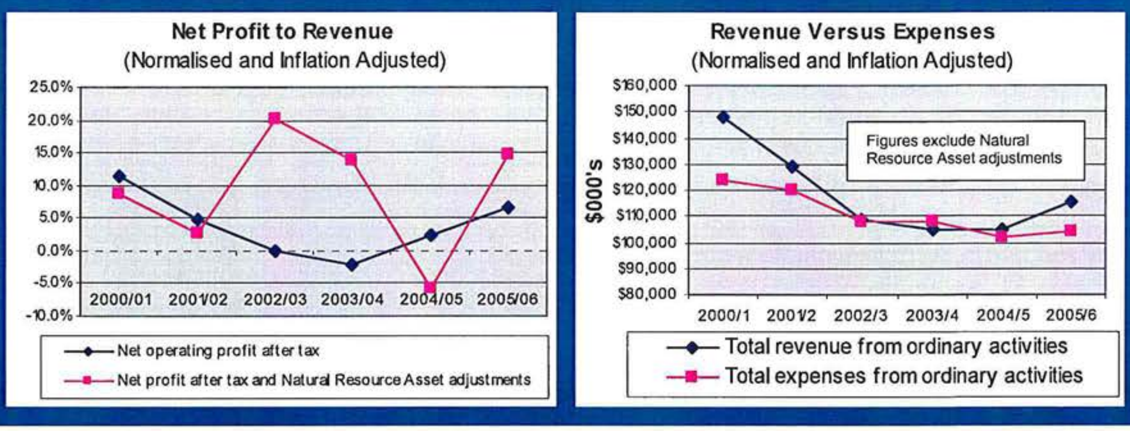
In reviewing the financial performance of the FPC, the following analysis has been conducted from two perspectives highlighting:

1. the bottom-line commercial performance of the business **with** Natural Resource Asset adjustments included; and
2. the underlying operating performance of the business **without** Natural Resource Asset adjustments.

In addition, to facilitate like-for-like comparisons and highlight underlying trends, all abnormal items have also been removed or harmonised and the accounts adjusted for inflation in line with the notes shown at Appendix 1.

Figure 3 highlights the performance of the FPC since its inception. While profitability has declined markedly in line with the structural change that has occurred to the business resulting from the Government's *Protecting Our Old Growth Forests* policy, revenue from the mature plantations and sandalwood businesses have helped address the situation over the last two years. In real terms however, aggregate operating revenue levels in 2005/06 are only 78% of what they were in 2000/01 (i.e. $115m versus $148m respectively).

FIGURE 3 – FINANCIAL PERFORMANCE

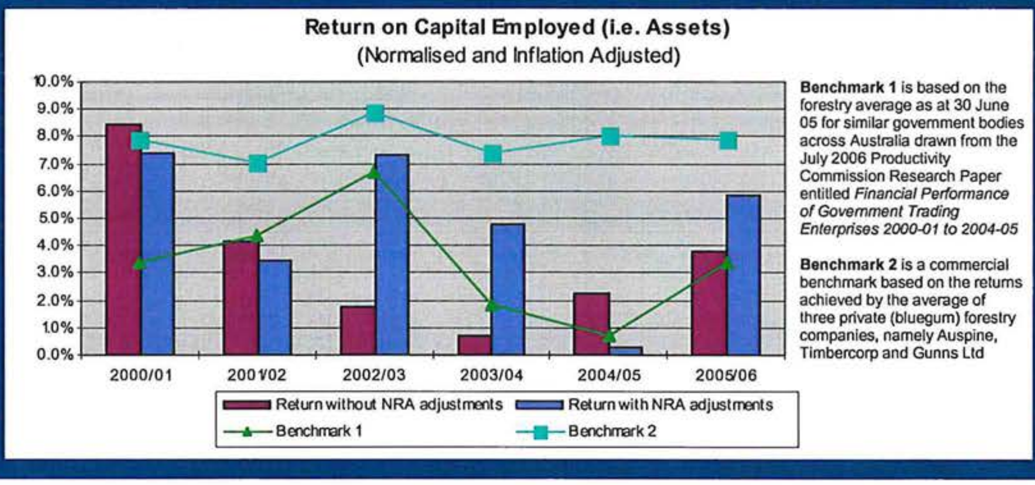


In addition, an underlying 6.7% net operating profit in 2005/06 – which is five and a half times higher than the average net profit for each of the preceding four years – is still only 58% of what it was in 2000/01 (11.5%). However, when Natural Resource Asset adjustments are included to reflect changes in the value of the unharvested forest, aggregate profits are now higher than they were in 2000/01, although this is entirely due to the results of the 2005/06 valuation.

The nature of Natural Resource Asset adjustments and reasons for their volatility (which are essentially related to early changes in allocated costs and more recently to changes in the discount rates used as underlying factors have changed) are discussed at **Section 2.3 – Volatility in financial statements**.

Figure 4 shows that, for the organisation as a whole, the underlying Return on Capital Employed (without Natural Resource Asset adjustments) has decreased from 8.5% in 2000/01 to 3.8% in 2005/06.

FIGURE 4 – RETURN AGAINST BENCHMARKS



This reduction is however more than halved when Natural Resource Asset adjustments are included, according to the 2005/06 valuation. Nevertheless, the underlying return for 2005/06 (without Natural Resource Asset adjustments) is slightly higher than that of comparable state forestry bodies across Australia (Benchmark 1), while the commercial return with Natural Resource Asset adjustments is currently only 73% of that achieved by private forestry companies (Benchmark 2), which under the circumstances is an acceptable result. It should be noted that Benchmark 2 reflects commercial operations in the more lucrative woodchip industry, including downstream processing in some instances, which has different dynamics from pine sawlog production. Consequently, caution should be exercised when undertaking comparisons.

The financial performance of each segment of the business is shown at **Figures 5** and **6** from two perspectives (i.e. with and without Natural Resource Asset adjustments). Both highlight the overall decline in profit related to logging in the native (South West) forest and the rise in profits sourced from Mature Plantations.

FIGURE 5 – FINANCIAL PERFORMANCE BY BUSINESS SEGMENT

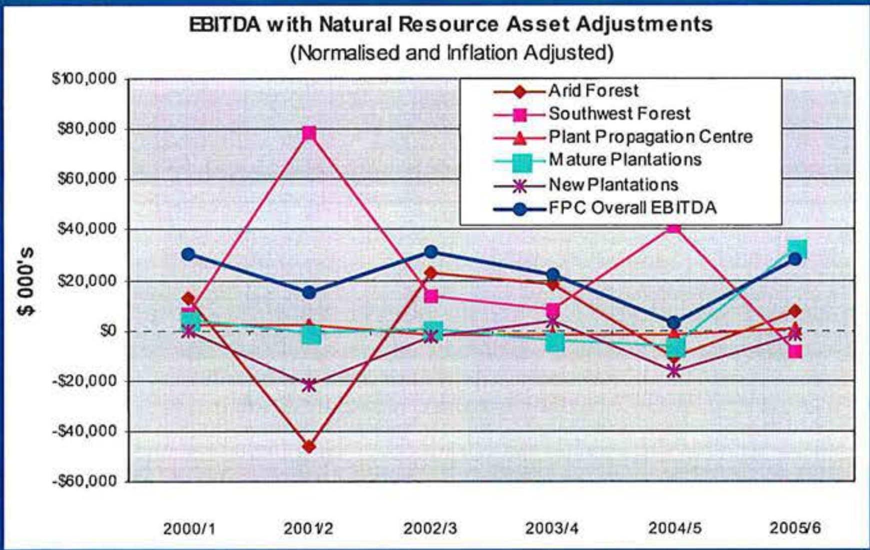
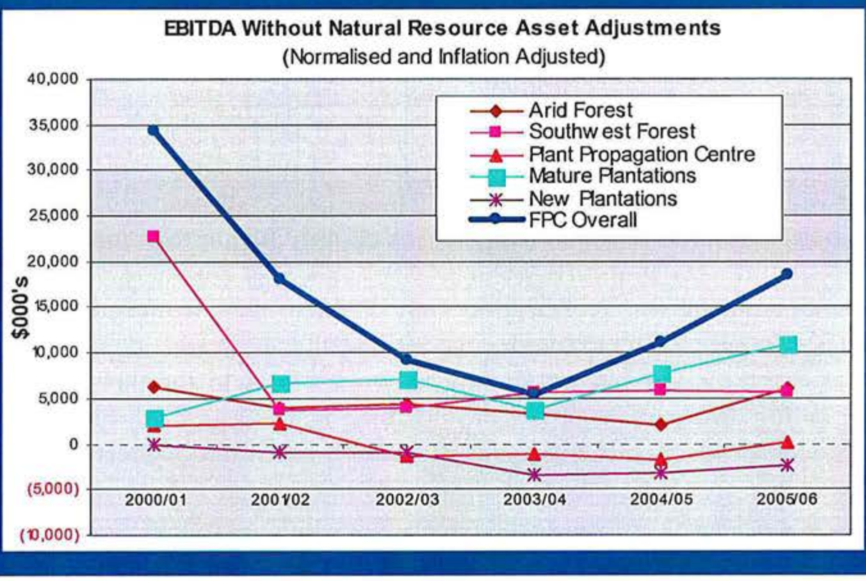


FIGURE 6 – FINANCIAL PERFORMANCE BY BUSINESS SEGMENT



Importantly, the FPC has two unprofitable segments: its New Plantations business and its Plant Propagation Centre. In addition, the recent Natural Resource Asset reduction in the value of the South West Forest (for 2005/06) has sharply affected the commercial performance of that segment at a time when the valuations for the organisation as a whole have sharply improved the FPC's overall performance (review **Figure 5**, South West Forest versus the FPC Overall for 2005/06). However, the reduction in the value of the South West Forest reflects a change in the discount rate used (commensurate with recent interest rate rises and risk assessments), rather than any reduction or over-cutting of the actual timber resource.

The New Plantations segment is currently at the investment stage of the plantation cycle – incurring set-up costs from which future revenue will flow. In addition, this business segment does not focus solely on maximising timber production since its operations are centred on strategic tree planting aimed in part at addressing salinity problems in lower rainfall areas and contributing to regional development. Its involvement in plantations under the National Action Plan, for example, are not commercially based (as discussed at **Section 1.2 – Quantifying the FPC's non-commercial roles**) with lower prospective rates of return and higher annualised costs, commensurate with lower yields and longer rotation times in lower rainfall areas. Consequently, there is a long-term risk (due to the inadequate financial coverage in the lower rates of return) that adequate timber revenues may not be realised down the track to fully cover all the costs and risks involved, which could further affect the long-term performance of the New Plantations business.

Figure 6 also shows that the performance of this business segment remains low over time as plantations are expanded and both staff and contractor costs (see **Section 2.2 – Staffing and labour costs**) and debt (**Figure 11**, discussed subsequently) all increase. While this is to be expected at this stage of the plantation cycle and the situation will improve as revenue flows occur in future years, the extent to which they can or will cover costs remains to be seen.

The Plant Propagation Centre, on the other hand, is currently operating at a scale below its break-even volume. The Centre is essentially a high-volume business unit with an annual capacity of 40 million seedlings and an estimated break-even volume of 20 million seedlings. Orders have been below this level in recent years because of lower demand related to delays in anticipated volumes from the National Action Plan program and other planned fee-for-service arrangements. **Figure 7** highlights the production levels over the past six years, demonstrating the scope of the challenge involved.

FIGURE 7 – PLANT PROPAGATION CENTRE PRODUCTION LEVELS

2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
33,970,805	19,179,234	15,822,942	10,477,831	8,339,104	9,979,071

Note: Data for 2000/01 – 2002/03 is based on orders while data for 2003/04 – 2005/06 is based on actual production

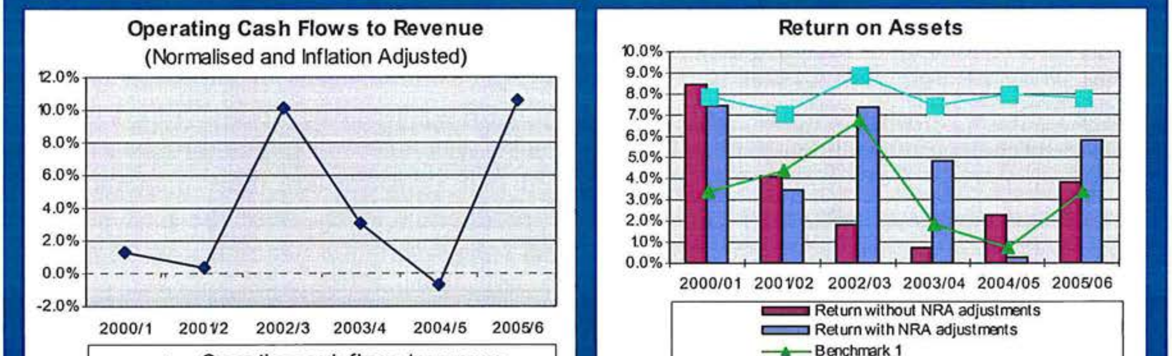
To comply with competitive neutrality requirements and ensure that operating divisions are not adversely affected by the excess capacity in the Plant Propagation Centre, seedling prices are periodically benchmarked against other nurseries, essentially constraining the capacity of the Centre to raise prices to cover costs. The production target for the 2006/07 year has been set at 14.6 million seedlings, at which level the Centre is forecast to break even at an operational level (i.e. cover its direct operating expenses with the revenue raised), although it will still not be in a position to contribute towards corporate overheads (i.e. break even on a commercial basis).

The Review was advised that the Board of the FPC has actively considered alternatives to the current in-house production of seedlings. However, the Plant Propagation Centre is the only known high-scale producer of Maritime Pine and Western Blue-gum seedlings in this state and with the expansion of work under the National Action Plan, the required volumes will increase further, offering good prospects for a return to profitability. In addition, the availability of the required volume and quality of seedlings represents a significant risk to the business, justifying a strategic decision to retain the operation in-house, subject to ongoing improvements.

The Review was also advised that the performance of the Plant Propagation Centre is currently being actively examined to identify additional improvements and measures to enhance its profitability.

Figure 8 reveals that the FPC has experienced seesawing operational cash flows. This has influenced Natural Resource Asset movements as well as the payment of dividends.

FIGURE 8 – CASH FLOWS AND RETURN ON ASSETS



NOTE: **Benchmark 1** is the government forestry benchmark while **Benchmark 2** is the commercial (private forestry company) benchmark, both of which are defined in detail at **Figure 4**

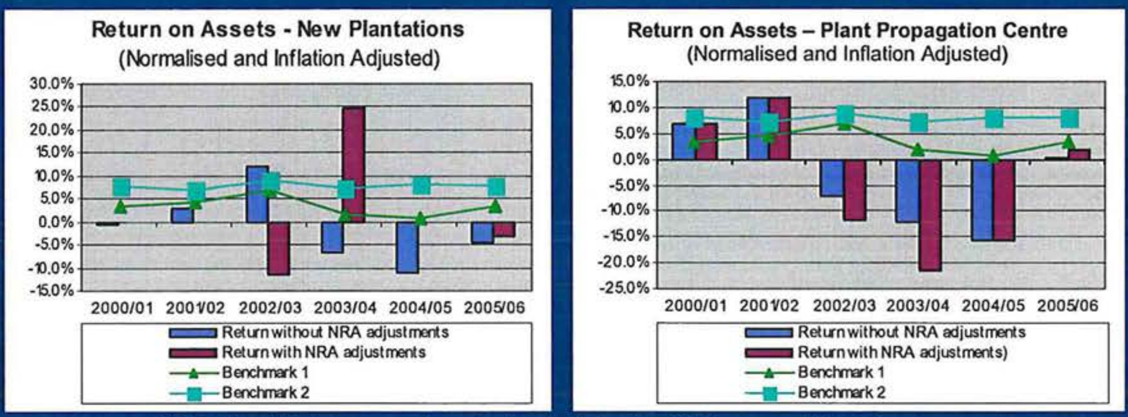
However, cash flows are higher (in 2005/06) than they have ever been as a result of good underlying performance and some one-off factors such as:

- better access for harvesting resulting from late rains;
- additional one-off revenue items (e.g. commercial settlements, refund of legal fees and compensation for the Perth hills fire);
- other income for services provided to the DEC, services related to the eradication of the European House Borer and work under the National Action Plan; and

- timing differences in the payment of the DEC service level agreements and supplies and services being under budget because of favourable weather conditions in the months before year-end.

