

TFS SANDALWOOD PROJECT NO.2

FINANCIAL REPORT
FOR THE YEAR TO 30 JUNE 2007

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MANAGER'S REPORT

The Directors of Tropical Forestry Services Ltd (ACN 080 139 966), the Manager for TFS Sandalwood Project No.2 ("the Project"), present their report together with the financial statements of the Project for the period ended 30 June 2007.

Directors

The names of the Directors of Tropical Forestry Services Ltd during the period and at the date of this report are:

Frank Cullity WILSON
Ronald Lionel EACOTT
Blake William MYLES
Ian MacKenzie MURCHISON
Ian Ross THOMPSON

Principal Activities

During the period the principal activity of the Project was the management of a Sandalwood plantation.

Change of State of Affairs

There was no significant change in the state of affairs of the Project.

Results of Operations and Likely Developments

The Project made a profit for the financial year ended 30 June 2007 of \$1,361,027 (2006: \$751,676).

This is due to the increment in the valuation of the sandalwood trees.

The plantation was established in 2000 and is now 7 years old.

With small quantities and lower grades of Indian Sandalwood on offer, the recent Tamil Nadu auction reflects India's diminishing supply of Indian Sandalwood, which is recognised as a vulnerable species on the World Conservation Union's Threatened Species Redlist (IUCN).

Only 21.5 tonnes of Jajpokal 2nd Class (consists of billets weighing not less than 500g to 1kg) was sold at the Tamil Nadu auction in April this year for a price of Rp3,350,000 (A\$98,390) per tonne. This compares to the November 2006 auction where 11 tonnes of Jajpokal 2nd class was sold for a value of Rp3,341,200 (A\$96,694) per tonne. This suggests that while the average price is falling due to the sale of lower grades of wood, the price of Indian Sandalwood continues to increase.

Expert Forester's Report

An extract from a report on the Plantation by our independent expert forester, Mr Peter Kimber follows:

Halfway through the year Malcolm Baker was appointed General Manager-Forestry Operations, resident in Kununurra. Malcolm is a highly qualified agricultural scientist and a highly experienced project manager. This was a vital appointment at a time when the company is rapidly expanding its plantation programme in response to the demand for Indian sandalwood products.

Weatherwise, the dry season of 2007 was exceptional in that it rained quite heavily in June which is generally one of the driest months. Water supply channels were delved to maintain their profile and to ensure unimpeded flows of irrigation water. Drains were periodically cleared of silt using a backhoe, and both water channels and drains were kept weed-free using herbicide sprays.

In established compartments, weeds that have developed over the wet season when the plantations are inaccessible have been mechanically slashed as soon as the soil surface has dried out. This was followed by a herbicide spray that also covered the edges of the beds on which the trees have been planted. Where necessary the herbicide application was repeated later in the dry season.

All compartments were regularly irrigated throughout the dry season on a cycle that increased from approximately weekly for newly planted sites to 6 to 8 weeks for plantations 5 years of age and older. The precise time to irrigate is based on readings from the "Diviner 2000" soil moisture monitoring instrument, which are taken regularly in each compartment.

Where plantations adjoin native savannah woodland vegetation, a 25 to 35 metre wide fire-break was maintained free of vegetation throughout the dry season by ploughing. There is little risk of fire entering a compartment from adjacent farms.

All plantations were regularly inspected for signs of insect and pathogen attacks on the trees. Matt Barnes is developing a reference collection of photographs of injurious insects which will aid field staff in identifying problems.

This small compartment of approximately 33 hectares situated on King Location 254, compartment 85A was treated to kill all the Leucena weed trees that had invaded these compartments. However, this has at last been brought under control due to the efforts of the now Establishment Manager, Kirk Hutchinson.

The northern-most third of the plantation is in good shape with acceptable growth rates due largely to its better planting pattern and its Cassia siamea hosts. The southern two thirds was planted as an intimate mixture of sandalwood and hosts, and a proportion of the hosts have died due to excessive shading by Sesbania in the early days of the plantation resulting in some stunting of growth of the Sandalwood. These areas have been, and are continuing to be replanted with long-term hosts.

