New South Wales
TREASURY

nov09

tpp
09-06

Financial Distribution Policy for Government Businesses

(applies from 1 July 2010)

OFFICE OF FINANCIAL MANAGEMENT

Policy & Guidelines Paper

Preface

The *Financial Distribution Policy for Government Businesses* is a component of the NSW Government's *Commercial Policy Framework*.

Since 1988, the *Commercial Policy Framework* has applied to Government businesses. The Framework consists of a suite of policies aimed at replicating, as far as possible, the disciplines and incentives that lead private sector businesses toward efficient commercial practices. The fundamental objective of the Framework is to maximise the wealth of the people of New South Wales by requiring the boards/management of Government businesses to allocate resources efficiently and to be accountable for financial management.

The key purpose of the *Financial Distribution Policy* is to subject Government businesses to the discipline of making dividend payments, in recognition of the opportunity cost associated with the Government's equity investment in its businesses. The policy also covers capital repayments, which represent a return of the Government's equity investment, and which may be used to achieve, or maintain, an appropriate capital structure for a government business.

This policy was recently reviewed by Treasury and significant changes have been made to the previous edition including refining its scope, promoting greater consistency in its implementation and addressing issues arising from changes to Accounting Standards since the policy's previous release in June 2002. As a result this new policy and guidelines paper supersedes the previous edition *Financial Distribution Policy for Government Businesses* (TPP02-3).

Michael Schur
Secretary
NSW Treasury
November 2009

Treasury Ref: **TPP 09-06**
ISBN: **978-0-7313-3429-2**

Note
General inquiries concerning this document should be initially directed to:
Commercial Policy Branch of NSW Treasury (Tel: 9228 3125).

This publication can be accessed from the Treasury's Office of Financial Management Internet site [http://www.treasury.nsw.gov.au/].
For printed copies contact the Publications Officer on Tel: 9228 4426.

Contents:

Executive summary

The Government represents the people of New South Wales as shareholder of Government businesses and expects an appropriate return on its equity investment in its portfolio of businesses. Financial distributions are the Government's primary means of realising a return from its equity investment.

Financial distributions comprise dividends and capital repayments. Dividends represent a return *on* the owners' equity investment in a firm, while capital repayments involve a return *of* the owner's equity. Tax equivalent payments are not financial distributions as they do not represent either a return *on*, or a return *of,* the Government's equity investment in the business.

Dividends are an important source of ongoing funding for health, education and other social services provided through the State Budget. Therefore the Government has a strong preference for dividends over capital gains and for a stable stream of dividends from its portfolio of Government businesses[1].

Policy application and objectives

The *Financial Distribution Policy* applies to all Government businesses with the exception of business units of not-for-profit agencies. Exemptions may be permitted in limited exceptional circumstances.

The objectives of the policy are to:

- recognise the opportunity cost associated with the Government's equity investment
- enhance the transparency of, and accountability for, financial performance of Government businesses
- ensure these businesses do not enjoy any special advantages over their private sector competitors
- support the initial determination and ongoing maintenance of each business' approved capital structure, in accordance with the *Capital Structure Policy for Government Businesses.*[2]

[1] Refer to Appendix 1 for the definition of Government businesses.

[2] NSW Treasury, *Capital Structure Policy for Government Businesses*, TPP 02-7, September 2002.

Negotiation of targets

Under the *Financial Distribution Policy*, dividend targets are negotiated annually between the shareholders and board/management of each Government business and agreed in writing in the Statement of Corporate Intent (for State Owned Corporations) or the Statement of Business Intent (for other Government businesses).

The policy requires Government businesses to negotiate ordinary dividends based on post-tax profits. Ordinary dividends refer to returns to the shareholders sourced from current year earnings or the prior year's retained earnings. They are distinguished from special dividends which represent additional, one-off dividend payments that are typically sourced from transactions, such as the sale of major physical assets.

A dividend payout ratio of 70 per cent of post tax profit should be used as a standard reference point based on commercial private sector practice. The target dividend payout ratio for individual Government businesses, however, may vary from the standard reference point, based on a case-by-case consideration of underlying capital structure and future cash flow requirements including a contingency for financial flexibility. Businesses with the financial capacity to pay dividends based on payout ratios above 70 per cent are expected to do so.