Figure 8 also demonstrates that the overall Return on Assets generally mirrors the performance of comparable government forestry bodies Australia-wide. In 2005/06, return on assets (with Natural Resource Asset adjustments) exceeded that achieved by comparable State forestry bodies Australia-wide, but was still below levels achieved by private forestry organisations. Significantly, the Return on Assets achieved by the New Plantations and Plant Propagation businesses, were both below each benchmark in recent years as shown in **Figure 9**.

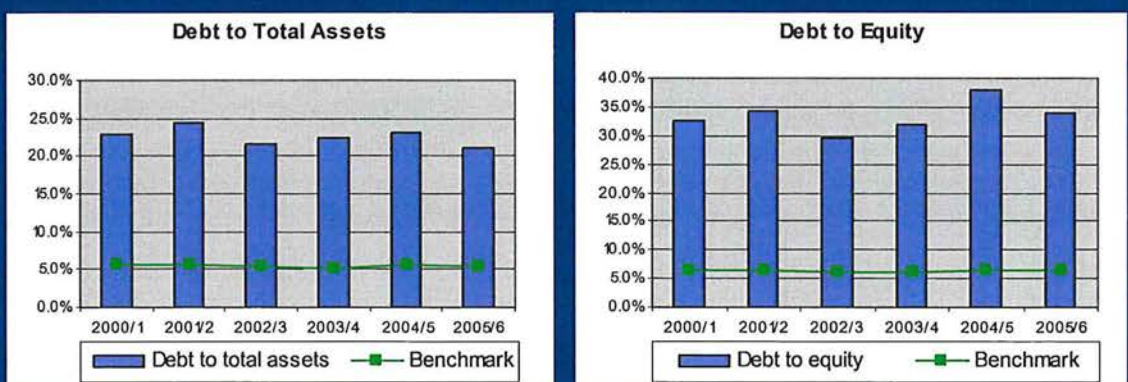
FIGURE 9 – BUSINESS SEGMENTS WITH ROA CHALLENGES



NOTE: **Benchmark 1** is the government forestry benchmark while **Benchmark 2** is the commercial (private forestry company) benchmark, both of which are defined in detail at **Figure 4**

Figure 10 highlights the high debt levels carried by the FPC relative to other State forestry bodies Australia-wide. In both Debt to Total Assets and Debt to Equity terms, the FPC exceeds the benchmark by a wide margin, carrying a minimum of four times as much debt as other bodies. The majority of this debt was inherited when the organisation was established.

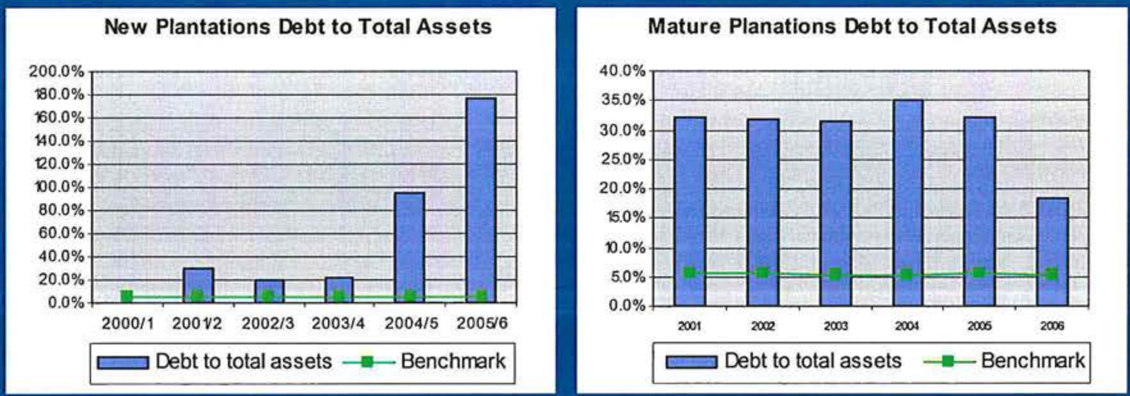
FIGURE 10 – DEBT POSITION



NOTE: The benchmark used is based on the forestry average as at 30 June 05 for similar government bodies across Australia drawn from the July 2006 Productivity Commission Research Paper entitled *Financial Performance of Government Trading Enterprises 2000-01 to 2004-05*

Figure 11 shows that the New and Mature Plantations businesses are responsible for the bulk of this debt, with the New Plantations business significantly increasingly its debt in 2004/5 with the commencement of early work under the National Action Plan while the Mature Plantations business inherited its debt with the inception of the FPC and is endeavouring to reduce it. Significantly, in 2005/06, the Mature Plantations business surpassed the South West Forests as the strongest contributor to the organisation's net profit from ordinary activities before tax, due to increased revenue and unrelated to recent reductions in debt. This highlights a key point that debt is not necessarily a problem or bad if it is used productively to generate profit and is appropriate for the scale of the investment.

FIGURE 11 – BUSINESS SEGMENTS WITH THE BULK OF THE DEBT



NOTE: The benchmark used is based on the forestry average as at 30 June 05 for similar government bodies across Australia drawn from the July 2006 Productivity Commission Research Paper entitled *Financial Performance of Government Trading Enterprises 2000-01 to 2004-05*

However, the Review noted the recent State Government decision to provide direct (Community Service Obligation) funding to offset further the FPC's borrowing associated with new plantations under the National Action Plan. This occurred as part of a large ($64.4 million) State and Commonwealth contribution to meet the establishment costs for the first two years of the new 18,000-hectare program, allowing the FPC to avoid further debt, which would otherwise further affect the performance of the New Plantations division and the organisation as a whole. The Review noted that the Plant Propagation Centre has been debt-free since 2001/02.

Given the current high level of debt the FPC is carrying (currently costing $5.9 million each year to service) and its impact on overall performance, it would be appropriate for the FPC to take action to bring it more in line with relevant benchmarks and to establish a formal gearing policy for the future to help manage and optimise its use of debt to expand the business. A formal gearing policy should be based on financial modelling to determine the optimum level of debt appropriate for the business taking account of required minimum rates of return, expansion priorities, debt-servicing capacity of particular uses and relevant benchmarks.

Going forward, the FPC has a number of challenges which include:

- improving its profit performance and Return on Assets closer to commercial rates where possible;
- constraining costs and stretching its margins to improve profitability and boost capacity to retire debt (where appropriate) or expand the business with new plantations;
- addressing the financial issues faced by the New Plantations business and Plant Propagation Centre; and
- closely monitoring current debt levels and usage, and taking whatever action is available to bring them more in line with industry and state forestry benchmarks where appropriate.

Finding 2.1: The FPC has returned to modest underlying profitability in recent years, which although well below commercial expectations, is in line with comparable state forestry bodies Australia-wide. (**Note**: The FPC is also charged with unfunded 'triple bottom line' obligations which currently affect its commercial performance, see Section 1.2 – Quantifying the FPC's non-commercial roles).

Recommendation 3:
That the FPC continue to focus on improving profit performance, Return on Capital Employed and Return on Assets, at closer to commercial rates and establish a formal gearing policy to help guide future debt management and optimisation decisions.

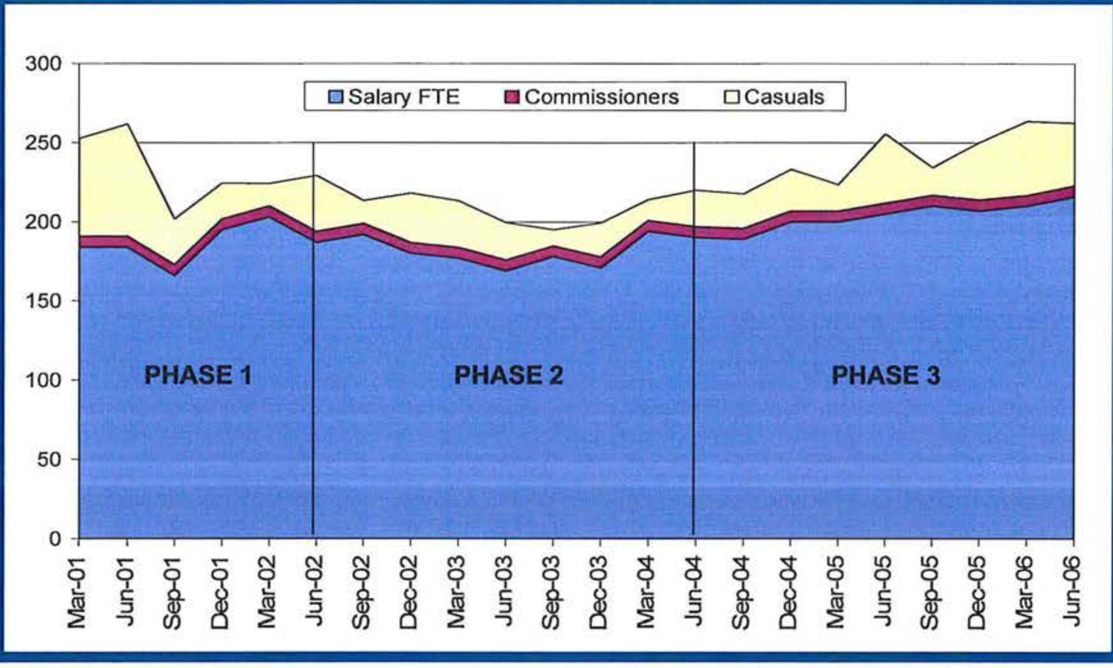
2.2 Staffing and labour costs

Figure 12 highlights the movement in staffing since the FPC was established, covering three broad phases:

- *phase 1* – reflects the initial establishment of the FPC and the filling of positions;
- *phase 2* – reflects the downsizing that occurred with the declining involvement in native forest and blue-gum plantations; and
- *phase 3* – reflects the increased recruitment of entry-level foresters to accommodate the enhanced environmental management required in native forests, the rebuilding of the plantation program (focused on pine saw log production), the internalisation of CALM research staff and the additional business and corporate staff related to business growth and public sector management requirements.

Overall, staffing numbers are 4% higher in June 2006 than they were in March 2001 (i.e. 263 versus 253), despite the 22% reduction in underlying operating revenue highlighted in **Figure 3**, **Section 2.1 – Financial performance** and the 13% overall reduction in revenue when Natural Resource Asset adjustments are included. Higher current levels of casual staff (i.e. at June 2006) reflect seasonal requirements within the Plant Propagation Centre, as the business gears up for the planting season ahead.

FIGURE 12 – FULL TIME EQUIVALENT (FTE) STAFFING



Current staffing overall reflects approximately 175 front-line business operations staff, 75 technical and administrative staff related to the business and a further 13 administrative staff performing duties related to industry policy and non-commercial activities. The 75 technical and administrative staff perform functions such as research and development, industry development, corporate communications, contract management, corporate support services and executive management.

Some stakeholders felt that the current mix of front-line to administrative staff needed to be reviewed. Typical comments included the following:

> *"It was the unanimous opinion by all that I consulted with that there was an overload of administrative staff ...It was also thought by the same that the shortage of field staff is unacceptable"*

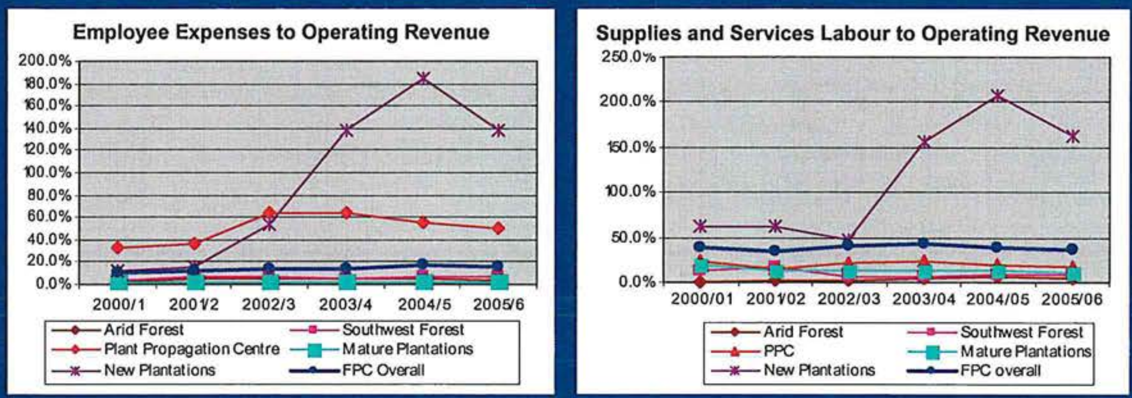
> *"It is the strong view of all sections of the industry that the operations section of FPC does not provide the on-the-ground level of support which the industry requires..."*

Given the changing nature of the business and the depth of feeling by key stakeholders, the Review felt it might be timely and appropriate for the FPC's internal structure to be reviewed, separate from the current exercise.

Figure 13 complements this analysis by highlighting two key cost components of the FPC's operations as percentages of operating revenue, namely 'employee expenses' and 'supplies and services labour'. NOTE: a meaningful break-up of actual staffing numbers by business segment over the period was not available due to changes to internal structures and redundancy of historical data.

Both cost components reflect the essential labour costs used to operate the business and generate sales. The latter includes a range of contracted services including fire management, silviculture, harvesting, site remediation and reforestation.

FIGURE 13 – SEGMENT PERFORMANCE BY KEY COSTS



Both charts highlight the proportionately higher costs associated with the New Plantations and Plant Propagation businesses, as discussed earlier at **Section 2.1 – Financial performance**. Importantly, the first chart demonstrates the high but declining employee costs (as a proportion of operating revenue) associated with the Plant Propagation Centre and the significant rise in employee costs in the New Plantations business over recent years, as work under the National Action Plan has accelerated. The sharp decline in the New Plantations 'Employee Costs to Operating Revenue' for 2005/06 reflects an increase in operating revenue for that year.

Overall, employee costs for the organisation as a whole have risen as a proportion of operating revenue (i.e. from 10.3% in 2000/1 to 14.8% in 2005/6) due largely to the reduction in operating revenue mentioned earlier and to a lesser extent the higher employee numbers. While this is in part caused by the New Plantations business taking on work under the National Action Plan (involving increased staff with deferred revenue flows not currently contributing to operating revenue), it is nevertheless something to be closely monitored in future in order to ensure the overall performance of the business meets required benchmarks.

Importantly, the cost of supplies and services labour as a proportion of operating revenue has remained relatively static overall (i.e. 38.2% in 2000/1 and 37.3% in 2005/6). However, the New Plantations segment has experienced a sharp reduction in 2005/06, again as a result of an increase in operating revenue.

Finding 2.2: Over the six years from 2000/01, employee costs have risen as a proportion of operating revenue, while the cost of supplies and services have remained relatively static.

Recommendation 4:
That the FPC closely monitor employee costs to achieve appropriate benchmarks to be set by its Board.

Recommendation 5:
That the Minister consider commissioning a review of resource allocation and the internal structure of the FPC.

2.3 Volatility in financial statements

Having observed volatility in the published accounts of the FPC, a number of stakeholders raised concerns about the reliability of reported results and, in particular, the fluctuating revenue associated with revaluations of the standing forest. One stakeholder noted that:

> *"From both a balance sheet and profit and loss point of view, the financial standing and performance of the FPC are almost totally dependent on these estimates [i.e. revaluations of the standing forest], especially that of the value of SW forests"*

In exploring this issue, the Review found that the past volatility in the FPC's financial statements and results related to the following factors:

- early changes in the division of costs between the FPC and CALM;
- valuation adjustments in the FPC's Natural Resource Assets (i.e. revaluations of the standing forest under the *AASB 141: Agriculture* accounting standard effective 1 July 2004 and, before that, under the superseded AASB 1037: Self-Generating and Regenerating Assets standard effective 1 July 1999);
- necessary adjustments to align the FPC accounts with other Australian equivalent International Financial Reporting Standards (AIFRS) from 1 July 2004; and
- the impact of raising a provision for $10 million in 2004/5 (to cover a commercial claim) and then reversing it in 2005/06,

As is standard practice, the FPC has explained items of this nature in notes to the Financial Statements in each of its Annual Reports.