This continued management and monitoring of both the sandalwood and their hosts will ensure that the plantation continues to recover to an acceptable level.

Auditor's Independence Declaration

The auditor's independence declaration for the year ended 30 June 2007 has been received and can be found on page 19 of the financial report.

For and on behalf of the Directors of Tropical Forestry Services Ltd:

A handwritten signature in black ink, appearing to read 'FCW', with a horizontal line underneath it.

Frank Cullity Wilson

Perth, 15th day of January, 2008



Independent Audit Report

To the Members of TFS Sandalwood Project No.2

We have audited the accompanying financial report of TFS Sandalwood Project No.2, which comprises the balance sheet as at 30 June 2007, and the income statement, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies and other explanatory notes and the directors' declaration at the year's end.

Directors Responsibility for the Financial Report

The directors of the manager are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standards AASB 101: Presentation of Financial Statements, that compliance with the Australian equivalents to International Financial Reporting Standards (IFRS) ensures that the financial report, comprising the financial statements and notes, complies with IFRS.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report and the remuneration disclosures in the directors' report.

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

Independence

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.


Independent Auditor's Report

To the Members of TFS Sandalwood Project No.2

Auditor's Opinion

In our opinion:

- a. The financial report of TFS Sandalwood Project No.2 is in accordance with the Corporations Act 2001, including:
 - i. giving a true and fair view of the registered scheme's financial position as at 30 June 2007 and of their performance for the year ended on that date; and
 - ii. complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001; and
- b. The financial report also complies with International Financial Reporting Standards as disclosed in Note 1



RIX LEVY FOWLER
Audit & Corporate Pty Ltd



PHILLIP RIX FCA F.Fin.
Director

DATED at PERTH this 15th day of January 2008

TFS SANDALWOOD PROJECT NO.2
 INCOME STATEMENT
 FOR THE YEAR TO 30 JUNE 2007

	NOTE	2007 \$	2006 \$
REVENUE FROM ORDINARY ACTIVITIES			
Establishment fees		-	-
Lease & management fees		69,707	68,987
Interest received		-	-
Other income:			
Net increment in net value of biological assets		1,361,027	751,676
		<u>1,430,734</u>	<u>820,663</u>
EXPENSES FROM ORDINARY ACTIVITIES			
Audit fees		1,825	1,250
Bad debt/ Provision for impairment of receivables		-	-
Leasing expenses		28,132	27,412
Management fees		41,575	41,575
Reimbursement of expenses by Manager		(1,825)	(1,250)
		<u>69,707</u>	<u>68,987</u>
NET OPERATING INCOME FROM ORDINARY ACTIVITIES			
		<u>1,361,027</u>	<u>751,676</u>

The Income Statement should be read in conjunction with the accompanying notes.

TFS SANDALWOOD PROJECT NO.2
BALANCE SHEET
AT 30 JUNE 2007

	NOTE	2007 \$	2006 \$
CURRENT ASSETS			
Cash and cash equivalents	2	-	-
Trade and other receivables	3	19,107	9,306
Other	4	46,427	46,427
TOTAL CURRENT ASSETS		<u>65,534</u>	<u>55,733</u>
NON CURRENT ASSETS			
Biological assets	5	5,492,503	4,131,476
Other	4	278,560	324,987
TOTAL NON-CURRENT ASSETS		<u>5,771,063</u>	<u>4,456,463</u>
TOTAL ASSETS		<u>5,836,597</u>	<u>4,512,196</u>
CURRENT LIABILITIES			
Trade and other payables	6	19,107	9,306
Unearned Income	7	46,427	46,427
TOTAL CURRENT LIABILITIES		<u>65,534</u>	<u>55,733</u>
NON CURRENT LIABILITIES			
Unearned Income	7	278,560	324,987
TOTAL NON-CURRENT LIABILITIES		<u>278,560</u>	<u>324,987</u>
TOTAL LIABILITIES		<u>344,094</u>	<u>380,720</u>
NET ASSETS		<u>5,492,503</u>	<u>4,131,476</u>
GROWERS' FUNDS			
Undistributed income reserve		5,492,503	4,131,476
EQUITY		<u>5,492,503</u>	<u>4,131,476</u>

The Balance Sheet should be read in conjunction with the accompanying notes.