In determining the annual dividend payment for each business the cash flow requirements of the business must be recognised and dividend payments must not knowingly place the business at financial risk. On the other hand a business should not retain any cash or financial investments in excess of its requirements. Such funds should be returned to the shareholders because investment in financial assets is not part of the core operations of the business.

Certain non-cash adjustments are excluded from the post-tax profit available for distribution to shareholders as dividends, for instance[3]:

i) non-cash fair value movements on financial instruments that are classified or designated "at fair value through profit or loss" under AASB 139 *Financial Instruments: Recognition and Measurement*

ii) tax expenses relating to i) above.

Relationship to Capital Structure Policy

Capital repayments are also a form of financial distribution. Such repayments are used to achieve an appropriate capital structure for the business.

The *Financial Distribution Policy* and the *Capital Structure Policy* are inextricably linked. The shareholders' long-term dividend preferences are a key input in determining an appropriate level of debt for a Government business and a target capital structure range. Annual dividend targets are negotiated with reference to expected post-tax profits so as to ensure the business meets key financial ratio targets such as gearing levels and debt servicing capacity. The Government expects businesses to manage the peaks and troughs of their investment cycle (and the consequent demand for funds) through the flexibility of the approved capital structure, without affecting the agreed dividend targets.

[3] As advised in Treasury Circular 09/01 *Accounting for Superannuation*, superannuation actuarial gains and losses are now recognised outside profit and loss. As a result, profit no longer needs to be adjusted for superannuation actuarial gains/losses for dividend calculation purposes.

1 Purpose of the policy

The key purpose of the *Financial Distribution Policy* is for the Government to receive an appropriate return on its equity investment in its portfolio of Government businesses in the form of dividend payments. Dividends from Government businesses are an important source of ongoing funding for social services through the State Budget.

The Government's equity investment has accumulated over time through the direct investment of capital and through indirect investment in the form of retained earnings. These investments carry an associated opportunity cost which is the benefit that the Government foregoes from an alternative use of that equity. It is therefore reasonable to expect Government businesses to achieve returns that are comparable to alternative commercial investments of similar risk.

Requiring Government businesses to pay dividends also ensures that such businesses do not enjoy any special advantages because of their government ownership over their private sector competitors. This concept of 'competitive neutrality' between Government and private sector businesses is a key principle underlying the *Commercial Policy Framework*.

The setting of dividend targets under the policy provides greater certainty to businesses regarding the Government's expectations of financial performance. At the same time it enhances the transparency of and accountability for such performance.

Another driver of the policy is the need to support the practical application of the *Capital Structure Policy* specifically by ensuring that dividend targets are determined with reference to each business' capital structure and associated key financial ratios such as gearing levels and debt servicing capacity. Financial distributions in the form of capital repayments (as defined in the policy) may be used to achieve an appropriate capital structure for a business following a review in accordance with the *Capital Structure Policy*.

The relationship between the *Financial Distribution Policy* and the *Capital Structure Policy* is explained in further detail in section 5 of this document.

2 Application of the policy

The *Financial Distribution Policy* applies to all Government businesses.

Temporary exemption from the policy is only permitted in exceptional circumstances. Application for exemption must be submitted to NSW Treasury for consideration by the Treasurer. The Treasurer will only grant a temporary exemption under specific conditions where it is considered that the payment of a dividend would place the business under financial stress.

It should be noted that the policy does not apply to business units of not-for-profit agencies although these business units may be subject to other aspects of the NSW *Commercial Policy Framework*, including the requirement to make certain payments consistent with competitive neutrality requirements.

3 Financial distribution theory

Theory would suggest that a residual approach to dividend policy is appropriate because it focuses on value creation and wealth maximisation by recognising the need to fund all available value-adding investment opportunities. Under a residual approach to dividend policy a dividend would be paid only if there were retained earnings left over after the firm has financed all investment projects capable of generating acceptable returns.[4] The amount of dividend payout would fluctuate from period to period according to the availability of such projects.