In the first few years of its operation, the FPC's valuations of Natural Resource Assets were materially affected by changes in the division of costs between the FPC and the DEC. Approximately $10 million in costs initially allocated to the FPC on its formation were subsequently withdrawn as a result of a 2001 Cabinet decision. This resulted in a commensurate increase in the 2001/02 valuation of the South West Forest in the accounts of the FPC.

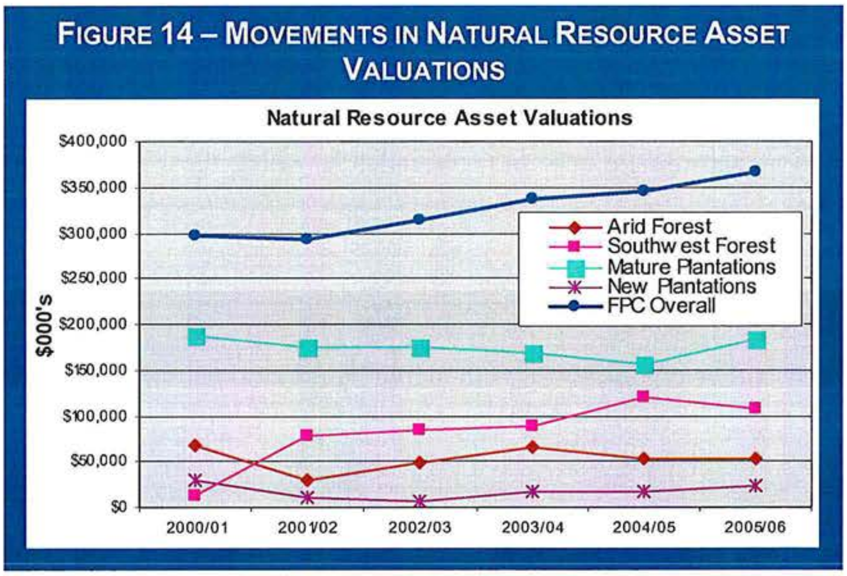
Since then, other changes in the valuation of Natural Resource Assets have been driven by the application of appropriate accounting standards, which the FPC is obliged to apply in accordance with Section 67(1) of the *Financial Administration and Audit Act 1985*. Both the current AASB 141 accounting standard and the previous AASB 1037 accounting standard require changes to the valuations of Natural Resource Assets to be included in the organisation's profit or loss for the period in which the change (i.e. natural growth of the standing timber) occurs. Adjustments are required to be recorded at fair value less estimated point-of-sale costs. For organisations with active liquid markets for their assets, valuing such adjustments is relatively simple. However, in the case of forestry or plantation companies, there are no active liquid markets for the entire amount of the assets involved (i.e. whole forests or plantations). In these circumstances, the accounting standard requires affected organisations to use suitable valuation methodologies such as discounted cash flows. As the accounting standard does not offer specific guidance on the discount rates to be used, the FPC has taken the advice of appropriate financial consultants, with the valuation results ultimately audited by the Office of the Auditor General.

Discount rates used in the valuations originally were reviewed by Ernst and Young for the 2001/2 year and by Deloitte and Touche for the 2003/4 year. Deloitte and Touche also provided a detailed methodology for calculating appropriate discount rates for each category of Natural Resource Assets (e.g. Mature Plantations, South West Forests etc), which has been used since (i.e. for 2004/5 and 2005/6). Currently, the FPC uses a real, pre-tax, base discount rate of 10.55% (reflecting its weighted average cost of capital), which is then risk-adjusted to provide specific rates for each category of Natural Resource Assets.

Over the years, the basic methodology for valuing Natural Resource Assets has not changed but the discount rates have moved as underlying factors have changed (i.e. the risk free rate, inflation, market risk premium, debt to equity ratio and beta coefficients[2] used in calculating the FPC's weighted average cost of capital). By way of comparison, the discount rate used for Mature Plantation valuations was 7% in 2000/01 and 11.05% in 2005/06.

[2] Beta coefficient – a measure of the volatility of an investment relative to the volatility of the general market

Figure 14 shows the year-end movements in Natural Resource Asset valuations for each business segment and the organisation as a whole over the last six years.



While in real terms the overall year-to-year movements have been relatively modest, they have had a dramatic effect on annual net profits and losses due to the narrow margins involved (see **Figure 3**, **Section 2.1 – Financial performance**).

Throughout the six years since the FPC was established, the Office of the Auditor General has audited all the valuation methodologies, cash flows and associated discount rates used to determine the Natural Resource Asset adjustments. For the last three years (i.e. 2003/4, 2004/5 and 2005/6), this work has been undertaken on their behalf by accounting firm KPMG. In addition, the FPC currently identifies the effect of movements in the valuations within the Segment Note in their Annual Financial Statements, so readers can identify the operating performance of each business segment, separate from movements in the valuation of associated Natural Resource Assets.

Other fluctuations in the FPC's financial statements have occurred as a result of aligning its accounts with the Australian equivalent International Financial Reporting Requirements (AIFRS). The effect, outlined in note 45 to the 2004/05 Financial Statements and note 40 in the 2005/06 financial statements, includes the following:

- reversal of valuation adjustments associated with in-forest infrastructure which is no longer separated from natural resource asset valuations;
- movements in provisions for deferred rental (i.e. *Profit a Prendre* crop share agreements) now separated from natural resource asset valuations;
- movements in provisions for forest restoration costs; provisions which were not required under previous Australian Generally Accepted Accounting Standards; and
- reversal of a nursery assets devaluation made in a prior year which was no longer able to be devalued due to Treasurer's Instruction 1101, which deems the FPC to be a 'not for profit' entity for AIFRS purposes.

Finally, the FPC's performance in both the 2004/5 and 2005/6 years was materially affected by the need to raise and subsequently acquit a $10 million provision to cover a claim by one of its customers. While the FPC was obliged under accounting standards to raise the initial provision, the matter was ultimately settled by Government at no cost to the Commission and needed to be reversed.

Finding 2.3: The observed fluctuations in the audited financial statements and results of the FPC have occurred for legitimate reasons.

2.4 Prices for pine sawlogs under long term State Agreements

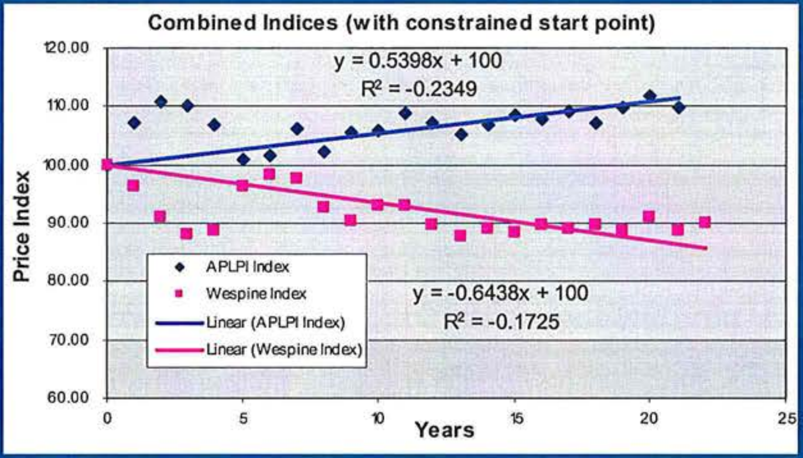
A number of stakeholders commented that the prices for softwood log timber arising under State Agreement Act commitments were too low. The Agreement Acts involved were passed by the Parliament to facilitate the development of the timber industry and encourage private investment. Generally, they are of 20 years duration, with the State undertaking to make contracted volumes of timber available in consideration for significant private investment in infrastructure such as major sawmills and timber processing plants (e.g. particleboard and laminated veneer lumber plants).

Low prices affect the FPC's long-term profitability and its planning options for the future. Many stakeholders noted this, commenting that not only did the low prices diminish the profit the FPC could make but, more importantly, they acted as a disincentive to private investment in the plantation industry. The following highlights typical comments:

> *"Artificially low softwood stumpages drive down stumpages and make private plantations unviable."*
>
> *"Government should not expect commercial profits from FPC while imposing caps on income which are not realistic. If the Government chooses to subsidise WA companies to encourage industry development and employment it should quantify the subsidy and fund the FPC to that extent to grow its business in line with the general growth in the economy."*

While contrary to original intentions, pricing arrangements attached to State Agreements and related contracts have not been successful in maintaining commercially appropriate prices over time. For example: the FPC Contract 2200, associated with the *Dardanup Pine Log Sawmill Agreement Act 1992*, has linked price movements to an in-house Wespine Index reflecting a *"basket of all those products produced by the Buyer from the Log Timber which are sold free of any chemicals added for the purpose of preventing insect or fungal attack"*. This approach has seen log prices steadily decrease in real trend-line terms by approximately 14% from January 1995 to January 2006, while prices reflected in a national Australian Pine Log Index, independently published by KPMG, have seen log prices increase by 11% over the same period. **Figure 15** tracks the respective movements of the two indices.

FIGURE 15 – MOVEMENTS IN THE WESPINE VERSUS AUSTRALIAN PINE LOG INDICES



The FPC has estimated that the difference between the two indices would currently mean an extra \$6-\$7 million income each year from the Wespine contract. Interestingly, the FPC does not have rights under the contract to independently assess or verify the data used in calculating the Wespine Index, although responsibility for producing it rests with an external auditor, albeit Wespine's external auditor.

As a result, current pricing is now well below commercial rates – as reflected in the national Australian Pine Log Index – and instead of being neutral or inducing further expansion of the industry, it was claimed, in submissions, to be having the opposite effect of inhibiting the development of private pine plantations and related processing industries. Current prices effectively reflect a discount to established players and may act as a ceiling on the market price for raw logs in this state, restricting returns and therefore the commercial viability of new investments. This could limit the natural development of the saw-log plantation industry for both government and the private sector.

Current pricing arrangements are also a major constraint on the profitability of the FPC's plantation business, trapping it and government in the role of producing discounted products that benefit particular players over others.

Some stakeholders suggested that the State Agreements Acts should be 'bought out', or that they should not be renewed when they expire. However, the Review noted that the *Dardanup Pine Log Sawmill Agreement Act 1992*, for example, commits the State to offer a further 20-year extension subject to its capacity to supply log timber within the limits of good forest management over the further term. The associated contract which expires at the same time as the Agreement Act (i.e. 2012) does, however, offer the opportunity to renegotiate the commercial terms, including pricing. In addition, the FPC is currently engaged in negotiations to see if an improvement in contract rates can be mutually agreed in return for a commitment to increase future volumes.

Irrespective of what action is taken, the inability to sustain commercial pricing and commercial rates of return under appropriate State Agreement Acts and related contracts, needs to be corrected if the State is to realise, not only commercially equivalent returns through the FPC, but also an expansion of the private plantation industry into pine saw-log production and all the benefits this could bring. The State was instrumental in the successful establishment of blue-gum plantations for the wood-chip industry and viable private pine plantations are achievable with the right policy settings. The key is to ensure that ongoing commercial returns are achieved from all State investments where possible so as not to inhibit incentives for subsequent industry development through private investment. In addition, the value of future State Agreement Acts or contracts in this industry could be reconsidered now that initial infrastructure and critical mass has been achieved.

Relevant State Agreement Acts and the timber supply contracts arising from them are generally due for renegotiation from 2008 onwards, as follows:

- the *Dardanup Pine Log Sawmill Agreement Act 1992*, in which the Government commits to providing some 5,500,000 cubic metres of softwood timber to Wespine in return for the expansion of operations at its existing sawmill at Dardanup – due to expire in 2012;
- the *Wood Processing (WESFI) Agreement Act 2000*, which commits the Government to providing 330,000 cubic metres of plantation softwood for the manufacture of wood based panel products – due to expire in 2025; and
- the *Wood Processing (Wesbeam) Agreement Act 2002*, relating to the supply of timber from the Gnangara Mound, or within 250 kilometres of this area – some 4,120,000 cubic metres over the course of the contract – due to expire in 2029.

To the extent that government establishes or facilitates further plantations through the FPC with non-commercial objectives in mind (e.g. to address salinity), the opportunity cost of doing so (i.e. the impact of lower rates of return on the FPC's performance) should either be directly funded by Government as a Community Service Obligation or quantified and accounted for as a performance offset in the FPC's annual Statement of Corporate Intent, as advocated in **Section 1.2 – Quantifying the FPC's non-commercial roles**. That way, the commercial performance of the FPC would be readily assessable and transparent at all times while accommodating non-commercial objectives. It would also help Government review, from time to time, the extent to which non-commercial arrangements affect new industry development and investment once basic infrastructure and critical mass has been achieved.

Finding 2.4: That State Agreement Acts and related contracts have led to the FPC supplying timber to companies at less than commercial prices which has affected its financial performance and may have acted as a disincentive to private investment in pine plantations.

Recommendation 6:
Any further State Agreements or State Agreement Acts, and related contracts, for supply of forest products must achieve and maintain commercial rates of return.

2.5 Dividend policy

The current dividend policy is under review between the FPC and the Department of Treasury and Finance. At present, the agreed policy is for dividends to be paid to the State based on the organisation's projected cash balance in excess of $1 million as at 30 June in the forward estimates. This approach is problematic in that it does not take account of:

- fluctuations in the level of working capital and operational cash flows needed for the business;
- timing and extent of the required cash flows for capital works such as establishing plantations under the National Action Plan;
- good practice which is to minimise spare cash (i.e. lazy capital); and
- the business fundamentals such as profitability, future prospects, growth and investment needs, optimal gearing and debt to equity arrangements and associated risk mitigation strategies.

A more sophisticated dividend policy is needed, particularly in light of the organisation's high inherited debt level and high debt to equity ratio compared with other government forestry bodies elsewhere in Australia. Possible alternative dividend policies could involve:

- a constant percentage of earnings/profits;
- a stable dollar amount, indexed by CPI or the FPC's weighted average return on its Natural Resource Assets; and
- a regular 'minimum' dividend, topped-up by 'bonus' dividend payments set at a percentage of 'excess earnings' in years when earnings exceed budget.

The Review noted that the FPC is currently working with the Department of Treasury and Finance to develop a more suitable dividend policy over the next few months, with the aim of including it as part of the organisation's 2006/07 Strategic Development Plan.

Finding 2.5: The current dividend policy that applies to the FPC is problematic and does not adequately account for the needs of the business. However, a revised policy is currently under discussion between the Department of Treasury and Finance and the FPC.

2.6 Native forest stumpages and industry impacts

Stumpages applying to native forest products were also raised by stakeholders, who displayed diametrically opposing views. One view was that existing native forest stumpages were too low, thereby undervaluing the quality of the product as well as acting as a disincentive to both hardwood and softwood plantation investors. The opposing view was that recent stumpage increases, particularly when viewed in concert with reduced log size and quality, were having a detrimental effect on local processing industries which are struggling to compete with lower priced imports.

The Review noted that the Government's *Protecting Our Old Growth Forests* policy included a commitment to review native hardwood stumpages, and that the Government has consequently increased jarrah stumpages by nearly 34 percent over 5 years and karri stumpages by 9 per cent over two years. Submissions suggested competitive linkages between native hardwood and softwood plantation products. These are tenuous as native forest products are now directed towards different end uses than plantation softwoods.

Under these circumstances the review did not consider it necessary to propose changes to native hardwood stumpages.

Nevertheless a number of submissions have drawn attention to the difficulties the industry is facing in dealing with the impact of rising costs and lower log quality. Although the issues are at the edge of the terms of reference the Review believes that the Minister should consider the preparation of an industry plan for the native forest timber industry in Western Australia

Finding 2.6a:
Native hardwood stumpages have been reviewed and raised, in line with Government policy.

Finding 2.6b:
To ensure the long term viability of the native forest products industry an industry plan should be developed.

Recommendation 7:
That the Minister should consider the preparation of an industry plan for the native forest timber industry in Western Australia.