TFS SANDALWOOD PROJECT NO.2
 STATEMENT OF CHANGES IN EQUITY
 FOR THE YEAR TO 30 JUNE 2007

	NOTE	Undistributed Income \$	Total \$
Balance at 1.7.2005		3,379,800	3,379,800
Profit for period		751,676	751,676
Sub-Total		4,131,476	4,131,476
Distributions provided for or paid		-	-
Balance at 30.6.2006		4,131,476	4,131,476
Balance at 1.7.2006		4,131,476	4,131,476
Profit for period		1,361,027	1,361,027
Sub-Total		5,492,503	5,492,503
Distributions provided for or paid		-	-
Balance at 30.6.2007		5,492,503	5,492,503

The Statement of Changes in Equity should be read in conjunction with the accompanying notes.

TFS SANDALWOOD PROJECT NO.2
 CASHFLOW STATEMENT
 FOR THE YEAR TO 30 JUNE 2007

	NOTE	2007 \$	2006 \$
CASH FLOWS FROM OPERATING ACTIVITIES			
<u>Inflows</u>			
Receipts from growers		20,450	27,566
Interest received		-	-
<u>(Outflows)</u>			
Payments to suppliers		(20,450)	(27,566)
Bank charges		-	-
	8(b)	<u>-</u>	<u>-</u>
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES			
Payment for establishment of plantations		-	-
		<u>-</u>	<u>-</u>
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES			
Other		-	-
		<u>-</u>	<u>-</u>
Net increase / (decrease) in cash held		-	-
Cash at beginning of financial year		-	-
Cash at end of financial year	8(a)	<u>-</u>	<u>-</u>

The Statement of Cash Flows should be read in conjunction with the accompanying notes.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR 30 JUNE 2007

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Preparation

The financial report is a general purpose financial report which has been prepared in accordance with the Project's constitution and the requirements of the Corporations Act 2001, which includes applicable accounting standards and other Australian Accounting Interpretations of the Australian Accounting Standards Board.

The financial report has been prepared on an accruals basis and is based on historical costs, except for Sandalwood trees (which are biological assets), which are recorded at net market value. This report does not take into account changing money values or, except where stated, current valuations of non current assets. Cost is based on the fair values of the consideration given in exchange for assets.

(b) Revenue Recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Project and the revenue can be reliably measured. All revenue is stated net of the amount of goods and services tax (GST). Specific revenues are recognised as follows.

Operations revenue:

- Timber Lot sales (Establishment Fees) are recognised as revenue on acceptance of the application by the manager. The directors of the manager are of the view that this recognition policy most appropriately reflects the timing in which the probability of the economic benefits flows to the entity based on commitments made by investors and costs expended to date.
- Lease and Management Fees are recognised as revenue in the period to which they relate.

(c) Biological assets

Sandalwood trees are measured at the Manager's Director's assessment of their market value at each reporting date. The net market value is determined as being the net present value of expected future cash flows (discounted at a risk adjusted rate).

Net increments or decrements in the market value of the Sandalwood trees are recognised as revenues or expenses in the Statement of Financial Performance, determined as:

- (i) the difference between the total net market values of the trees recognised as at the beginning of the period and the total net market values of the trees recognised as at the reporting date; less
- (ii) costs incurred during the reporting period to acquire and plant Sandalwood trees.

Costs incurred in maintaining or enhancing trees are recognised as expenses when incurred. Therefore, those costs are not included in the determination of the net increment in net market values.

(d) Income Tax

Under current legislation, the scheme is not subject to income tax provided the Growers are presently entitled to the income of the Project.