Given the unique circumstances for Government as the shareholder, however, the Government's strong preference is for dividends over capital gain and for a reasonably stable stream of total dividends from its portfolio of businesses.

For Government realising a capital gain from its businesses is more difficult to achieve than for private sector shareholders who are able to divest shares relatively easily. The Government's preference for dividends recognises this constraint. A reasonably stable stream of total dividends on a long term portfolio basis is preferred because these payments are an important source of funding for social services provided through the State Budget. The total funding requirement for such services tends to be either constant or increasing. Significant fluctuations in total dividends should therefore be avoided if the services expected by the community are to be maintained regularly from year to year.

While the setting of dividends should consider the funding requirements of investment opportunities the financial viability of such projects must nevertheless be assessed according to the Government's *Guidelines for Financial Appraisal*[5] and other relevant requirements. Capital expenditure is reviewed and approved in the context of the SCI/SBI and for Projects of State Significance, by the Cabinet Standing Committee on the Budget[6].

Reflecting practice observed in the subsidiaries of private sector holding companies, excess cash accumulated by Government businesses should be returned to shareholders. These funds are more efficiently managed on a whole-of-state basis. Excess cash is defined as any cash balances exceeding the business' requirements for working capital and an appropriate contingency for financial flexibility.

---

4 From the firm's perspective, an 'acceptable return' for a project is a return which is greater than the firm's weighted average cost of capital.

5 NSW Treasury, *Guidelines for Financial Appraisal*, TPP 07-4, July 2007.

6 For further information please refer to NSW Treasury, *Guidelines for Assessment of Projects of State Significance*, TPP02-4, June 2002.

4 Policy statement and guidance for practical application

The *Financial Distribution Policy* and guidance for its practical application can be summarised by the following points:

- Government businesses are expected to make dividend payments that are comparable to alternative commercial investments of similar risk.
- Dividend targets and actual payments are set by negotiation between the shareholders and the boards/management of each business, with ultimate determination reserved for the shareholders. The expected dividend payments over three years are agreed in writing in the SCI/SBI. NSW Treasury acts as the financial adviser to the shareholders during this negotiation process.
- The approach should also take into account the shareholders' preference for dividends rather than capital gains and for a reasonably stable stream of total dividends from its businesses.

Negotiation of dividend targets

- Dividends are negotiated with reference to the post-tax profits of the business, in line with private sector practice and in recognition of the payment of income tax equivalents by Government businesses as a business expense.
- Where practical dividend targets should be expressed as a payout ratio, i.e. a dividend as a percentage of post-tax profit and adjusted where required for items including non-cash fair value movements in financial instruments. A dividend payout ratio of 70 per cent is a standard reference point that represents a commercial benchmark based on private sector practice. A Government business' dividend target may vary from the standard reference point based on case-by-case negotiations.
- Dividends are to be negotiated based on consideration of the business' stand-alone credit rating, underlying capital structure and cash flow requirements for:
  - working capital
  - the funding of acceptable capital investments
  - an appropriate contingency for financial flexibility.
- A business's dividend target may be set lower than the standard reference point of 70 per cent where such a commitment would:
  - constrain the business from undertaking approved value-adding investment opportunities, or
  - threaten business financial sustainability as measured by key financial ratios such as gearing levels and debt servicing capacity.

  Businesses with the financial capacity to pay dividends based on payout ratios above 70 per cent are expected to do so.
- Dividend targets must recognise the cash flow requirements of the business and must not knowingly place the business at financial risk.

- The Government views its businesses on a long term, portfolio perspective. When individual businesses require higher levels of cash (and shareholders agree), this may be compensated for by negotiating changes in the timing of major capital expenditure from other businesses or by making equity injections.

- A business should not retain any cash or financial investments in excess of its requirements for working capital, with an appropriate level of financial flexibility for contingencies. Surplus funds should be returned to the shareholders because investment in financial assets is not part of the core operations of the business. NSW Treasury manages more efficiently such funds at the 'holding company' level.

- Negotiation of dividends therefore requires a balance between the funding needs of the business to secure long-term value creation and ensuring that the State's revenue requirements are met.