3. Structure for the Future

Are the functions undertaken by the FPC necessary at all?

Issues relating to the sustainable management of forests, conservation and the livelihoods of forest workers are complex and bring to the fore deep commitment from those who wish to grapple with these issues. While acknowledging that there are complex issues involved, the Review took most guidance from the State Agreement Acts, which contractually oblige the Government to providing quantities of forest products to companies for periods of up to a further 23 years. Originally intended to attract investment in the forestry industry, these Acts reflect a commitment which is ongoing in the medium term and requires a body to manage the State's obligation. The Review also took similar guidance from the current Forest Management Plan, which does not expire until 2013.

This leads to consideration of the most appropriate structure for that body. In the draft report, opinion was canvassed on whether the FPC could be amalgamated with the Department of Agriculture and Food (DAFWA). Generally speaking, it seems that this was not a burning issue for stakeholders, with very little commitment to the notion that change would be a good thing. The general flavour was that the functions performed were more important than who would do it:

> *"Structure should be secondary to resolution of the fundamental issues in the funding of non-business forestry activities and the model separating roles between FPC and DEC."*
>
> *"Changes to agency status would be costly, and only cosmetic in effect if the fundamental issues are not resolved."*

A number of comments supported the current structure and suggested that clearer roles and funding would assist the FPC to do its job, and expressed concern that an amalgamation with DAFWA would be a bad outcome, due to forestry issues becoming 'lost' in a larger department.

> *"There is total support within industry for the enhanced statutory authority model. There is no confidence that an amalgamation with DAFWA would produce a beneficial result. Rather than an amalgamated department becoming a larger and more successful lead agency with a greater capacity to represent industry, the FPC would be submerged in a larger established department with its entrenched culture. There is nothing in the structure or culture of DAFWA to suggest the management of supply sits comfortably with their other important functions. If the industry is to remain viable it cannot afford a lessening of commercial focus in order to facilitate a greater lead agency role. The disruption that would accompany such a significant change would have a very detrimental impact on industry."*

Some comments supported the FPC being merged into DAFWA, saying that 'native forest logging is unsustainable and hugely unprofitable'. It is interesting to note that such comments imply that a merger would be beneficial because it would result in a decrease of focus on the sale of forest products being commercially viable. It seems clear that merging FPC with DAFWA would be widely seen as a move towards a lessened focus on profitability. The Review feels that such a merger is not the best outcome, as the harvesting of forest products should be done in a commercially viable manner, within appropriate ecologically sustainable guidelines.

While some comments favoured the FPC being merged with DAFWA, this appeared to be in response to it being suggested by the Review report, rather than a reflection of significant commitment to the idea. DAFWA, in response to the Draft report made a submission to the Review which included many qualified conditions to be met before the merger of the FPC with it could go ahead. It is the opinion of the Review that far more uniform, strong stakeholder support would be required to justify the disruption that a merger would entail.

There was also a submission supporting a re-amalgamation of the commercial and land management roles conducted by the FPC and the DEC. While this might appear superficially attractive, the changed nature of DEC has seen a significant realignment of its priorities towards the conservation and protection of the environment. This is inconsistent with the commercial role of the FPC. This makes the suggested re-amalgamation philosophically untenable.

Finding 3: That the proposed amalgamation between the FPC and DAFWA was not well supported by stakeholders. The functions undertaken by the FPC should continue, and the current statutory authority model is appropriate for a commercial enterprise.

Recommendation 8:
That the functions undertaken by the FPC be retained, as a separate statutory authority.

3.1 Board representation

The FPC, as part of its statutory authority status, has a board of Commissioners who are the governing body of the FPC, setting its policies and direction. As the Review recommends that the FPC retain its statutory authority status, it follows that it also recommends that a seven-member Board of Commissioners be retained. However, the Review feels that broadening the range of expertise used to select Board members would be of benefit.

For example, at present, Section 5 of the Forest Products Act states that the General Manager is ineligible to be on the Board. The Review is of the opinion that the person holding the General Manager position could well be a person highly suited to being on the Board by virtue of relevant experience and great insight into the operations of the FPC. It is therefore suggested that this legislation be changed, so that the General Manager *may* be appointed as a member of the board, where appropriate.

However, this change would require a different mechanism for appointment of the General Manager, because at present Schedule 2 of the Forest Products Act establishes that the General Manager is appointed by the Board of Commissioners, in consultation with the Minister. This is clearly not an appropriate mechanism if the General Manager is a member of the Board of Commissioners. This is discussed in more depth in the following chapter, **Section 3.2 The authority to employ the General Manager**.

In the first round of feedback to this report, some comments were received that specific stakeholder interests should be better represented on the Board. In reply, the draft Review report argued that it is an important governance principle that such conflicts of interest be avoided. The second round of submissions also had some comments calling for stakeholder representation on the Board:

> *"Sectoral interests should be capable of being represented on the Board, so long as they are in a minority. If sectoral interests cannot be represented then sufficient communication with Commissioners should be possible to ensure all operational matters are in accord with stated strategic direction."*

The Review has investigated s.6 of the Act, which establishes that Commissioners must have expertise in commercial activities, the plantation timber industry, or labour relations. This section also stipulates very clearly who may not be on the board, such as members of the Conservation Commission, members of the FPC or members of the DEC. Further, section 6(3)(d) explicitly excludes from eligibility for Board membership:

> *a person who has a material personal interest in a production contract or in a company or business that is a party to a production contract.*

The intent of the legislation is clearly to minimise the potential for conflict of interest to arise. The Review acknowledges the desirability of this objective but also the comments made in the submissions and recommends that the criteria for selection should be broadened. There are at least two areas of expertise that should be included in Section 6(1) of the Act. These are in the areas of forestry/sustainable silviculture, and finance. It is proposed that at least one member of the seven member board will have expertise in forestry/sustainable silviculture and at least one will have expertise in finance.

Like most Government Boards the Commissioners receive little, if any, formal training in their role as Board members or the expectations of Government. This undoubtedly has the potential to affect the contribution they can make, the role the Board adopts, the decisions it feels capable of, its general strategic focus and its overall approach to governance.

The Review finds that all new members should undergo a two-tier formal induction process. The first tier of the induction would focus on broad issues relating to accountability in public sector entities, such as:

- the general role of a Board member and the legal duties, responsibilities, liabilities and standards of conduct required; and
- Western Australian public sector governance processes, procedures and practices.

The second tier of the induction would be on elements specific to the FPC, such as:

- the goals, nature and business of the FPC, as well as current strategic issues;
- specific material such as relevant legislation, annual reports, previous reviews and minutes; and
- expectations of the Minister and Government in terms of key outcomes and direction.

In line with best practice the Board should also undertake an annual self-assessment of Board performance

Finding 3.1: That it is not appropriate for the Board of Commissioners to include sectoral representation, as any such representatives would be subject to a persistent conflict of interest. However, the expertise base of the Commissioners could be more closely specified.

Recommendation 9:
That the Board of Commissioners be retained, its appointment criteria broadened, with an additional requirement that at least one member has expertise in finance and at least one has expertise in forestry/sustainable silviculture.

Recommendation 10:
That all new Board members undergo a two-stage formal induction process.

3.2 The authority to employ the General Manager

Currently the FPC is a non-SES organisation for the purposes of the PSM Act 1994. This enables the Board of Commissioners to employ the General Manager. The Review feels that it would be preferable for the Minister for Public Sector Management to undertake this function. This would have the positive effect of allowing the General Manager, where appropriate, to be a member of the Board.

As a general rule, public sector officers should not be appointed to Boards while they retain a public sector position within the same portfolio. However, it is accepted that in some instances it is appropriate for board members to have public sector skills and expertise, as long as the reasons for the appointment and its associated responsibilities are made public. The FPC already has a role in providing policy support for the Minister for Forests, which means that it is undertaking core Government services. Making the FPC an SES organisation is consistent with its core policy support role.

If the Minister for Public Sector Management was made the employing authority of the General Manager, it would also have the positive effect of encouraging a high degree of responsiveness to Government priorities, and open up a formal line of communication between the General Manager and the Government which does not currently exist.

To bring about this change, legislative amendment would be required to the Forest Products Act to designate the FPC as a Senior Executive Service authority, in addition to amending Schedule 2 of the *Public Sector Management Act 1994* to add the FPC.

Finding 3.2: Formal lines of communication between the General Manager and Government are desirable, but do not currently exist.

Recommendation 11:
That the FPC be made an SES organisation, to allow the Minister for Public Sector Management to employ the General Manager.

4. Commercial Outlook

The FPC has put forward the view that it has opportunities for improved commercial performance in the future and that good prospects exist for a number of important settings influencing the business to improve, some significantly.

An important factor which could significantly affect the revenue earning potential of the FPC is the possible emergence of a "carbon economy" in Western Australia. While not currently planned, the external drivers for such developments remain in place and have had some effect in other Australian jurisdictions. Any initiative that drives or supports carbon sequestration and trading in WA is likely to fundamentally improve the commercial outlook for the New Plantations business, and by extension the FPC.

South West Forests

While business operations in the South West Forests will remain constrained to the sustained yields set in the FMP, the FPC believes its commercial performance in this area will improve going forward. The industry is advanced in adapting to the major structural changes brought about by the Government's policy *Protecting Our Old Growth Forests* and the *Forest Management Plan 2004-2013,* and almost all major contracts for native sawlogs have been finalised. Completion of these processes will provide the opportunity to take advantage of a level of stability over the next seven years that is in strong contrast to the changing environment of the previous five. This will allow the FPC to better focus on commercial performance and identify efficiencies in operations that will contribute to profitability.

The FPC has continued to develop a number of business opportunities based on the sale of lower grade or residue products from native forests (typically low grade logs and smaller logs from thinning operations). Such sales are not straightforward due to the generally low margins in end use industries, combined with relatively high production and transport costs for forest product inputs. However, the FPC has identified opportunities over the next four years for the sale of up to 275,000 tonnes per annum of currently unsaleable low quality or residue products from native forests. Two of these with good prospects of success involve annual sales of more than $2 million over the next two to three years. The success of these projects will also contribute indirectly to the FPC's commercial performance by reducing the cost of post-harvest silviculture and regeneration.

Other potential drivers of better performance include improved technology allowing the utilisation of a wider range of log size and quality, and the possible emergence of new industries, such as activated carbon, a product which has a number of uses such as air conditioning and filtration.

Arid Forests

The FPC's Arid Forests business, based on the harvest and sale of WA Sandalwood (*Santalum spicatum*) from rangelands, is currently very profitable for the volume of timber involved and is an important contributor to the FPC's overall position. While production levels are likely to remain static, around currently approved levels, there are several indicators that the performance of this business segment can be improved.

The FPC sells the majority of its sandalwood harvest to export markets and supplies around 40 per cent of the world market for sandalwood. This market share has increased in recent years due to reduced supplies of other sandalwood species, particularly Indian Sandalwood (*Santalum album*), as a result of unsustainable harvesting in other countries. It is expected that this trend will continue and that demand will continue to drive price increases that will benefit the FPC.

The Arid Forests program is subject to pre-existing contractual arrangements to develop a local processing industry. However, lower prices received under these contracts for domestic WA sandalwood sales, in comparison with export prices, cost the FPC several million dollars annually. The opportunity to renegotiate these contracts on more commercial terms within the next decade will enhance the profitability of the Arid Forests performance. In the longer term, trial plantations of Indian Sandalwood in the Gascoyne offer the potential for a new revenue stream for the business.

Mature Plantations

The mature plantations business also suffers from constraint on its margins as a result of the existing State Agreement contracts (see **Section 2.4 – Prices for pine sawlogs under long term state agreements**). This low profitability constrains the FPC's capacity to invest in new plantations in the South West to expand its business. The low profitability also has implications on private investment in plantations. This can mean that the forest industry has difficulties in achieving the 'critical mass' necessary to compete in world markets.

If more commercial agreements are entered into in the future, it can be expected that the Mature Plantations business will achieve significantly improved profitability, based simply on receiving commercial rates for its products, within a 6-year timeframe. **Section 2.4 – Prices for pine sawlogs under long term state agreements** identifies, for example, that an extra $6-$7 million of annual income would be generated if commercial rates applied on logs supplied under the *Dardanup Pine Log Sawmill Agreement Act 1992*. This would be in addition to a possible expansion in private investment as the artificial ceiling on log prices is removed.

Like native forests, the mature plantations business is also pursuing increased revenue through the sale of additional industrial wood and residues. In particular, sales of plantation residues could be worth around $1 million per annum for biomass power within two years. Such sales would also deliver annual cost savings in the order of $500,000 for re-establishment of plantation areas after final harvest. Any trend towards biomass power, as part of increasing demand for renewable energy, would result in further opportunities for plantation residue sales and silvicultural savings.

New Plantations

Under current and foreseeable circumstances the FPC's New Plantation business in the 400-600 mm rainfall belt of the agricultural area is not expected to make normal commercial returns based on the value of timber alone. However, consistent with the Government's sustainability policies, the program delivers other economic, social and environmental benefits for the community.

In the future, the true commerciality of plantations established on farmland in lower rainfall regions is likely to be based on new funding arrangements that recognise and pay for these additional benefits. The FPC has recently moved some way towards such a model by attracting State and Commonwealth Government funding for its 'Strategic Treefarming Project' under the National Action Plan for Salinity and Water Quality (NAP). This has reduced its future borrowing and debt servicing requirements, and improved the margins in the New Plantations business, although they are still below commercial rates of return (see **Figure 2, Section 1.2 – Quantifying the FPC's non-commercial roles**). Arrangements of this or a similar nature lead to questions about long-term security of funding for such programs but they currently enjoy joint Federal/State support and longer-term arrangements may be possible.

The FPC has positioned itself for public private partnership models for plantation establishment, and private leverage of public funding for plantations appears to be a realistic option within a short timeframe. As in the NAP example above, the public funding in this model is effectively a partial payment for the environmental and social dividends flowing from plantation establishment. Under such circumstances, the FPC is also well positioned to provide assistance in plantation establishment and maintenance to private investors, thus providing an additional revenue stream and a wider base for overheads.

However, based on the current rates of return, the growth of New Plantations in lower rainfall areas also has risks for the FPC going forward. The organisation currently has 97,000 hectares of Mature and New Plantations, on both public and private land, of which 29% is in the New Plantations (lower rainfall) area. In addition, a further 13,000 hectares of New Plantations will be added over the next two years (under the NAP initiative) lifting this proportion to 37%.

Due to the longer rotation times and considerably lower rates of return in lower rainfall areas, the overall performance of the FPC could decline longer term unless the situation is closely monitored and other measures are taken. These other measures would include initiatives mentioned earlier such as the continued growth in sandalwood production and pricing, possible carbon trading, the introduction of commercial returns under State Agreement Acts and contracts, and the sale of current residues.

The FPC expects that income streams from the new plantations will commence during the next decade. These will not be substantial in the short-term but will nevertheless reduce current losses and contribute to the overall viability of the business.

Finding 4: While the FPC has faced a number of challenges in making its operations profitable, the Review notes that it has put in place strategies which are anticipated to increase the commercial returns of a number of its programs.

5. Competitive Neutrality

Competitive neutrality is a competition principle whereby Government businesses should not enjoy any net competitive advantage by virtue of their ownership, when competing with other businesses. It is one facet of National Competition Policy, which applies to all States and Territories in Australia.

Some submissions to the review expressed, in various ways, the belief that the FPC did not meet competitive neutrality requirements and therefore enjoyed a competitive advantage over the private sector. However, the FPC has been subject to three separate reviews of its legislation, its native forest operations and its plantation operations and has met the competitive neutrality requirements set by Government, in consultation with the National Competition Council. The National Competition Council has referred specifically to Western Australia's progress on competitive neutrality in forestry in its 2003 and 2004 National Competition Policy Assessments (www.ncc.gov.au)

The three reviews of competitive neutrality can be summarised as follows:

5.1. Legislative Review – Conservation and Land Management Amendment Act 2000 and Forest Products Act 2000

This review was completed by Environmental Resources Management Australia Pty Ltd (ERM) in November 2000, shortly before the CALM Act Amendment Bill and the Forest Products Bill were enacted. The review identified eight possible restrictions to competition, three in the CALM Act and five in the Forest Products Act. All restrictions were found to be in the public interest.