Unrealised gains and losses on investments which are regarded as income, are transferred to Growers' funds and are not distributable and assessable until realised. When income is realised, tax will be paid by the growers at the marginal rates of tax that exist under the relevant tax legislation at the date of realisation.

(e) Cash and Cash Equivalents

For the purposes of the Statement of Cash Flows, cash and cash equivalents includes cash on hand and in banks, and short-term deposits at call.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR 30 JUNE 2007 (CONTINUED)

(f) Trade and other Receivables

Trade receivables are recognised and carried at original invoice amount, or the amount due less a provision for any uncollectible debts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. The amount provided for is the portion of deemed uncollectible after the value of trees as security has been taken into account. Bad debts are written off as incurred. Amounts due from growers are recognised and carried at the amount stated in the loan agreement plus accrued interest, less any principal repayments received.

(g) Trade and other Payables

Liabilities for creditors and other amounts are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the consolidated entity. Payables to related parties are carried at the principal amount. Interest is recognised as an expense on accruals basis. Deferred cash settlements are recognised at the present value of the outstanding consideration payable on the acquisition of an asset discounted at prevailing commercial borrowing rates.

(h) Unearned Income

Prepaid Lease and Management Fees are recognised on a straight line basis over the term of the project as this is considered to closely approximate the value of the service provided. The unearned portion is deferred and recorded as unearned income.

(i) Goods and Services Tax

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Taxation Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense. Receivables and payables in the Balance Sheet are shown inclusive of GST.

Cash flows are presented in the cash flow statement on a gross basis, except for the GST component of investing and financing activities, which are disclosed as operating cash flows.

(j) Impairment of Assets

At each reporting date, the economic entity reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have been impaired. If such an indication exists, the recoverable amount of the asset, being the higher of the asset's fair value less costs to sell and value in use, is compared to the asset's carrying value. Any excess of the asset's carrying value over its recoverable amount is expensed to the income statement.

(k) Financial Instruments

Financial instruments are initially measured as cost on trade date, which includes transaction costs, when the related contractual rights or obligations exist. Subsequent to initial recognition these instruments are measured as set out below.

Financial assets at fair value through profit and loss

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management and within the requirements of AASB 139: recognition of Measurement of Financial Instruments.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are stated at amortised cost using the effective interest rate method.

Held-to-maturity investments

These investments have fixed maturities, and it is the group's intention to hold these investments to maturity. Any held-to-maturity investments held by the group are stated at amortised cost using the effective interest rate method.

Available-for-sale financial assets

Available-for-sale financial assets include any financial assets not included in the above categories. Available-for-sale financial assets are reflected at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to equity.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR 30 JUNE 2007 (CONTINUED)

Financial Liabilities

Non-derivative financial liabilities are recognised at amortised cost, comprising original debt less principal payments and amortisation.

Fair value

Fair value is determined based on current bid prices for all quoted investments. Valuation techniques are applied to determine the fair value for all unlisted securities, including recent arm's length transactions, reference to similar instruments and option pricing models.

Impairment

At each reporting date, the entity assesses whether there is objective evidence that a financial instrument has been impaired. In the case of available-for-sale financial instruments, a prolonged decline in the value of the instrument is considered to determine whether an impairment has arisen. Impairment losses are recognised in the income statement.

(l) Comparative Figures

When required by Accounting Standards, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

Critical Accounting Estimates and Judgements

The directors of the Manager evaluate estimates and judgements incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data obtained both externally and within the group.

Key Estimate – Biological Asset valuation

As referred to in Note 1(c) and Note 5, as required under the accounting standards the directors of the manager make an estimate as to the market value of the standing sandalwood trees held by the scheme. The carrying value of the sandalwood trees at year end is shown in Note 5. The market value is calculated as the net present value of expected future cashflows. The estimates used in calculating the expected future cashflows include assumptions on yields in terms of survival rates of trees, and heartwood and oil content of the trees, as well as assumptions as to the future price of the heartwood logs. All estimates are based on the best information currently available and where there is any doubt the scheme uses the more conservative estimates.