- The *Financial Distribution Policy* operates together with the *Capital Structure Policy* to ensure that a business' capital structure is set with regard to the shareholders' preferences for dividends over the long run. The peaks and troughs of the investment cycle (and the consequent demand for funds) should be managed by the business as far as possible through the flexibility of the approved capital structure without affecting agreed dividend targets.

- Capital repayments are determined in accordance with the *Capital Structure Policy* and are distinguished from dividends because they represent a return *of* the Government's equity in a business in order to achieve an appropriate capital structure.

- Dividend targets should not be adjusted for the provision of any agreed Community Service Obligations (CSOs)[7]. CSOs should be funded on a transparent basis through the State Budget process rather than funded from within Government businesses. CSOs should only be internally-funded where a transitional period has been approved by shareholders.

---

[7] NSW Government, *A Social Program Policy for NSW GTEs,* July 1994

Non-cash adjustments to post-tax profit

- Sometimes increases or decreases in reported profits may not be reflected in cash flow. For instance the following non-cash adjustments[8] should be excluded from profit available for distribution to shareholders:
    - non-cash fair value movements in financial instruments that are classified or designated “at fair value through profit or loss” under AASB 139 *Financial Instruments: Recognition and Measurement*
    - tax expense relating to the above.

  Businesses, however, should not automatically exclude all non-cash items for dividend calculation purposes. Non-cash adjustments other than financial instruments need to be assessed on a case-by-case basis. A worked example of calculating dividends is outlined in Appendix 3.

- Note that dividend payments are still subject to the constraint that a dividend may be paid only out of the profits of a company[9]. Actual dividend payments may be affected by accounting circumstances where there are insufficient funds in retained earnings or the asset revaluation reserve for payment of the agreed dividend.

- Excluding fair value movements in financial instruments will serve to reduce volatility in the dollar amount of ordinary dividends. It will however, increase the volatility in the ex-post dividend payout ratio, i.e., the dividend payout ratio based on actual year end results. To reduce the potential for misinterpretation businesses are strongly encouraged to disclose on the face of the Income Statement in their financial report, the underlying profit on which the dividend is based, i.e., the profit before financial instrument fair value movements.

Determination of actual payments

- The final cash dividend payments made during a particular financial year relate to the business’ performance from the previous year. The final dividend payment will be based on actual financial results allowing the total dividend amount (comprising the interim and final dividend) to be revised (compared to the targeted amount) in light of performance and any other relevant considerations.

- Further negotiation may be necessary where the board/management of a business proposes to make actual dividend payments that vary significantly from agreed targets or where the shareholders need to revise their dividend preferences.

---

[8] As advised in Treasury Circular 09/01 *Accounting for Superannuation*, superannuation actuarial gains and losses are now recognised outside profit and loss. As a result profit no longer needs to be adjusted for superannuation actuarial gains/losses for dividend calculation purposes.

[9] This policy adopts the definition of dividends under section 254T ‘Dividends’, *Corporations Act 2001* (Cth). Case Law has established that profits include current year earnings, retained earnings and the asset revaluation reserve, in certain circumstances. Refer to the definition of “dividends” in Appendix 1.

5 Relationship to other policies

The *Financial Distribution Policy* operates together with a number of other policies and guidelines which form part of the *Commercial Policy Framework*, including the *Capital Structure Policy* and the *Reporting and Monitoring Policy for Government Businesses*[10].

Capital Structure Policy for Government Businesses

Capital structure refers to the mix of debt and equity used to finance a firm's assets. In accordance with the *Capital Structure Policy* a business' capital structure is set with regard to the debt capacity of the business. The debt capacity is assessed with reference to the business' operational requirements, namely its requirement to fund its approved capital expenditure program and its working capital requirements while ensuring an appropriate allowance for financial flexibility.

To facilitate a relatively stable stream of dividends through the peaks and troughs of the capital expenditure cycle fluctuations are permitted to a business' capital structure as determined by key financial ratios such as gearing levels and debt servicing capacity.