However, it was considered that one of the restrictions in the Forest Products Act, namely that *"The price for the sale of forest products by the Commission must include certain specified components (Forest Products Act S59(1))"*, may give rise to commercial constraints on the FPC that are contrary to use and sale of forest products to the best commercial advantage.

It concluded that the costs of this restriction could be reduced by:

- provision of a mechanism to over-ride the requirements of Section 59 in certain circumstances, such as subject to the approval of a relevant authority enabling prices to be established for sale of particular products that do not fully recover historical costs; and/or
- making it explicit that the pricing requirement applies to the pricing and sale of forest products *in toto*, rather than pricing for each individual forest product or sale of products.

The legislative amendments proposed by the FPC as part of the statutory review process include a provision consistent with the second option above.

5.2. Competitive Neutrality Review – Native Forest Operations

The competitive neutrality review of native forest operations was also conducted by ERM and was completed in December 2001.

This review identified two competitive advantages and four competitive disadvantages for the FPC's native forest operations by virtue of its Government ownership. In fact, it identified a net disadvantage to the Commission.

Nevertheless, it concluded that the disadvantage was small in comparison to revenues, would have a small impact on Commission costs, and therefore on the prices of forest products, and that *"removal of these particular competitive advantages and disadvantages may therefore give rise to a public cost without any commensurate benefit"*.

As a result, the recommendation was *"that competitive neutrality not be applied to the Commission's native forest operations in so far as this would involve removing or negating the competitive advantages and disadvantages identified in this review"*.

5.3. Competitive Neutrality Review – Plantation Operations

The competitive neutrality review of plantation operations was completed in December 1999 by Forestry Pacific Pty Ltd (ForPac) as part of its wider review of what were then CALM Plantations Business Unit activities.

The review identified a number of competitive advantages and disadvantages of varying levels of importance, that applied to plantation operations, and made several recommendations with regard to reform mechanisms, including commercialisation, corporatisation, or privatisation.

Commercialisation, through the establishment of the Commission, together with several other responses, has addressed the major issues raised in the review.

All three competitive neutrality reviews, and the recommended responses to them, were endorsed by ERC in March 2004 and by Cabinet in April 2004.

Most comments in submissions related to competitive neutrality were general in nature, but a specific concern reflected in several submissions was the belief that the FPC is not liable for payment of taxes and rates.

However, the FPC pays local government rate equivalents, income tax equivalents under the National Tax Equivalent Regime (NTER), all state taxes, duties and charges, and charges for government guarantees on borrowings, in order to meet competitive neutrality requirements. This issue is outlined by the NCC in Table 1.14 of the 2003 NCP Assessment referred to above.

Finding 5: The FPC has undergone the relevant competitive neutrality reviews of its operations and legislation as required under the National Competition Policy. Currently there are no outstanding requirements of the FPC in satisfying competitive neutrality principles.

6. Ecologically Sustainable Forest Management (ESFM)

The Terms of Reference to this review relate only to the functions and structure of the FPC and the effectiveness of its operations. Other Government policies, such as the content of the Forest Management Plan 2004-2013 (FMP), which outlines the requirements of ESFM, were excluded as the FMP has been endorsed by Cabinet following extensive community consultation and does not form part of this review. Notwithstanding this, a number of stakeholders raised concerns relating to the FPC's performance in meeting its obligation, under s12 of the Act, to apply the principles of ecologically sustainable forest management to its operations. This statutory principle is clearly within the terms of reference.

Under the CALM Act, the Conservation Commission is responsible for the FMP, prepared through the agency of CEO of CALM (now DEC). In the past, the FPC had a formal part in developing the FMP, but in 2002 s.60 of the CALM Act was amended to remove this provision. The FMP contains a statement of policies or guidelines to be followed, and a summary of the operations proposed to be undertaken, and gives substance to ESFM principles referred to in both the CALM Act and the Forest Products Act. The FMP may not exceed 10 years in application and the current plan applies to the period 2004-2013, while the previous one was 1994-2003.

In preparing the FMP, the Conservation Commission has the objective of achieving or promoting a variety of benefits. In native State Forest or timber reserves these benefits include conservation, recreation, timber production on a sustained yield basis and water catchment. In plantations of exotic species, this includes benefits such as an optimum yield for social and economic goals. In conservation parks and national parks expected benefits include fulfilling recreation needs and maintaining the natural environment. Some stakeholders felt that the forestry industry had not been best served by the current FMP, which did not adequately address social and economic concerns:

> *"The restoration of the previous situation where DEC and the FPC, and their respective Ministers, were equal partners in development of the FMP is of vital importance to the industry. If this is not within the scope of the review we request that the matter be brought to the Government's attention by way of comment or recommendation. The current FMP does not address social or economic matters, though this is required by the Act."*

Other stakeholders, however, felt that the current FMP gave the forestry industry too much support and strong positions were expressed, for example, that all logging in native forests should cease.

These views raise questions about whether the FMP is a suitable mechanism for ensuring that timber harvesting is managed sustainably. In the course of the Review, members of the Conservation Commission told the Review that the Conservation Commission is an entity with a strong focus on the environment, as its name suggests. Similarly, the DEC, as its name suggests (the Department of Environment and Conservation) focuses strongly on the environment, as reference to its functions under its legislation will attest. As the FMP is the primary responsibility of the Conservation Commission, and is prepared by the DEC, it is the opinion of this Review that a strong mechanism is in place to address environmental aspects of forest management. It is therefore critical that the FPC adhere to the standards set by the FMP, which is discussed in the next section.

Where the FPC operations occur outside the area covered by the FMP, such as New Plantations and Arid Forests, they must nevertheless comply with a range of relevant statutes such as the *Environmental Protection Act 1986*, the *Sandalwood Act 1929*, the *Wildlife Conservation Act 1954*, the *Soil and Land Conservation Act 1945*, and the *Country Areas Water Supply Act 1947*, or other guidelines such as the *Code of Practice for Timber Plantations in Western Australia.*

Finding 6: That the current arrangements in the Forest Management Plan, relevant statutes, and other relevant instruments, provide strong mechanisms for setting standards in ecologically sustainable forest management.

6.1 Compliance with ESFM obligations

As indicated above, the review received a number of submissions to the effect that the FPC gave insufficient attention to compliance with ESFM obligations required of it under s12 of the Act, and detailed in the FMP and subsidiary documents.

The majority of such comments were general in nature, and coincided with a philosophical view that harvesting of native forests is inappropriate. One stakeholder, however, quoted figures from the CALM (now the DEC) Annual Reports of 2004/05 and 2005/06, the first two full financial years following the release of the FMP, which appeared to indicate that the number of Works Improvement Notices (WINs) and Management Letters (MLs), issued by CALM to the FPC in relation to incidents of non-compliance, had more than doubled.

Further investigation showed, however, that the 2005/06 figures were preliminary and that 11 WINs and two MLs actually issued in 2004/05, had mistakenly been included. Reporting by actual year of issue changes the picture significantly, as indicated in **Table 2**, and does not suggest that the performance of the FPC has deteriorated. Both the stakeholder concerned and DEC have subsequently acknowledged the revised figures to be correct.

Table 2 – Non-compliances corrected for year of issue

	2004/05	2005/06
CALM Annual Report	13 WINs, 9 MLs, 22 Total	19 WINs, 28 MLs 47 Total
Actual	24 WINs, 11 MLs, 35 Total	8 WINs, 26 MLs 34 Total
FPC EMS Incidents	94	98

For reasons discussed below, the Review believes that a simplistic analysis of total numbers of WINs and MLs is not an adequate measure of compliance. Nevertheless, it is important that the systems used by the DEC and the FPC to issue and respond to them are both sound and well co-ordinated. A joint approach to this issue is warranted.

Sparrow (2000) argues that use of enforcement-related activity counts as a measure of compliance may be misguided unless it is based on proven linkages with real results. Just as increased non-compliance reports may reflect poorer compliance levels, they could simply reflect greater enforcement effort, without any impact on actual performance. Conversely, regulators who report less non-compliance are often criticised for reduced effort rather than given credit for improved industry performance, unless more objective measures for the latter are also available in support.

He quotes a senior US Environmental Protection Agency official,

> *"Society would be crazy to judge the success of an enforcement enterprise on its ability to maintain levels of violations. Yet that is exactly how EPA's enforcement program is judged. Each year, the numbers of inspections, fines and civil and criminal actions are counted. Any drop in the numbers is considered not to reflect a reduction of violators, but a lack of effort [on behalf of] the EPA."*

It should be pointed out that, while Sparrow advocates that more meaningful compliance measures be developed, he suggests it cannot cease to use simple measures of violations until such time as improved ones are available.

Environmental compliance can be compared to that for occupational health and safety (OHS). It is accepted in the OHS field that, while the objective of work systems should be to avoid accident and injury totally, systems that identify hazards and develop preventative measures are crucial to that objective. This relies heavily on meaningful involvement of people in the workplace that is fostered by a co-operative, non-judgemental approach that encourages self-reporting.

Thus OHS reporting focuses on objective results such as number of injuries or work days lost, rather than incidents of non-compliance with laws or regulations, and emphasis is placed on continuous improvement.

In its wider consideration of ESFM compliance by the FPC, the Review also looked at incidents reported by the FPC staff and contractors under its internal Environmental Management System (EMS). The EMS is externally audited and accredited in accordance with ISO 14001 and provides a framework within which the FPC is able to record and monitor its own performance in complying with legal and other requirements related to environmental and associated matters. It forms the basis for continual improvement in environmental performance and supporting systems and procedures.

As is indicated in Table 2, recorded incidents of non-compliance in the FPC operations was around three times the number of notices issued by the DEC. WINs and MLs are recorded as EMS incidents by the FPC so an incident may arise by self-reporting, as a result of a DEC notice, or sometimes both. The figures therefore indicate that the FPC staff and contractors are self-reporting around twice as many incidents as are being picked up by the DEC in its regulatory role. Moreover, about 20 per cent of reported incidents were procedural matters which had no 'on ground' impact but which were routinely reported as part of the continual improvement process within the EMS. This allows the FPC to identify issues, monitor trends and amend procedures accordingly.

Incidents of non-compliance with standards, whether operational or procedural, are documented. The Incident Report includes a rating of the consequence of the incident, describes corrective actions where appropriate, identifies the causal factors and outlines preventative actions designed to avoid recurrence of the incident. These may include training, procedural changes or other actions.

In relation to training and induction, the contractor's representative (the contractor's bush supervisor) and employees receive EMS inductions specific to the types of activities they perform before commencement of work related to their contract, and subsequently when there are substantive changes to circumstances to warrant further induction.

Induction and training of new contractor employees follows a typical adult-learning model in which, after an initial induction in basic environmental and safety issues, inductees are provided with further information as required, in line with their ability to contextualise and absorb it. Initially high levels of supervision are decreased in accordance with the ongoing training and experience of the operator concerned.

Over and above the general EMS training and induction process described above, there is a supervisory process in which the FPC formally 'hands-over' a coupe to the Contractor's Representative, inspects progress and then certifies the coupe as completed to necessary standards.

The formal handover to the contractor includes a detailed coupe plan on which the coupe boundary, all formal and informal reserves, hygiene boundaries and other issues of importance are highlighted for discussion between the FPC Coupe OIC and the Contractor's Representative.

During the operation the Coupe OIC inspects the coupe regularly and notes items requiring action to ensure sound environmental management and resource utilisation, as well as safe working practices. At the end of harvesting operations, and when all the required actions have been completed to the satisfaction of the Coupe OIC, the block is certified as complete and ready for hand back to FPC.

While the Review acknowledges that an objective of total compliance with ESFM objectives is an appropriate goal, absolute numbers of incidents of non-compliance must be considered in the context of trends in such matters as the seriousness of consequences and the development of preventative measures and procedures.

Given the level of self-reporting by the FPC and the absence of performance measures other than non-compliance counts, the Review could not substantiate claims that the FPC performs poorly in relation to, or gives insufficient weight to, its environmental performance. Nevertheless, the FPC acknowledges that it is capable of improvement and the challenge exists for both the FPC and the DEC, as regulator, to develop meaningful, objective measures to indicate whether or not such improvement is realised over time.

The Review noted that there is a significant number of compliance monitoring tools currently in operation, as follows:

- the FPC EMS
- the FPC Internal Audit
- FMP Compliance report (the FPC/the DEC)
- the DEC Sustainable Forest Management and Audit
- Conservation Commission of WA Audit
- Community Forest Inspections

Further mechanisms are unlikely to add value to efforts by the parties to improve performance and supporting systems.

Finding 6.1: Improved systems for recording and responding to incidences of non-compliance with environmental standards, and for objectively measuring environmental performance are required.

Recommendation 12:
That the FPC and the DEC establish, in consultation with the Conservation Commission, a joint system for dealing with non-compliance in ESFM standards, and objective measures of environmental performance for forest operations.

6.2 Water protection

Protection of water quality and quantity was raised as an issue for consideration by the Review, principally by the Water Corporation, which suggested that the review of the Forest Products Act should recommend inclusion of specific provisions related to water protection, and the Department of Water, which suggested it include a specific requirement that the FPC comply with the relevant statutes.

Other submissions alleged instances when harvest operations had led to disturbance of, or turbidity in, nearby water courses.

The Review recognises the importance of water and the need for measures which protect water quality and quantity during timber harvesting and associated operations. This is an issue around which there has been a significant level of research and standards development over several decades.

The Review noted that most impacts of the forest products industry on water management and hydrology are well understood, and the following points can be made:

- there is a significant and adequate regulatory regime for water quality protection which includes existing statutory measures, the Forest Management Plan, and industry codes of practice;

- timber harvesting can be undertaken in accordance with this framework without lasting impacts on stream salinity; and
- harvesting operations under existing guidelines need not affect water quality but may improve water production in catchments.

In particular, the review noted that water quality protection, apart from being the subject of several relevant statutes that the FPC complies with, is covered quite comprehensively by the Forest Management Plan, which devotes a chapter to protection of "Soil and Water". These instruments are reflected more prescriptively in codes of practice and similar guidelines for timber harvesting operations.

Accordingly, the Review does not believe that further measures are required to ensure that water quality and quantity is adequately protected in the FPC operations, although it is appropriate that its operations are audited for compliance with existing laws and guidelines.

Finding 6.2: Adequate measures are in place for the protection of water values through several relevant statutes to which the FPC is subject.

7. Interaction between the FPC and the DEC

The functions currently performed by the FPC used to be performed by the DEC. When the DEC was responsible for both conservation and the sale and harvesting of forest products, it was criticised by various parties on the grounds that this was a conflict of interest. With the sale and harvesting of forest products transferring to the newly created FPC, the DEC naturally became more focussed on conservation, while the FPC has more of a focus on commercial goals. The fundamentally different raison d'etre of each agency inevitably creates tension between them, and stakeholders have perceived these tensions as a serious rift, with the following being a typical comment:

> *"...taking responsibility for the production of timber out of an integrated system immediately creates a barrier to harmonious internal interaction. It is not surprising there is now such animosity, and lack of cooperation between DEC and FPC staff."*

Their different raison d'etre notwithstanding, both entities have to work very closely together, through instruments such as the Forest Management Plan. As one example, the FMP requires the FPC to develop guidelines to protect native fauna as part of the Fauna Distribution Information System, in consultation with the Conservation Commission and to the DEC's satisfaction. Once these guidelines are developed, the FPC and the DEC are to conduct their operations in accordance with it. This is just one case where the activities of one entity inform what the other is expected to do. It can be seen that this requires the agencies to act together in a completely coordinated way, with an assumption that consultation will produce satisfaction and a workable plan. The FMP is full of other examples where the agencies are required to work very closely together. The FMP is not particularly helpful in providing guidance on what happens if the agencies disagree on how to handle particular matters.