Change in Accounting Estimates

Biological Asset valuation

During the year the directors of the Manager chose to modify some of the variables used in calculating the net market value of the sandalwood trees held by the scheme. The directors believe that the changes help to arrive at a more accurate estimation of the current value of the company owned plantations.

As detailed above, the market value is calculated as the net present value of expected future cashflows. In estimating the expected future cashflows for the present year, the directors have agreed to modify some of the variables as follows:

- (i) the discount rate applied to the calculations has been changed from a fixed rate of 17% to a variable rate of 15%-17% based on the age of the trees, with the older trees having a lower discount rate than younger trees. The directors believe that this more accurately reflects reduced risk applicable to the plantations as the trees mature. In the present year this adjustment has a positive impact on the year end valuation of approximately \$364,753 before tax.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR 30 JUNE 2007 (CONTINUED)

- (ii) The price indicator previously used to estimate the value of the heartwood contained in the sandalwood trees was the average price obtained at auctions in Tamil Nadu, India that occurred roughly every 6 months. The average prices were then reduced by a factor which represented the estimated lower oil yields that were expected to be derived from the TFS plantations as compared to the longer standing native trees from within India. Due to the reducing supply of wood to the auctions and the varying nature of the quality of that wood, the average prices obtained from the auctions are in the opinion of the directors less reliable as a true comparable indicator of the value of the end heartwood.

The directors have now agreed to use a price indicator based on known trading price of indian sandalwood oil and converting that to a wood price based on the estimated oil yield that is expected to be achieved at harvest. In the present year this adjustment has a negligible impact on the year end valuation as if the previous method was used, a similar price indicator would have been obtained although it would have necessitated a re-rating of the factor representing the difference in oil yields from the TFS trees to those sold at the latest auction (due to the reduced quality sold at the recent auction as compared to previous auctions).

- (iii) Given the above change of applying a sandalwood oil price as a derivative of the harvest value of the heartwood logs, the calculations have added an additional amount in applicable costs relating to the cost per hectare of extracting the oil. In the present year this adjustment has a negative impact on the year end valuation of approximately \$50,288 before tax.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2007 (CONTINUED)

	NOTE	2007 \$	2006 \$
2. CASH			
Cash at bank		-	-
3. TRADE AND OTHER RECEIVABLES			
Outstanding fees (i)		19,107	9,306
Less: Provision for impairment of receivables		-	-
		<u>19,107</u>	<u>9,306</u>
 (i) Outstanding fees represent moneys receivable from growers for the cost of establishment of the plantation. No interest has been charged on amounts due.			
4. OTHER ASSETS			
Current			
Prepayments (i)		<u>46,427</u>	<u>46,427</u>
Non Current			
Prepayments (i)		<u>278,560</u>	<u>324,987</u>
 (i) prepayments represent lease and management fees paid to the manager in advance of the period in which the lease and management services are to be provided.			
5. BIOLOGICAL ASSETS			
Sandalwood trees at cost of establishment (still to be planted at balance date)		-	-
Sandalwood trees at net market value (planted at balance date)		<u>5,492,503</u>	<u>4,131,476</u>
		<u>5,492,503</u>	<u>4,131,476</u>
(a) Physical quantity of sandalwood trees planted and owned			
Number of sandalwood trees		9,282	9,511
Area under lease (planted)		33.0	33.0
Area under lease (to be planted)		0.0	0.0
Growers in project (units)		198	198

(b) Nature of Asset

Investors in the TFS Sandalwood Project No.2 who are referred to as "Growers" subscribed for Sandalwood Lots of size one-sixth of a hectare each upon which Sandalwood trees have been established.

The Sandalwood plantation is situated at King Location 385, approximately 8 kilometres from the Western Australian township of Kununurra.