The expected level of ordinary dividends, as negotiated under the *Financial Distribution Policy*, is a key input used in setting a business' capital structure. This ensures that the dividend preferences of the shareholder over the long run are taken into account.

Once the capital structure is determined, however, it operates as a constraint on both the dividend targets negotiated and the actual dividends paid. Targets for ordinary dividends and actual payments for ordinary and special dividends are determined with reference to their impact on the business' capital structure. For example, dividend targets may be constrained to prevent a business from exceeding its target capital structure. Conversely dividend targets may be maintained even during peak investment periods where a business has the capacity to fund its approved capital expenditure through additional debt and maintain capital structure within the target range. In this way, the *Financial Distribution Policy* and the *Capital Structure Policy* are inextricably linked.

Capital repayments are a form of financial distribution and are used to achieve an appropriate capital structure following a review under the *Capital Structure Policy*.

---

10 NSW Treasury, *Reporting and Monitoring Policy for Government Businesses*, TPP 05-2, November 2005.

Monitoring and accountability

The Government's relationship with its businesses can be compared to a private sector holding company, which controls a number of wholly owned subsidiaries. The subsidiaries are accountable to the holding company for their financial performance. This involves the holding company in the setting of performance targets and monitoring of results.

The *Financial Distribution Policy* operates within the context of the *Reporting and Monitoring Policy for Government Businesses*.[11] The policy is based on an annual written agreement between the shareholders and board/management of each business, known as a Statement of Corporate Intent (SCI) for a State Owned Corporation and a Statement of Business Intent (SBI) for a non-corporatised business. The purpose is to enhance accountability for performance and provide the business with certainty as to the shareholders' expectations of financial performance.

Among other key matters the Statement contains financial performance targets and the forecast capital program. The ordinary dividend is one of the financial performance targets to be agreed in the Statement in accordance with the *Financial Distribution Policy*.

In order for year-end dividends to be recognised in an entity's financial statements the SCI/SBI is to be signed before 30 June in the financial year to which it relates. Signing the SCI/SBI creates a present obligation in affected entities that a dividend will be paid and a provision for the full amount of the dividend for the year must be recognised at 30 June. The provision includes any change in the amount of the dividend after the reporting date, which constitutes an "adjusting event after the reporting date" under Accounting Standard AASB 110 *Events after the Balance Sheet Date.*[12]

---

[11] NSW Treasury, *Reporting and Monitoring Policy for Government Businesses,* TPP 05-2, November 2005.

[12] See Treasury Circular TC 05/11 *Accounting for Dividends,* or any subsequent document that supersedes TC 05/11.

6 Administration

Ordinary dividends are paid in arrears. The following table summarises the administration of ordinary dividend payments using the financial year ended 30 June 2011 for illustrative purposes. Treasury will advise Government businesses of any changes in timing in the context of the annual updates to the *Reporting Calendars*.

Item	Timing
▪ Negotiation of target financial distributions in the context of the SCI/SBI process.	▪ Draft 2010-11 SCI/SBI to be provided to Treasury, on behalf of Shareholding Ministers/Treasurer and Portfolio Minister in the last week of March 2010. ▪ Final SCI/SBI ready for signing by the first week of August 2010.
▪ Interim dividend, comprising 50 per cent of target dividend payment based on 2010-11 *target* post-tax profits.	▪ Payable on a date to be determined by the Shareholding Ministers/Treasurer, but prior to 1 August 2011.
▪ Negotiation of final dividend.	▪ Board final dividend recommendation to be provided to Treasury, on behalf of Shareholding Ministers/Treasurer by the third week of July 2011. ▪ Final dividend recommendation to be agreed by Shareholding Ministers/ Treasurer prior to the third week of August 2011, or the date of submission of the financial report to the Auditor-General and Minister[13], whichever is earlier.
▪ Final dividend, comprising balance of total dividend payment based on 2010-11 *actual* post-tax profits.	▪ Payable on a date to be determined by the Shareholding Ministers/Treasurer, but prior to 1 December 2011.

Special dividend payments and capital repayments may be made at any time as negotiated between shareholders and the board.