The FMP is not the only document which requires the DEC and the FPC to work closely together. Both agencies have signed a Memorandum of Understanding, which sets out, in general terms, how they will work together. The subtitle of the MOU states that it is for *"The performance of statutory functions and joint obligations with respect to the sustainable management of native forests, the management of public plantations and the harvesting of forest products and related matters."* The MOU has a section on disputes, which specifies that if there is a dispute, the staff of each agency will attempt to resolve it. If this is unsuccessful, it is to be considered by the Director General of the DEC and the General Manager of the FPC. If this is unsuccessful:

> *...the matter will be referred to the Minister for the Environment and the Minister for Forest Products for joint resolution. The joint decision of the Minister for the Environment and the Minister for Forest Products shall be final.*

Although this dispute process allows, at each step, an escalation of authority, it does not overcome a major flaw: it never steps outside the forest products/conservation paradigm, which has a fundamental element of opposition to it. The best outcome for the FPC may not be the best outcome for the DEC, and vice versa. If there is a deadlock at junior staff level, it may not be resolvable no matter if it is taken to Ministerial level.

The Review has formed the view that matters in dispute between the two agencies have, on occasion, dragged on for some time without resolution. As such matters impact on the operations of both agencies, the Review feels that guidelines should be in place to more quickly enter into dispute resolution. For example, if a matter is unresolved at agency level after six months, then the dispute should be presented to the Ministers. If the matter is still unresolved then Cabinet should be called upon to make a final decision. This would provide both agencies with guidance as to their expected roles.

While the Review has outlined a dispute resolution process which should assist in delivering an outcome when the agencies are completely deadlocked, it notes that it is of the highest priority that the agencies seek such a close working relationship that any disputes are minimised, or are resolved at agency level.

As part of this working relationship, the Review notes that an improved process for determining the works program to be conducted by the DEC for the FPC, and reporting on its implementation, is required. While a works program is currently provided to the DEC by the FPC, difficulties in the working relationship have resulted in payments for works being made by FPC indirectly, via the Department of Treasury and Finance, in a manner that places no accountability for performance on the DEC and is inconsistent with the commercial approach expected by, and of, the FPC.

The Review suggests that, irrespective of payment mechanisms, the MOU should include provision for annual reporting by the FPC of the standard and extent of works and services provided by the DEC in the form of a reconciliation against the program provided by the FPC at the start of the year. This would provide a degree of accountability and important information for the Minister in considering the commercial performance of the FPC. The Review recommends that, eventually, this process would become fully commercial so the FPC only pays for works and services which are completed to standard.

Finding 7a: The current dispute resolution arrangements have not prevented some matters from being in dispute for some time. The MOU should be amended so that differences not resolved at agency level after six months should proceed to Ministerial level for resolution and if not resolved at Ministerial level should be referred to Cabinet.

Finding 7b: The MOU should also include provision for annual reconciliation of the works and services delivered to FPC by DEC against the schedule of works provided by the FPC.

Recommendation 13:
That the MOU between the DEC and the FPC be amended to provide more effective dispute resolution procedures, and a means for transparently recording the delivery of works and services by the DEC to the FPC. Eventually payments for work undertaken by DEC should reflect the work actually performed.

7.1 Fire management

Fire management is a matter by which the FPC and the DEC are inextricably linked for several reasons:

- the DEC is funded to provide fire protection services to the FPC for protection of timber assets on departmental land. This cost is met by the FPC;
- the DEC provides silvicultural burning services to the FPC related to regeneration of native forests. This cost is met by the FPC; and
- FPC personnel make up a significant proportion of, and operate virtually seamlessly with, the DEC's fire management and suppression organisation. The FPC's costs are met by the DEC.

Both agencies agree that there are no alternative practical options and that this symbiotic relationship will continue for the foreseeable future.

Nevertheless, there have been a number of issues related to fire management over which the parties have had different viewpoints.

The agencies have disagreed over the appropriate levels of fire protection for the FPC assets, but the agencies have agreed to a joint review of this issue during the 2006/07 financial year.

The DEC also raised its fire protection services to the FPC in the context of the Review's preliminary finding that it should transfer certain fee-simple plantation land to the FPC. However, the Review remains of the belief that the matters can be treated separately and that "ownership" of the land need not change the approach to fire protection services.

Finding 7.1: That the DEC should continue to provide fire and other services as currently funded, on a fee for service basis.

7.2 Standards of fire services

More recently the FPC has been concerned with the standard of certain fire services and the business risk this represents. This is an aspect of a wider concern on the part of the FPC about its lack of standing in land use and management decisions made by the DEC which impact directly on the FPC's business.

The Review addresses the broader issue in Section 8. However, the standard of fire protection services is a less straightforward matter and is best managed through the dispute resolution procedure recommended above. FPC has commented on the regular shortcoming on the part of the DEC in performing the annual works program. The dispute resolution procedure should identify any shortcoming which should then be referred to the Department of Treasury and Finance who fund the program in the first instance.

A further issue, which has been the subject of discussion between the FPC and the DEC, and which was raised by a cross section of stakeholders, is the potential conflict between the FPC's harvesting management and standards compliance responsibilities on the one hand, and its over-riding responsibility to assist the DEC in fire suppression operations on the other. The likelihood of conflict is quite high because both objectives peak during the dry summer months.

Industry stakeholders showed concern over this issue because the absence of the FPC staff has the potential to delay or otherwise impact on their operations, while conservation representatives were primarily concerned that it might lead to non-compliance with required environmental standards. The following are similar comments from different stakeholders:

> *The proposal that CALM (DEC) should continue to provide fire and other services as currently funded is supported but DEC should not be allowed to take FPC staff away from the FPC duties to assist with prescribed burning.*
>
> *The submission that the FPC's role in fire management be clarified is supported. The FPC should not be required to take its officers away from their FPC duties in order to carry out, for example, prescribed burning.*

It is interesting that both comments refer to prescribed burning rather than fire suppression, quite possibly because the need to give absolute priority to suppression is generally acknowledged. Nevertheless, the symptoms are the same and, in fact, the conflict is more easily addressed and overcome in relation to prescribed burning than to fire suppression.

It appears to the Review that the integration of the FPC staff into the DEC's fire management operations are possibly the most successful aspect of the arrangements between the parties. As a result, discussion of this issue by both parties has generally acknowledged the importance of, and the inherent conflict between, fire suppression and harvesting management without fully resolving the matter.

The FPC has expressed concern that there have been instances when the DEC has commented negatively on the FPC's environmental performance at times when its staff have been heavily involved in lengthy continuous periods of commitment to the DEC fire suppression operations. The FPC argues that this concern is magnified because a substantial proportion of the FPC staff commitment to the DEC fire suppression operations is related to fires on conservation or recreation lands, or threatening community assets, rather than to protection of the FPC assets.

The FPC also expressed the view that a large proportion of the DEC staff do not participate in fire management operations and that the DEC therefore has the capacity to significantly increase its own fire suppression capability rather than rely so heavily on the FPC staff at times of peak demand. The Review is of the opinion that this opportunity should be pursued as part of a strategy to reduce the conflicting demands on the FPC.

Like the parties, the Review recognises that fire suppression operations, which may involve threats to life, property or natural assets, must remain paramount. However, mechanisms to minimise potential conflicts with the FPC's core functions and to appropriately recognise and deal with them when they occur should be found.

Given the relative level of mutual interest and goodwill between the FPC and the DEC in relation to this matter, it appears likely that an agreement could be reached in which a threshold level of the FPC staffing required for harvesting supervision is recognised by both parties. Usage of the FPC staff up to that threshold could continue to occur in the current "seamless" manner through local level fire preparedness arrangements.

However, commitments beyond the threshold would only occur with the concurrence of the FPC management, allowing a formal risk management approach to core functions such as harvesting supervision while providing for an adequate response where fire threatens life or property assets.

Finding 7.2: Fire suppression operations appear to be the best example of cooperation between the FPC and the DEC. The current situation in which fire suppression is given priority over other responsibilities of the FPC, including harvest supervision and standards compliance, is appropriate. A mutually agreed mechanism to recognise and manage the inherent conflict would further strengthen the working relationship.

This should involve a cooperative inter-agency approach, for inclusion in the FPC/ the DEC Memorandum of Understanding, based on:

- equitable levels of staff participation in fire suppression;
- retention of a minimum threshold level of the FPC staff for harvesting supervision, unless a greater commitment is approved by the FPC management in response to threats to life and property; and
- recognition by the DEC that above-threshold involvement in fire suppression by the FPC will impact on harvest planning and supervision, and must be managed.

Recommendation 14:
That the Minister require the development of a cooperative inter-agency strategy to manage the competing requirements of the DEC and the FPC in regards to harvest supervision and fire suppression responsibilities.

7.3 Clarification of responsibilities

The respective roles of the FPC and the DEC in the management of native forest harvesting operations are not well defined, and the agencies have not yet been able to reach a mutual position on the matter. This has resulted in a level of tension between the organisations which is beyond that incumbent in the management model.

The FPC has reported operational delays as a result of extended approval processes, and in a level of duplication in which both agencies are taking a responsibility for similar duties. In particular, the latter occurs in ensuring the FPC contractors comply with environmental and other standards because the FPC has a direct supervisory role and the DEC often undertakes a high level of oversight as part of its audit role.

In its submission to the Review, the DEC speaks of:

> *"...the lack of clarity in the legislation, and any agreement with the FPC, concerning the role of DEC in the implementation of the Forest Management Plan 2004-2013 and its associated guidelines with respect to timber harvesting."*

From the DEC's perspective the FPC might be seen to be ignoring its (the DEC's) role as a regulator.

There are definite gains to be made in both efficiency and the quality of the working relationship between the FPC and the DEC if the respective roles can be better defined and agreed. In simple terms the FPC should have responsibility for ensuring that its operations are conducted in a manner that is compliant with all its obligations under the FMP, while the DEC, assisting the Conservation Commission, has roles in ensuring that the areas the FPC proposes to harvest are appropriate, that the standards to which the FPC are to perform are clearly stated and an audit role in ensuring that compliance is occurring. It is noted that the DEC also has a management role for State Forest in general, but clarity is needed to avoid duplication of the FPC's role in timber harvesting.

Currently, the following requirements must be prepared before harvest commences:

- Forest Management Plan
- three year plan
- annual plan
- Fauna Habitat Zone (FHZ) location
- pre-harvest checklist
- DRA Permit
- winter coupes approvals

- soil management plan
- basic raw materials (BRM) extraction plan
- roading plan
- dieback hygiene plan
- permission to take listed flora

In instances where the DEC requires separate approval of each step, this has become, in the FPC's view, overly bureaucratic and process driven, rather than outcome-driven. As a result significant staff and financial resources are spent by both agencies that could otherwise be better applied to environmental performance or to other objectives.

The FPC submitted that the appropriate roles for the respective agencies are best described as follows:

Conservation Commission
- broad system planning through the Forest Management Plan
- auditing of FMP outcomes

Department of Environment and Conservation
- sets specific guidelines, specifications and outputs to achieve the FMP goals
- approves areas for harvesting (three year and annual harvest plans) consistent with the FMP and specifications, and integrates with other land use requirements
- assist the FPC in preparing harvesting strategies to achieve environmental outcomes
- audits implementation
- provides feedback to the FPC on performance, including any necessary remedial action to achieve standards
- monitors outcomes (e.g. Forestcheck) to see if its specifications actually achieve desired outcomes
- reviews specifications based on monitoring and research
- reports to Conservation Commission and publishes reports

Forest Products Commission
- provides advice to the DEC on specifications and standards based on what is practical
- provides advice as to impact on industry
- produces plans for areas to be harvested for approval (annual plan) consistent with FMP and the DEC specifications
- prepares strategies with the DEC to address management requirements
- implements specifications and guidelines
- monitors performance
- reports to the DEC and CCWA on performance and publishes reports;
- investigates substandard performance including any notices from the DEC
- administers harvesting contracts to ensure contractors comply with specifications and standards

This represents a mature and efficient system in which the 'controls' are best achieved through clear specification, monitoring, feedback and review of implementation. It is noted that the FPC and the DEC have acknowledged the need to improve planning, implementation, and compliance audit systems and undertaken to work together to achieve greater efficiencies while meeting necessary standards.

In such circumstances there is considerable scope to make planning processes more efficient and significantly reduce duplication. A model similar to that used by other industries, in which a proponent presents an operational plan for approval, based simply on its compliance with set procedures and standards, appears to be capable of achieving these outcomes.

In these circumstances it is appropriate that an agreed time limit be placed on the endorsement process to ensure timely approvals so that seasonal targets are not threatened.

In the developmental phase of new initiatives closer involvement from the DEC, including separate approvals, may be appropriate, as was the case during development of moist soil management procedures in recent seasons. However, once procedures are agreed, the above process achieves the same outcomes far more efficiently.

It should be noted that at a senior officer level there has already been considerable progress towards agreeing on the improvements outlined above.

Finding 7.3: Clarification of the responsibilities of each agency is required if tensions between environmental and commercial objectives are to be maintained at a healthy and constructive level. The FPC and the DEC recognise the need for improved cooperation and have recently made progress on this matter.

Recommendation 15:
That the Minister, in cooperation with the Minister for the Environment, support initiatives by the FPC and the DEC to clarify their respective roles and interactions.

8. Land

8.1 Changes in land usage

Under the FMP, the FPC is provided access to certain lands for harvesting of forest products for the term of the plan. The FPC expressed concern that it has frequently 'lost' access to this land to other uses, such as for powerlines, sand or gravel pits, recreation and water catchment purposes, within the term of the plan. This has occurred where DEC has agreed to land use changes without reference to the FPC. The effect of this is to diminish the volume of forest products which it has access to, affecting its ability to meet its obligations under State Agreement Acts and contracts, putting it in a very difficult position

This led to the Review making a preliminary finding in the draft report that the FPC's usage of lands should be protected by agreement. While land uses other than timber production might well be very important, at the present time the FPC is not consulted over changes in land use and has no ability to influence the decision making process. The Review considers this a problem, and there are a number of possible mechanisms to address this.

1. Section 17(6a) of the CALM Act establishes that any change in land use in timber reserves requires the concurrence of the Minister for Forest Products (Minister for Forestry). This provision does not apply in State forest areas. However, as this is a review of the FP Act, not the CALM Act, the ability to achieve this outcome via an amendment to CALM legislation is outside our terms of reference.

2. Similar to the above suggestion, another possible mechanism is to amend the Forest Products Act so that the Minister for Forestry must concur with land use changes in State forest in so far as the proposed change impacts or may impact on FPC operations. This would need to include the notation that, where the CALM Act and the Forest Products Act contradict each other in relation to changing land use in State Forest, the latter act will prevail.

   This legislative change would take some time to implement, but would ultimately give the Minister responsible for administration of the Forest Products Act a statutory opportunity to have input into matters which greatly effect the ability of the FPC to conduct its operations and importantly would put the Forestry portfolio on an equal footing with the position now afforded the Fisheries and Mines portfolios in the CALM Act (eg s13(4a), s14(1a) & (6), 17(6) s60(2b) and s62A(3)) with respect to changes of land use. This would then be consistent with the approach taken in regards to Marine Parks and the Ministers for Fisheries and Mines, and it is understood would re-instate a procedure which had previously applied under the CALM Act prior to 2002.

3. Another possible mechanism is that the MOU be altered. The MOU establishes that the agencies have some areas of mutual interest, and that there will be obligations on each of the parties relating to the management of plantations in native forests and on Departmental land. At present, the MOU establishes that the agencies have a mutual interest in:

- access to native forest for harvesting of forest products
- access to plantations on "Departmental land" and their forest products for establishment, silviculture and harvesting activities

Although the obligations of each party in relation to access to forest products is not specified, it seems reasonable to conclude that, under the existing MOU the FPC has the right to be consulted about any change in land use that affects its ability to meet its obligations. However, since this does not appear to have been the case, the MOU could be altered to specify that access to native forest or plantation land is to be subject to working arrangements which allow the FPC to have input into any proposed land changes. The MOU is subject to annual reviews, so that this would be a quick way to effect a change.

Considering these three options, it appears that amendment to the MOU is the quickest means by which the FPC can have some say over its access to land for the purposes of harvesting forest products. In addition, a change to the Forest Products Act so that the Minister for Forestry concurs with land use changes would give the FPC greater stability in its operations, and the lengthy process of legislative change should be embarked upon.

Finding 8.1: That the FPC requires greater certainty in its ability to access land for the harvesting of forest products. At a minimum, this would include a right to be consulted if proposed land use changes would result in their 'losing' land.