The land upon which the Sandalwood plantation is located is owned by an associate of the Manager. Growers lease the land from the Manager for the duration of the Project. The Project will continue in operation until the date on which the last of the Growers has been advised that the produce of the Sandalwood crop from each leased area which is leased by the Grower has been harvested and that the relevant Lease and Management Agreement has been terminated but in any event, not later than 30 June 2015.

The net market value of the Sandalwood trees has been determined in accordance with a Directors' valuation in accordance with the AASB's to reflect the market value of plantation.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2007 (CONTINUED)

(c) Significant Assumptions

Significant assumptions made in determining the net market value of the trees are:

- 100% of the trees will be harvested and sold in 2014/2015;
- the price of Sandalwood is constant in real terms;
- the costs expected to arise on harvest are constant in relative terms; and
- the pre-tax average real rate at which the net cash flows have been discounted is at between 15%-17% per annum

Cash flows exclude income taxes and are expressed in real terms.

	NOTE	2007 \$	2006 \$
6. TRADE AND OTHER PAYABLES			
Trust funds payable to manager (i)		19,107	9,306
GST payable		-	-
Other		-	-
		<u>19,107</u>	<u>9,306</u>

(i) Trust funds payable to the manager represents the sum of monies payable by growers to the manager under the lease and management agreement yet to be paid across. No interest is payable on outstanding amounts.

7. UNEARNED INCOME

Current

Prepaid lease & management fees		<u>46,427</u>	<u>46,427</u>
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Non Current

Prepaid lease & management fees		<u>278,560</u>	<u>324,987</u>
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Represents lease and management fees received in advance of services provided.

	NOTE	2007 \$	2006 \$
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8. CASH FLOW INFORMATION

(a) Reconciliation of cash

Cash balance comprises:

Cash at bank		<u>-</u>	<u>-</u>
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(b) Reconciliation of net operating income to net cash flows from operating activities

Net operating income		1,361,027	751,676
Adjustments:			
(Increase) / decrease in net receivables		(9,801)	(1,893)
(Increase) / decrease in prepayments		46,427	46,427
(Increase) / decrease in market value of sandalwood trees		(1,361,027)	(751,676)
Increase / (decrease) in GST payable		-	-
Increase / (decrease) in accounts payable		9,801	1,893
Increase / (decrease) in unearned income		(46,427)	(46,427)

Net cash inflow / (outflow) from operating activities.		<u>-</u>	<u>-</u>
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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2007 (CONTINUED)**

9. RELATED PARTY DISCLOSURE

(a) Manager

The Manager of the TFS Sandalwood Project No.2 is Tropical Forestry Services Ltd, whose immediate and ultimate holding company is TFS Corporation Limited.

(b) Directors of the Manager

The Directors of the Manager during the period were:

Frank Cullity WILSON
Ronald Lionel EACOTT
Blake William MYLES
Ian MacKenzie MURCHISON
Ian Ross THOMPSON

(c) Fees paid or payable to the Manager

The Manager receives all Establishment, Lease and Management Fees which have been paid by the Project during the period.

The Manager provides Sandalwood plantation establishment and management services for TFS Sandalwood Project No.2 and carries out the custodial and administrative functions.

Transactions between TFS Sandalwood Project No.2 and Tropical Forestry Services Ltd result from normal dealings with that company as the Project's Manager.

(d) Holdings of Directors and Director Related Entities

A total of 60 lease interests are held by Directors or parties related to Directors on the same terms and conditions as other Growers. No amount is outstanding at year end.

(e) Key management compensation

No compensation has been paid by the scheme directly to key management personnel

10. AUDIT

Rix Levy Fowler are the auditors of the Project and the Project's Compliance Plan.

11. SEGMENT INFORMATION

The Project operates in one industry segment, being investment activities and in one geographical segment, being Australia.