[13] In accordance with the *Public Finance and Audit Act 1983*, sections 41A and 45D, public sector entities are required to prepare and submit their final financial report to the Minister and the Auditor General, within the period of six weeks after the end of each financial year. However, this date is brought forward by Treasurer's Direction for some entities to allow the timely preparation of the Total State Sector and General Government Sector financial reports.

7 Roles and responsibilities

Boards and management of Government businesses perform a stewardship role and are responsible for developing organisational strategies and operational management. This involves:

- negotiating target and final financial distributions with shareholders
- ensuring the target financial distribution is met
- reporting movements in target financial distributions and negotiating actual payments, upon finalisation of the annual accounts by providing a recommendation to shareholders
- advising shareholders on an exceptions basis of significant revisions to profitability and their associated impact on financial distributions.

NSW Treasury is responsible for the development of the *Financial Distribution Policy* and its administration. The policy-making role involves:

- developing, promulgating and promoting the policy
- engaging stakeholders in consultative processes
- updating and revising the policy where necessary.

The administration of financial distributions involves exercising strategic control consistent with shareholders' accountability to Parliament. This involves Treasury analysts, on behalf of shareholders:

- negotiating with management regarding target and final financial distributions
- monitoring financial distribution levels and the maintenance of agreed targets
- reporting movements in target financial distributions upon finalisation of the annual accounts and associated reasons in quarterly exception reports
- ensuring that the *Financial Distribution Policy* is applied as a mechanism to maintain the approved capital structure.

Further information

General inquiries concerning this document should be initially directed to:

Commercial Policy Branch
NSW Treasury
Telephone: (02) 9228 3125
Internet: www.treasury.nsw.gov.au.

References

Australian Taxation Office, *Manual for the National Tax Equivalent Regime*, January 2008.

NSW Government, *A Social Program Policy for NSW GTEs*, July 1994.

NSW Treasury, *Accounting for Superannuation,* Treasury Circular 09/01, May 2009.

NSW Treasury, *Accounting for Dividends,* Treasury Circular 05/11, December 2005.

NSW Treasury, *Capital Structure Policy for Government Businesses*, TPP 02-7, September 2002.

NSW Treasury, *Contributing by Owners Made to Wholly-Owned Public Sector Entities,* TPP 09-3, April 2009.

NSW Treasury, *Guidelines for Assessment of Projects of State Significance*, TPP02-4, July 2002.

NSW Treasury, *Guidelines for Financial Appraisal*, TPP07-4, July 2007.

NSW Treasury, *Government Guarantee Fee Policy for Government Businesses*, TPP 04-2, July 2004.

NSW Treasury, *Reporting and Monitoring Policy for Government Businesses,* TPP 05-2, November 2005.

NSW Treasury, *Tax Equivalent Regime for Government Businesses*, TPP 03-4, June 2003.

Further reading

Bhattacharya S, “Imperfect Information, Dividend Policy and the Bird in the Hand Fallacy,” *Bell Journal of Management Science*, 10, 259-270, Spring 1979.

Miller M H, “Behavioural Rationality in Finance: The Case of Dividends,” *Journal of Business*, 59, S451-S468, October 1986.

Miller M H and Modigliani F, “Dividend Policy, Growth and the Valuation of Shares,” *Journal of Business*, 34, 411-433, October 1961.

Miller M H and Rock K, “Dividend Policy under Asymmetric Information,” *Journal of Finance*, 40, 1031-1052, September 1985.

Shefrin H and Statman M, “Explaining Investor Preference for Cash Dividends,” *Journal of Financial Economics*, 13, 253-282, June 1984.

Appendix 1 – Definition of terms

Government businesses

The generic term 'Government business' includes:

- Public Trading Enterprises (or Public Non-financial Corporations under ABS classifications). State Owned Corporations are included in this classification, but are distinguished by their corporatised status
- Public Financial Enterprises (or Public Financial Corporations under ABS classifications)
- General Government businesses (or General Government agencies under ABS classifications, which are also non-Budget dependent and operate under the Commercial Policy Framework.

Financial distributions

Financial distributions reduce the owners' equity in a firm. They comprise dividends and capital repayments. Dividends represent a return *on* the owners' equity investment whereas capital repayments involve a return *of* the owner's equity investment.