Recommendation 16:
That the MOU between the DEC and the FPC be amended to specify that access to land be subject to working arrangements which allow the FPC to have input into any proposed land use changes.

Recommendation 17:
That the Forest Products Act be amended so that the concurrence of the Minister for Forestry is required before changes reducing the land available for forestry can go ahead.

8.2 The FPC's ability to buy or sell land

A preliminary finding of the draft report was that "Legislation should be amended to make it clear that the FPC can buy and sell freehold land with certain restrictions." This finding relates to the fact that the Forest Products Act is currently ambiguous in relation to whether the FPC can buy or sell land. The State Solicitor's Office provided advice on this matter and stated that the sections of the Forest Products Act dealing with the FPC's capacity to acquire and dispose of land are confusing, ambiguous and should be amended as soon as possible.

Stakeholder feedback to this suggestion was divided, with some comments received that were very positive about the suggestion, and others very negative. Generally speaking, where stakeholders did not believe that the FPC should be able to buy and sell land, it was due to a lack of confidence that it would be bound by Government policy or the public interest.

The FPC cannot be expected to be a viable enterprise when its assets diminish without being replaced and it has no power to reverse the process. One stakeholder expressed the following view:

> *Any long-term investment in forest silviculture and infrastructure will require security of tenure to the assets, or at least a vesting authority with a genuine commitment to all the values the forests are meant to provide.*

If the FPC had the power to buy, lease and sell land to ensure sufficient trees to meet future demands it would allow flexibility in making commercial decisions such as in the choice of suitable locations, and the management of its growing assets. Accordingly, the Review is of the opinion that the FPC should be able to buy and sell land if this assists it in meeting its functions under the Forest Products Act.

The concern could be raised that, if the FPC could buy and sell land, it would succumb to the temptation of dealing in real estate - potentially a far more lucrative business than growing trees. To ensure that the FPC acts in accordance with Government policy and the public interest, Ministerial approval should be necessary before any purchase or sale of land goes ahead. To ensure that other Government agencies are not disadvantaged by the actions of the FPC, they should have the first right of refusal for any land to be sold at market value.

Additionally, the FPC should be able to substantiate that the sale or purchase of any land is in the public interest.

Finding 8.2: For the FPC to meet its commercial obligations, its ability to buy or sell land should be confirmed. Appropriate checks and balances for the purchase and sale of land include that:

- permission from the Minister and Treasurer is granted;
- Government agencies get first right of refusal for the sale of land;
- it is in the public interest; and
- it assists the FPC to meet its primary functions as defined by the Forest Products Act.

Recommendation 18:
That the Forest Products Act be amended to confirm that the FPC can buy and sell freehold land, with appropriate checks and balances.

8.3 Fee simple plantation land

The DEC and the FPC have been in dispute for a number of years over approximately 12,000 hectares of fee simple land. The land in question is primarily farmland that was bought from 1950-1992 to establish pine plantations on the better soils of South West river valleys, mainly the Blackwood River.

The land is currently held by the DEC, while the FPC manages timber production on it. The FPC maintains that, at the time of the split of the FPC from CALM it was agreed by both parties that the land would be transferred to the FPC. The DEC argues that it is not appropriate that such a transfer should be decided between them, rather that this should be a policy decision by Government.

However, it is reasonably clear that the Government intended that some plantation land would be transferred from the DEC to the FPC. For example, the explanatory memorandum of the *Forest Products Bill 1999* lists several points where it was clearly intended for plantation lands to be transferred, such as the following:

> *Subclause 10(3)(f) provides that the Commission* [FPC] *can have plantations, nurseries, and seed and propagation orchards vested in it or placed in its care, control and management.* ***This will facilitate transfer of existing plantations*** **[from DEC]*****, etc. to the Commission and the establishment of new plantations. [emphasis added]***

There is other evidence that it was Government policy to transfer plantation lands from the DEC to the FPC, including, in 2000, a joint Cabinet submission and a Memorandum of Understanding between the Minister for Environment and the Minister for Forestry, which both envisaged this transfer. Notwithstanding this, in its submission the DEC has stated that "the current Government's policy is not bound or necessarily guided by the administrative arrangements made by a previous Government".

In 2001 the Executive Director of CALM and the General Manager of the FPC signed the *Agreed Treatment of Outstanding Liabilities* which envisaged that commercial forestry related land might be transferred to the FPC. It is the FPC's contention that a 2001 document that was jointly developed between the DEC and the FPC "The Marketable Land Review" was effectively an agreement between the two entities on the lands that would be transferred.

The background of the Marketable Land Review document is that, at the time the FPC was formed, the DEC was near the end of an asset rationalisation program and the document was a list of parcels of the DEC's land at that time. It included information such as the location and area of each parcel of land, its value and current use, the type of tree growing on it, any improvements present, and comments such as whether it was plantation land, adjacent to State forest and whether it had heritage buildings or recreation sites on it.

Of particular relevance is that the document indicated the proposed future use of the land, whether this was for:

- sale
- retention by the DEC

- transfer to the FPC
- a split between the two agencies, apparently on the basis that parts of the land had conservation, creation or heritage values and would therefore be retained by the DEC

In its first-stage submission, the DEC has argued that this document did not constitute an agreement between the two entities to transfer the lands, and has cited several reasons for this. For example, the DEC states that the report was by two mid-ranked officers of the DEC and the FPC. The Review accepts that this specific report was apparently not signed-off at senior levels. However, the Review takes guidance from the fact that the Government had expressed a high level of in-principle agreement that some commercial forestry lands were to be transferred to the FPC.

In addition, the DEC states that the report was not an assessment and decision on the ultimate ownership of each property. The Review notes the DEC's position that the report was not intended to be the final word on ownership of the lands in question. However, it seems clear that the two agencies were taking a mutually agreed step to work towards the transfer of some lands. The Review considers the report a most useful tool because reference to it clarifies, in the vast majority of cases, that the lands in question are primarily established pine plantations. It is difficult to see why a Department whose primary goal is to act in the interests of conservation and the environment should retain ownership of land whose primary purpose is for timber production.

The Review notes that there are conservation considerations for some plantations which are adjacent to State forest, with important fire management implications for the DEC. However, this is not viewed as sufficient reason for the title of these plantation lands to remain with the DEC. It is the Review's opinion that the DEC should retain control over its fire management functions and the FPC should continue to pay for those services on a fee for service basis.

In its submission, the DEC states that the report does not address biodiversity, recreation and heritage values of the land. The Review has investigated the report and found that it does seem to address these concerns. In its first submission, the DEC argued that many of the plantation lands had biodiversity, recreation and heritage values, and listed some examples. For instance, it mentioned Beyonderup Falls, within Ellis Plantation, a natural feature with recreation values which are well known and valued by the local community. However, reference to the report in question reveals that the Beyonderup Falls area seems to have been either earmarked for retention by the DEC or to be split between the two agencies, which seems to indicate that its recreation features had been taken into account.

Similarly, the DEC refers to heritage-listed homesteads such as the Golden Valley Homestead. Again, the report indicates that this land was to be retained by the DEC. In any case, any heritage-listed building would have its own protection regardless of whether its ownership was transferred to the FPC. The DEC also refers to some plantations which have areas of native vegetation subject to recommendations of the Environmental Protection Authority's System 6 report. It does appear that some of these lands have been earmarked for transfer to the FPC, and the report includes a notation that they are subject to System 6 recommendations. It is the opinion of the Review that the FPC, with its legislative obligation to take environmental considerations into account, will be able to adhere to recommendations made by the Environmental Protection Authority. The Review also considers it a relevant feature that, virtually all of the land parcels earmarked for transfer to the FPC are already planted with pine (or in a small number of cases, with other commercial crops such as bluegum) and bush remnants, where they exist, are generally a very small fraction of the overall area.

Also in its submission, the DEC states that the report's authors indicated that there were several issues requiring resolution before any firm decisions were made. The Review acknowledges that this report was not seen to be a final document. However, it clearly is a substantial body of work which was entered into by both agencies to determine, on a parcel-by-parcel basis, the appropriate ongoing use of the freehold land.

Notwithstanding the DEC's objections, for the reasons outlined above, the Review stands by the preliminary finding in its draft report.

Finding 8.3: That fee simple land plantation lands should be transferred from the DEC to the FPC where appropriate. The report *Marketable Land Review* dated 22 November 2001 is the best basis for determining which fee simple land is to be transferred to the FPC.

Recommendation 19:
That the DEC transfer to the FPC the fee simple land identified in the *Marketable Land Review* dated 22 November 2001.

8.4 Vesting of public land reserved principally for forest products

The Review has also noted that there is a range of timber and sandalwood reserves, as well as some ex-pastoral leases purchased under the Sandalwood Conservation and Regeneration Project (SCARP) with money from sandalwood sales, where the initial purpose was clearly connected with the production of forest products.

The Review believes the Minister should consider legislative amendment allowing subsequent vesting of these reserves in the FPC, consistent with the purpose of production of forest products.

Finding 8.4: That there is a range of timber and sandalwood reserves and pastoral leases initially intended for production of forest products.

Recommendation 20:
That the Minister considers legislative change and subsequent vesting in the FPC of reserves intended for the production of forest products.

9. Suggested Miscellaneous amendments to the *Forest Products Act 2000*, and other consequential amendments

A preliminary finding of the draft report was that "Existing functions of the FPC should be retained but consideration should be given to making the list of functions in s.10 of the Act less prescriptive."

This refers to Part 3 of the Forest Products Act, which establishes the functions of the FPC. Rather than set the broad principles by which the FPC conducts its business, this section is unusually long and prescriptive, with a detailed list of clauses running from 10(1)(a) through to 10(1)(w) with a number of further subsections. The Review would prefer to see a smaller list of broader functions.

Legislative change is required to bring about changes to the Board's composition, as discussed in **Recommendation 3.1**, its potential membership criteria broadened to include forestry/sustainable silviculture and finance and to provide that the General Manager of the FPC may be a member of the Board. Similarly, **Recommendation 3.2**, that the FPC be made an SES organisation, requires an amendment to the Forest Products Act.

In accordance with **Recommendation 8.1b**, the Act should be amended so that the concurrence of the Minister for Forestry is required before changes reducing the land available for the production and harvesting of forest products are approved, and to provide precedence of the new provision over relevant sections of the CALM Act.

As discussed in **Recommendation 8.2**, the Forest Products Act should be amended to clarify that the FPC can buy and sell freehold land, subject to the conditions mentioned.

Additionally the Review recommends that s.38, and other relevant sections of the Act, are amended to remove the term "General Manager" and replace it with a generic term, consistent with Government policy to provide for flexibility in titles for chief employees. Similarly, amendments to the Act should be made to replace references to the Minister for Forest Products with the more generic term "Minister responsible for administration of the Act".

The draft report suggested a number of legislative changes, particularly intended to clarify the role and the operations of the FPC. Some of these legislative amendments had already received Cabinet approval to draft. The Review supports these proposed legislative amendments. A short description of the proposed changes follows, along with stakeholder feedback received in response to the draft report.

9.1 Legislative changes already approved by Cabinet

A number of proposed legislative changes have already been approved for drafting by Cabinet. They attracted little comment from stakeholders, and it is the opinion of the Review that these changes should go ahead.

- Amend Section 4 of the Act so that 'forest products' has the same meaning on all land, regardless of who owns the land. At present, the definition of 'forest products' is only valid on public or sharefarmed land. Under the current definition, the FPC cannot provide silviculture services to investors of privately owned plantation land. This would also be a barrier to the FPC owning its own land, as it would not be able to buy or sell forest products on that land. This legislative change was supported a number of stakeholders, the DEC included.
- Amend Section 10(1) of the Act to augment the FPC's ability to enter into business undertakings, similar to the powers that the DEC has under Section 34A of the *Conservation and Land Management Act 1984*. This would allow the FPC to deal in shares, enter into partnerships, and appoint office holders in a business undertaking. No stakeholder comment was received in regards to this suggestion.
- Amend Section 10(3)(f) of the Act to take account of carbon rights by adding a general power enabling the FPC to acquire, hold and dispose of, or otherwise deal with, freehold and leasehold interests in land for, or in connection with, a purpose set out in Section 10(1)(g) of the Act. Under the *Carbon Rights Act 2003*, carbon rights are an interest in land separable from the land and from the trees in a plantation, and such rights cannot currently be acquired, held or disposed of by the FPC as there is no express power under the Forest Products Act to do so. While a number of stakeholder comments supported this suggestion, one negative comment was received, which said that it was undesirable, inasmuch as it allowed the FPC to own land. However, the Review has outlined elsewhere in this report why it supports that the FPC be given the power to own land, and therefore proposes that this amendment proceed.

Finding 9: That the proposed legislative changes that have been already received drafting approval from Cabinet were generally well received by stakeholders.

Cabinet has not yet considered the remaining legislative changes. These can be considered in two groupings, those that were either well-supported by stakeholders, or attracted no comment, and those that received strong opposition. These will be considered in turn.

Suggested legislative changes which were unopposed:

- If necessary, amend Section 3 of the Act so that the definition of "tree" clearly includes monocotyledonous such as grass trees and palms, as well as dicotyledonous species. However, advice from the State Solicitor's Office has been sought as to whether monocotyledonous species are already included in the definition. Where it was mentioned by stakeholders, this suggested change was supported.
- Amend the Act to allow for products of artificial propagation to fit within the meaning of "forest products". Where it was mentioned by stakeholders, this suggested change was supported.

- Amend the Act to clarify and separate the commercial and non-commercial functions of the FPC, and link the funding of both to Part 6 – Financial Provisions. This proposal is discussed in Chapter 1, where the review has commended that a separation of commercial and non-commercial functions of the FPC is highly desirable. This proposed change was strongly supported by stakeholders.
- Amend Section 10(1)(k) of the Act to clarify that the role of the Executive Director in stockpiling of forest products relates only to 'bush stockpiles' and not to 'mill stockpiles'. This is intended to ensure that stockpiling of forest products in the forest is limited to necessary levels. Further, it seeks to distinguish that 'bush stockpiles' are within the role of the DEC, while 'mill stockpiles', are the role of the FPC. Where it was mentioned by stakeholders, this suggested change was supported.
- Amend Section 10(1) of the Act to allow the FPC to provide advice, work or facilities to any entity as long as it is in the public interest. This was put in because it is not currently an express function of the FPC to provide advice or undertake work other than for the Minister. For example, this would allow an FPC staff member to lead a discussion on forestry matters at a university. Where it was mentioned by stakeholders, this suggested change was supported.
- Amend Sections 20(2) and 29(2) of the Act to require submission of the draft strategic development plan and draft statement of corporate intent by 1 December, or 7 months before the start of the next financial year. This amendment is intended to synchronise submission of these documents with the financial cycle, and reflects administrative arrangements already agreed by the FPC and DTF. This proposal did not attract any stakeholder comment.
- Include within Part 6 provisions giving the FPC specific powers related to write-offs of public property, revenue and other debts, to clarify that amounts owing from customers can be considered write-offs. This proposal did not attract any stakeholder comment.
- Include within Part 6, provisions allowing the FPC to participate in foreign currency transactions for purposes related to its core functions. This is proposed because the FPC needs to conduct business in foreign currency, such as by receiving foreign currency in payment for forest products, or making payments in foreign currency for shipping and insurance. The FPC would still refer to WATC or DTF before entering into such transactions. This proposal did not attract any stakeholder comment.
- Amend Section 54(5) to clarify that any personal covenant by a transferor of a profit a prendre agreement transfers to a transferee, as the current legislation is not clear in this regard. Where it was mentioned by stakeholders, this suggested change was supported.
- Amend Section 55 to make the definition of "plantation tree", and thereby "plantation product", consistent with the definition of "forest product" in Section 4 by removal of reference to "departmental land". No stakeholder comment was received on this point, however it is consistent with an earlier redefinition which did receive broad support.
- Amend Section 59 to make clear that the various components of contract price may be recovered by the FPC from the sale of all forest products "in-toto", rather than on a product-by-product basis. This is consistent with the recommendation of the competitive neutrality review of the Act. This proposal did not attract any stakeholder comment.