12. SUBSEQUENT EVENTS

Since 30 June 2007, there has not been any matter or circumstance not otherwise dealt with in the financial report that has significantly affected or may significantly affect the Project.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR TO 30 JUNE 2007 (CONTINUED)

13. FINANCIAL INSTRUMENTS

(a) Interest Rate Risk

Interest rate risk is the risk that a financial investment's value will fluctuate as a result of changes in market interest rates. The Project's exposure to interest rate risk is as follows:

Financial Assets

Cash	\$0
Weighted average debit interest rate (p.a.)	0%
Weighted average credit interest rate (p.a.)	3.00%
Interest rate type	Variable

The Project had no other financial assets or financial liabilities with exposure to interest rate risk as at balance date.

(b) Credit Risk

Credit risk represents the risk that a counterparty will fail to perform contractual obligations under a contract. The Project's only credit risk exposure relates to debtors who comprise the receivable balance at 30 June 2007. A provision for doubtful accounts is recognised when collection of the full nominal amount is uncertain.

(c) Net Fair Value

The Project's financial assets and liabilities included in the Statement of Financial Position are carried at their net fair value. Refer to Note 1 for the methods and assumptions adopted in determining net fair values for Sandalwood trees.

14. PROJECT DETAILS

The registered office of the project is:

254 Adelaide Terrace
Perth WA 6000

The principal places of project are

Head Office
254 Adelaide Terrace
Perth WA 6000

Plantation
King Location 385, Packsaddle Road
Kununurra WA 6743

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR TO 30 JUNE 2007 (CONTINUED)

15. CHANGES IN ACCOUNTING POLICIES

The following Australian Accounting Standards have been issued or amended and are applicable to the project but are not yet effective. They have not been adopted in preparation of the financial statements at reporting date.

AASB Amendment	AASB Standard Affected	Nature of Change in Accounting Policy and Impact	Application Date of the Standard	Application Date for the Group
AASB 2005–10 Amendments to Australian Accounting Standards	AASB 1: First-time Adoption of AIFRS AASB 4: Insurance Contracts AASB 101: Presentation of Financial Statements AASB 114: Segment Reporting AASB 117: Leases AASB 133: Earnings per Share AASB 1023: General Insurance Contracts AASB 1038: Life Insurance Contracts AASB 139: Financial Instruments: Recognition and Measurement.	The disclosure requirements of AASB 132: Financial Instruments: Disclosure and Presentation have been replaced due to the issuing of AASB 7: Financial Instruments: Disclosures in August 2005. These amendments will involve changes to financial instrument disclosures within the financial report. However there will be no direct impact on amounts included in the financial report as it is a disclosure standard.	1 January 2007	1 July 2007
AASB 7 Financial Instruments: Disclosures	AASB 132: Financial Instruments: Disclosure and Presentation	As above	1 January 2007	1 July 2007

All other pending Standards issued between the previous financial report and the current reporting dates have no application to the project.

DIRECTORS' DECLARATION
FOR THE YEAR TO 30 JUNE 2007

In accordance with a resolution of the Directors of Tropical Forestry Services Ltd, I state that:

In the opinion of the Directors:

- (a) the financial statements and notes of the Project are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the scheme's financial position as at 30 June 2007 and its performance, as represented by the results of its operations and its cash flows for the period ended on that date; and
 - (ii) complying the Accounting Standards and the Corporations Regulations; and
- (b) there are reasonable grounds to believe that the scheme will be able to pay its debts as and when they become due and payable.

On behalf of the Board
Tropical Forestry Services Ltd



Frank Cullity Wilson

Dated: this 15th day of January, 2008



To The Board of Directors

**Auditor's Independence Declaration
under Section 307C of the Corporations Act 2001**

This declaration is made in connection with our audit of the financial report of TFS Sandalwood Project No.2 for the year ended 30 June 2007 and in accordance with the provisions of the Corporations Act 2001.

We declare that, to the best of our knowledge and belief, there have been:

- no contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to the audit;
- no contraventions of the Code of Professional Conduct of the Institute of Chartered Accountants in Australia in relation to the audit.

Yours faithfully

RIX LEVY FOWLER
Audit & Corporate Pty Ltd

PHILLIP RIX FCA F.Fin
Director

DATED at PERTH this 15th day of January 2008