Government businesses also make interest payments on borrowings obtained from NSW Treasury Corporation and are required to pay tax equivalents and Government guarantee fees in accordance with their requirements under the *Commercial Policy Framework*.[14] These payments, however, do not constitute financial distributions as they do not represent either a return *on* or a return *of* the Government's equity investment in the business. Rather these payments represent expenses incurred by Government businesses determined in accordance with competitive neutrality principles.

[14] The requirement for Government businesses to pay guarantee fees and tax equivalent payments is outlined in separate policies under the NSW Government's *Commercial Policy Framework* (namely, the NSW Treasury *Government Guarantee Fee Policy for Government Businesses,* TPP04-2 and the NSW Treasury*, Tax Equivalent Regime for Government Businesses,* TPP03-4, *respectively*) and the *Manual for the National Tax Equivalent Regime,* published by the Australian Taxation Office.

Dividends

This policy adopts the private sector definition of dividends, as provided by the *Corporations Act 2001*[15] whereby a dividend may only be paid out of the profits of a company. Case Law has established that profits include current year earnings, retained earnings and the asset revaluation reserve. Dividend payments from the asset revaluation reserve can only occur where the reserve is based on a competent valuation, is not liable to short-term fluctuations, and the firm's constitution does not restrict the payment of dividends to trading profits only.[16]

For the purposes of the *Financial Distribution Policy* dividends are further categorised according to their source and whether or not they represent regular or 'one-off' payments.

This distinction between ordinary dividends, special dividends and capital repayments is required to harmonise Government Finance Statistics (GFS) conventions with Generally Accepted Accounting Principles (GAAP)[17].

If agencies are uncertain as to how a dividend should be classified, they should contact their relevant Treasury analyst.

Ordinary dividends

Ordinary dividends represent a return on equity and are generally sourced from current year earnings although they may also be sourced from prior year's retained earnings. Ordinary dividends, however, should not be sourced from significant:

- gains (or losses) arising from the revaluation of assets
- proceeds from the sale of assets, or
- other forms of income that do not directly relate to the business's production.

This definition of ordinary dividends reflects the GFS concept of an operating surplus which differs from the concept of profit as normally understood in commercial accounting. The GFS operating surplus excludes forms of income that do not directly relate to the business's production.

Ordinary dividends are generally expected to be maintained over the foreseeable future.

---

15 Section 254T 'Dividends', *Corporations Act 2001* (Cth)

16 *Marra Developments Limited v BW Rofe Pty Limited* (1977) 3 ACLR 185; *QBE Insurance Group Limited v ASC* (1992) 8 ACSR 631

17 GFS conventions are administered by the Australian Bureau of Statistics

Special dividends

'Special dividends' also represent a return on equity paid out of the profits of a business. They differ from ordinary dividends in that they refer to additional one-off dividend payments that are typically sourced from transactions such as the sale of major physical assets. 'Special dividends' only refers to payments that are sourced from income that does not directly relate to the business's production. Special dividends are not expected to be maintained over the foreseeable future.

This definition of special dividends differs from the general usage of the term in private sector practice. While in the private sector, special dividends may be sourced from significant profits arising from one-off transactions, such as the sale of assets, they are also often declared after exceptionally strong company earnings as a way of distributing additional profits available to shareholders.

Capital repayments[18]

Capital repayments represent a return of the Government's equity in a particular business. They are determined in accordance with the *Capital Structure Policy* and are applied in order to achieve an appropriate capital structure. Where the proceeds from the sale of a significant part of the business are returned to shareholders this would also be typically categorised as a capital repayment.

Where required and to ensure consistent treatment between the Crown and the Government business making a financial distribution payment NSW Treasury will clarify with the Government business whether a distribution to owners represents a dividend payment or a capital repayment.

Shareholders

In the context of Government businesses the term 'shareholders' is used in this document to refer to Ministers of State who act as representatives of the people of New South Wales. For State Owned Corporations (SOCs) these Ministers are known as Voting Shareholders. There are two Voting Shareholders for every SOC. For other non-corporatised Government businesses the 'shareholder' role is shared by the Treasurer and relevant Portfolio Minister.