- Clarify the meaning of s59(1)(c) so that the FPC is only responsible for the full recovery of Departmental costs related to the specific area of departmental land from which forest products are harvested in any given year. This is to clarify that the cost of managing lands which have uses other than timber production is not fully borne by the FPC. The DEC did not raise any objection to this proposed change in its submission.
- Add a provision to Section 59 which allows the FPC to charge customers additional amounts to cover costs such as interest, administrative, legal, securitisation (including stamp duty) and other fees. This would give the FPC greater commercial flexibility than it currently has. At present, when a party to a contract is not meeting its contractual obligations the FPC's only course of redress is to pursue action for default. In many cases this may not be the most appropriate response. Where it was mentioned by stakeholders, this suggested change was supported.
- Include within Part 9, powers similar to Part 9 Division 2 of the CALM Act allowing the FPC to take enforcement action in relation to regulations made either under the transition arrangements of the CALM Act or under Section 70 of the Forest Products Act. The Act is currently very limited in the provision of powers for regulation and enforcement related to management of forest products. As an interim measure, the savings provisions within the CALM Act allow the FPC and the DEC to share responsibility for administration of the *Forest Management Regulations 1993*. However, it would be preferable for those regulations to be repealed and replaced by necessary regulations under each Act separately. The proposed amendment would provide the necessary power for the FPC (and the DEC) to pursue that option. This proposal was supported by the DEC in its submission.

Suggested changes attracting negative comment but should proceed:

- Amend Section 4 of the Act to include within the meaning of forest products basic raw materials (including sand, rock, gravel, limestone and shale) to be used for the construction or maintenance of roads for the purpose of managing or harvesting forest products. This was proposed to allow the FPC access to raw materials on the DEC's land for the purpose of road construction.

  Comment: A stakeholder voiced concern over this proposal, stating that it would give the FPC access to all land vested in the Conservation Commission. However, this proposal was supported by the DEC, who noted that the current situation, where the DEC had to provide the gravel to the FPC and then recoup the costs, was an inconvenient administrative arrangement. The single stakeholder objection does not seem to take into account that the FPC already makes use of basic raw materials for the construction of roads, albeit through cumbersome administrative arrangements. On this basis, **the Review supports that the proposed legislative change goes ahead.**

- Amend the act to allow the FPC to make use of sequestered or stored carbon and carbon rights, as defined in the *Carbon Rights Act 2003*.

  Comment: A number of stakeholder comments supported this suggestion. However, one comment was received that it was "opposed insofar as it relates to giving the FPC the power to buy land". As this report strongly recommends that the FPC be given the right to buy and sell land, **the Review supports that this legislative change goes ahead.**

- Amend Sections 12(1) and 59(1)(g) of the Act to avoid the negative term "exploitation" with a positive term such as "utilisation".

  Comment: One stakeholder comment was received on this comment, which suggested the term "use", instead of "utilisation". This is a good suggestion - it avoids the negative connotation of 'exploitation', and is a better word than "utilisation" because it is more in keeping with 'plain English' legislation. **The Review accepts the proposed change to the definition.**

- Include within Part 6, provision for the FPC to receive and disburse Commonwealth or State grant moneys. The FPC does not currently have power to receive or disburse Commonwealth or State grant funds and such funds must be channelled through other agencies. The proposed amendment would improve efficiencies and flexibility in dealing with grant monies.

  Comment: Two comments disagreed with this suggestion, on the grounds that it puts the FPC in competition with NGOs and private individuals who have fewer resources. However, these comments reflect may reflect a misunderstanding. The provision is not intended to put the FPC into competition with other entities who may apply for grants. Rather, it is to allow the FPC to disburse the money to other entities. Commonwealth or State grant monies are usually tied to a particular purpose. For example, many regional groups received money from the Federal Government under the NAP scheme. This money had to be disbursed to those groups through the DAFWA. An argument can be put forward that giving the FPC the power to disburse funds directly to the groups who are growing trees represents a sensible step in streamlining the process and giving the opportunity for better lines of communication. On this basis, **the Review supports that the proposed legislative change goes ahead.**

- Include within Part 7 provisions to address conflict of duty implications. There is scope for the FPC to face a conflict of duty where its duty to the State is inconsistent with its role in agency or fee-for-service agreements. The amendments would specify that the highest priority is to the State, and provide the FPC with protection from action against it where its actions in the interests of the State are alleged to prejudice the other party.

  Comment: One comment was received which opposed the amendment, saying that, instead, the FPC should ensure that there is no conflict of interest. The Review wonders if the person making this comment really understood the nature of a conflict of interest and how easily they can arise. The challenge with conflicts of interest is not that they never happen, but that they are appropriately managed. This amendment would provide the FPC with clarity and direction if a conflict of interest were to arise. For this reason, **the Review supported the legislative change going ahead.**

- Revise and retain s71 so that this requires a regular five yearly review of the operations and effectiveness of the Commission.

  Comment: While there was one stakeholder comment that five years was too soon for another review, two other comments were received that supported the 5 year timeframe. It is the opinion of the Review that five years would be an opportune timeframe to have another review, as it will be close to the end of current State Agreement Acts, and therefore a good time to take stock of the FPC's business situation. **The Review supported the proposed change in legislation.**

- Amend Section 55, and others, to make the definition of "production contract" include the meaning "road contract". The Act currently defines two types of contract, production contracts for the management, harvesting or sale of forest products and roading contracts. However, the term 'road contract' is redundant as roads can be constructed under production contracts and are only constructed to manage or harvest forest products.

  Comment: Some stakeholders vigorously opposed this suggestion, saying that this would allow the FPC to avoid complying with the *Wildlife Conservation Act 1950.* However, the Review is satisfied that the proposal to introduce one contract type is intended to reduce complexity in the legislation and will not change the way in which roads are constructed. In particular, the Review does not believe this legislative change is an attempt to avoid complying with the *Wildlife Conservation Act 1950.* In coming to this conclusion, the Review takes guidance from the fact that the Forest Management Plan sets stringent standards for biodiversity and ecosystem health, including the protection and recovery of threatened and priority species of flora and fauna. For this reason, **the Review supported the proposed change in legislation.**

Finding 9.1: After considering stakeholder feedback, the Review is of the opinion that the proposed legislative changes should go ahead.

Recommendation 21:
That miscellaneous and consequential amendments as detailed in Chapter 9 should proceed.

Going Forward

10. Implementation Plan

It is proposed that implementation of the various changes and initiatives should commence as soon as possible, with the key priorities involving:

1. incorporation of a full description and quantified impact of all non-commercial activities in the organisation's upcoming 2006/07 annual Statement of Corporate Intent;
2. applying commercial investment analysis to all future projects, including those involving non-commercial activities;
3. establishing a formal gearing policy for the organisation;
4. considering a separate review of the internal structure of the FPC;
5. following through on current efforts to re-establish commercial rates of return within current State Agreement Acts and associated contracts;
6. preparing the policy framework and groundwork for the review of the State Agreement Acts to facilitate a wider development of the plantations industry;
7. finalising a revised dividend policy for the organisation with the Department of Treasury and Finance;
8. arranging a formal induction program for new Board members in respect to their corporate governance role and responsibilities within government;
9. revising the Memorandum of Understanding between the DEC and the FPC;
10. pursuing proposed amendments to the *Forest Products Act 2000*; and
11. arranging the transfer of identified fee-simple land from the DEC to the FPC.

In addition, the FPC should undertake a formal communication process to inform all stakeholders about the outcomes of the review (and this report) and the organisation's plans for the future.

It is also intended that implementation will be closely monitored by the Board, with a formal report on progress to the Minister by 1 February 2008.

Recommendation 22:
That accepted recommendations in this report be implemented as soon as possible and a progress report provided to the Minister by 1 February 2008.

Recommendations linked to the Terms of Reference

This section looks at the terms of reference for the Review, and provides a short guide showing where these issues have been addressed in the report. The Review was to consider and have regard to the following three main points:

(a) the effectiveness of the operations of the FPC

To investigate the effectiveness of the operations of the FPC, the Review looked at many key issues. These have included the non-commercial programs entered into, its financial performance now and its anticipated future performance. As part of its investigation, the Review looked into some of the constraints to the FPC's business, such as contractual obligations under State Agreement Acts. This report looks into the mechanisms which are in place to protect the environment, and how the FPC is required to conduct its operations in accordance with them. The relationship between the DEC and the FPC has been investigated to gauge the effect on the operations of the FPC, and made some recommendations to improve the working relationship. The sections which address the effectiveness of the operations of the FPC are as follows:

- **1. Non commercial objectives**
- **2. Commercial Operations**
- **4. Commercial Outlook**
- **6. Ecologically sustainable forest management**
- **7. Interaction between the FPC and the DEC**
- **8. Land**
- **9. Suggested Miscellaneous amendments to the Forest Products Act 2000**

(b) the need for the continuation of the functions of the FPC

The Review considered whether there was a need for the functions of the FPC in section **3. Structure for the future**.

(c) any other matters that appear to the Minister to be relevant to the operation and effectiveness of this Act

Within this main point, these 'other matters' have included the following:

- ## The functions, activities and structure of the FPC to ensure consistency with relevant Government policies and priorities

The FPC currently strives towards meeting Government policies relating to having social, economic and environmental benefits. This is discussed in section **1.2 Quantifying the FPC's non-commercial roles**. This section recommends that the FPC formalise this process by fully quantifying the cost of its non-commercial activities, and make them a part of its annual Statement of Corporate Intent. The process of preparing the Statement of Corporate Intent involves discussion with the Minister, a mechanism which will strengthen the FPC's ability to reflect Government policy.

In section **2.4 Prices for pine sawlogs under long term State Agreements** the Review looked into the FPC's requirement to act consistent with Government policies which were intended to encourage investment in the timber industry. The Review makes a recommendation that any further contracts set more commercial rates for forest products.

In section **2.5 Dividend Policy,** the Review notes the FPC's adherence to dividend policy which has been problematic, and notes the current attempts to rectify this situation.

In section **5 Competitive Neutrality**, the Review notes that the FPC has satisfied its requirements under competition policy.

In section **6 Ecologically sustainable forest management**, the Review notes that there are strong mechanisms in place to ensure that the FPC adheres to Government policy on matters relating to the environment.

- ## Progress towards the achievement of all recommendations pertinent to the FPC arising from any relevant machinery of government reviews, functional reviews, or other recent reviews

This is the first statutory review completed for the FPC. The Machinery of Government Taskforce which was undertaken in 2001 noted that it was too early in the FPC's operations to conduct a review at that time. In its report *"Government Structures for Better Results – The Report of the Taskforce Established to Review the Machinery of Western Australia's Government"* it suggested a review in 2005.

- ## The extent of any overlap or duplication that may be occurring with other State Government agencies with closely related areas of responsibility

The FPC's relationship with the DEC has been discussed in section **7 Interaction between the FPC and the DEC**, as the two agencies are required to work very closely together. The

Review has found some areas where the two agencies overlap, and in section **7.3 Clarification of Responsibilities** suggests ways for this overlap to be minimised.

• Opportunities for, and barriers to, improved policy coordination and collaborative planning and monitoring of service delivery across the State

As the DEC and the FPC have to work quite closely together, opportunities and barriers to improved policy and collaborative planning have been investigated in a number of chapters in this report. These are as follows:

- **8. Land**
- **8.1 Changes in land usage**
- **8.2 The FPC's ability to buy or sell land**
- **8.3 Fee simple plantation land**
- **6.1 Compliance with ESFM obligations**
- **7.1 Fire management**
- **7.2 Standards of fire services**

The FPC is also involved in other examples of coordination or collaboration, such as with DAFWA in regard to the Strategic Tree Farming project under the NAP or with DoIR in regard to industry assistance. The Review is satisfied that these other relationships are operating effectively and has not made recommendations in relation to them.

• The most efficient and effective arrangements for collaborative delivery of services, and opportunities for cost savings

As the FPC is a commercial enterprise, there are a limited number of services which can be delivered in conjunction with other agencies.

Section **7.3 Clarification of Responsibilities,** looks at resolving the lack of clarity in the respective roles of the DEC and the FPC, which could lead to cost savings for both agencies.

Similarly, addressing some of the issues raised in section **2.3 Volatility in Financial Statements, 2.4 Prices for Pine Sawlogs Under Long Term State Agreements** and **2. 5 Dividend Policy** may deliver some cost savings.

• The appropriateness and feasibility of incorporating the functions undertaken by the FPC into a department of State

This matter was discussed in section **3. Structure for the future**. The Review concluded that the commercial functions undertaken by the FPC meant that it was appropriate that it remain a statutory authority rather than be incorporated into a department of State.

Appendix 1

Account Normalisations

In normalising the FPC accounts, the following adjustments were made to the organisation's published financial statements:

1. The Commission commenced operations on 16 November 2000. The figures for 2000/01 have been proportioned upwards to reflect a full year.

2. 2001/02 corrected accounts shown in 2003/04 Annual Report have been used to address fundamental errors – refer Note 4 in the 2003/04 Annual Report.

3. 2004/05 figures have been restated under the Australian Equivalent to International Reporting Standards (AIFRS).

4. 2005/06 figures are from the draft (unaudited) Annual Financial Statements.

5. Provision for a $10 million claim in 2004/05 (which was settled in 2005/06 at no cost to the Commission) has been removed.

6. The write-off of assets have been removed.

7. Figures excludes National Action Plan income other than profit for services delivered.

8. Administration costs have been adjusted for an abnormal increase in the provision for doubtful debts in 2004/05 and its reversal in 2005/06.

9. The CPI All Groups for Perth was used to adjust the FPC accounts for inflation.

Appendix 2

Statutory Review of the *Forest Products Act 2000* Submissions

Round 1

No	Submitter
1	Mr Peter Lane
2	Mr Phil Shedley
3	Goldfields-Esperance Development Commission
4	The Bushfire Front
5	Palcon Group
6	Australian Forest Contractors Association Ltd
7	Water Corporation
8	Colonial Wood'n'Poles Pty Ltd
9	Trees South West
10	Unidentified
11	Valuwood International Pty Ltd
12	Institute of Foresters of Australia (WA Division)
13	Mt Romance Australia
14	South Coast Regional Initiative Planning Team (SCRIPT)
15	Furniture Industry Association (WA)
16	Timber Communities Australia
17	Southern Tree Breeding Association
18	Mr Peter Beatty
19	Western Australian Farmers Federation
20	Conservation Commission of WA
21	Avongro (incl Avon Sandalwood Network and WA Sandalwood Plantations)
22	Softwood Logging Services
23	Albany Plantation Export Company
24	Department of Water
25	Main Roads WA
26	Mr Jim Frith
27	Forest Industries Federation of WA
28	Plantall Forestry Consultants
29	Conservation Council of WA
30	Department of Premier and Cabinet
31	Forest Products Commission
32	Environmental Defenders Office
33	Wilderness Society
34	The Laminex Group
35	Leeuwin Environment
36	Great Southern Development Commission
37	Department of Industry and Resources
38	Peel Development Commission
39	Department of Agriculture
40	Department of Conservation and Land Management

Round 2

No	Submitter
1	Mr Phil Shedley
2	South Coast Regional Initiative Planning Team (SCRIPT)
3	Ms Carole Perry
4	Ms Liz Troup
5	Trees South West
6	Avongro
7	Mr Mark Sheehan
8	Northcliffe Environment Centre Inc
9	Mr Tony Simpson, MLA (State Opposition Spokesperson for Forestry)
10	Department of Agriculture and Food
11	Conservation Commission of WA
12	Great Southern Development Commission
13	Wilderness Society WA Inc
14	The Australian Workers Union (West Australian Branch)
15	The Institute of Foresters of Australia (WA Division)
16	Australian Forest Contractors Association Ltd
17	Preston Environment Group
18	Forest Products Commission
19	Forest Industries Federation (WA) Inc
20	Conservation Council of WA
21	Mr Don Spriggins
22	Western Australian Forest Alliance
23	Dr Leonie van der Maesen
24	Mr Peter Lane
25	Unidentified
26	Timber Communities Australia Ltd (WA)
27	Department of Water
28	Water Corporation
29	Department of Environment and Conservation
30	North Native Hardwoods