---

[18] Transfers to adjust an agency's capital structure are designated as 'contributions by owners' (i.e. capital adjustments) by NSW Treasury *Contributions by Owners Made to Wholly-Owned Public Sector Entities*, TPP09-3, April 2009.

Appendix 2 – Legislative provisions

Legislative basis for obtaining payment

The *Public Finance and Audit Act 1983 (PF&A Act)* provides the legislative basis for financial distribution payments. Section 59B of the Act gives the Treasurer the power to require a prescribed statutory authority to pay an amount to the credit of the Consolidated Fund. Prescribed authorities include statutory SOCs (under section 35A (3) of the *State Owned Corporations Act 1989*) and other, non-corporatised statutory authorities scheduled under the *PF&A Act*.

Amounts payable under section 59B may constitute either dividends or capital repayments, consistent with the definition of those terms used in this policy.

While the *PF&A Act* provides the legislative basis for obtaining these payments the amount of any payment is determined in accordance with this *Financial Distribution Policy* (for dividends) and the *Capital Structure Policy* (for capital repayments).

Share dividend schemes for SOCs

Section 20S(1) of the *State Owned Corporations Act 1989 (SOC Act)* requires a statutory SOC to have a share dividend scheme, as provided in the SOC's constitution, in a form approved by the Treasurer. For energy service SOCs, the share dividend scheme is to be determined by the Voting Shareholders in consultation with the board.[19]

The concept of share dividend schemes for statutory SOCs does not affect the operation of section 59B of the *PF&A Act*. Statutory SOCs may be required to pay dividends either pursuant to section 20S of the *SOC Act* or section 59B of the *PF&A Act*. However, if the Treasurer requires payment to be made under the *PF&A Act*, the Treasurer has to provide reasons why the payment is to be made pursuant to section 59B of the PF&A Act rather than section 20S of the *SOC Act*.

In the case of a company SOC, the *SOC Act* requires dividends to be agreed between the shareholders and the board.[20] In the absence of such an agreement, dividends may be determined by the Voting Shareholders, by written notice, after consultation with the board. Currently there are no company SOCs in the NSW Government's business portfolio.

---

[19] Schedule 2 clause 4, *Energy Services Corporations Act 1995* (NSW).

[20] Schedule 2 clause 5, *State Owned Corporations Act 1989* (NSW).

Appendix 3 – Dividend payment calculation – an example

Worked examples for a hypothetical business with an agreed dividend payout ratio in its Statement of Corporate / Business Intent of 70%. The business has recognised fair value movements in financial instruments through profit and loss rather than outside profit or loss.

Example 1 – Non-cash gain on financial instruments of $30 million.

	($m)	
	Actual Accounting result	**Dividend policy calculation**
Profit before tax (excluding financial instrument fair value movements)	100	100
Unrealised non-cash gains on financial instruments	30	-
Profit before tax	130	100
Income tax expense (30%) (AASB 112)[21]	39	-
Notional income tax expense (30%)[22]	-	30
Net profit after tax	91	70
Dividend payable	49	
Dividend payout ratio	54%	70%

Example 2 – Non-cash loss on financial instruments of $30 million

	($m)	
	Actual Accounting result	**Dividend policy calculation**
Profit before tax (excluding financial instrument fair value movements)	100	100
Unrealised non-cash losses on financial instruments	-30	-
Profit before tax	70	100
Income tax expense (30%) (AASB 112)[21]	21	
Notional income tax expense (30%)[22]		30
Net profit after tax	49	70
Dividend payable	49	
Dividend payout ratio	100%	70%

[21] This is a simplified example that assumes there are no reconciling differences between the AASB 112 *Income Taxes* 'tax expense' and the product of accounting profit multiplied by the applicable tax rate.

[22] This is a notional adjustment for dividend policy purposes only. It does not affect the income tax expense that is calculated according to the National Tax Equivalent Regime of the NSW Tax Equivalent Regime (TPP 03-4) and reported in the accounting financial report.