



The
Treasury

May 2014

tpp

14-04

**Financial Distributions Policy
for Government Businesses**

Policy & Guidelines Paper

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Replaced by TPP16-04

Preface

Treasury has revised the *Financial Distribution Policy for Government Businesses*. This May 2014 edition replaces and supersedes the previously issued TPP09-6.

The *Financial Distribution Policy for Government Businesses* is a component of the NSW Government's Commercial Policy Framework. The *Commercial Policy Framework* applies to Government businesses and 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 and management of Government businesses to be accountable for commercial financial management.

The purpose of the *Financial Distribution Policy for Government Businesses* is to outline the Government's expectations for the payment of dividends. The policy also covers capital repayments, which represent a return of the Government's equity investment.

The Government has a significant equity investment in a portfolio of Government businesses, including State Owned Corporations. This equity investment has accumulated over time through the direct investment of capital and indirectly in the form of retained earnings.

Government businesses make dividend payments as a return on this equity investment and these funds are returned to the State Budget to contribute to the funding of social services such as health, education, justice and transport provided by Government agencies.

This policy has been updated to clarify the mechanics of negotiating and calculating dividends, deriving Distributable Net Profit After Tax (NPAT) and constraints to the payment of dividends.

This policy applies to financial distributions payable in respect of the 2013–14 financial year and financial years thereafter.

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May 2014

Treasury Ref: TPP14-04
ISBN: 978-0-7313-3654-8

Note

General inquiries concerning this document should be initially directed to your relevant Treasury analyst or the Business Policy and Performance Unit, Commercial Policy and Financing Directorate.

This publication can be accessed from the Treasury's website www.treasury.nsw.gov.au.

Contents

	Page
Preface	i
Purpose of the policy	1
Financial Distributions	1
Dividends	1
Capital repayments	1
Other payments to Government	2
Application	2
Shareholders	2
Board	3
Dividend policy	3
Profit available for distribution	4
Constraints on the payment of dividend	4
Recommended Dividend by the Board	5
Shareholder approval of dividend to be declared	5
Payment of dividend	5
Accounting for dividends	6
Capital repayments	6
Appendix 1 – Legislative provisions	7
Appendix 2 – Dividend policy	9
Appendix 3 – Dividend Recommendation Letter	10

Purpose of the policy

The key objective is for the Government to receive an appropriate return on its equity investment in its portfolio of Government businesses.

The policy seeks 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 or disadvantages over their private sector competitors in accordance with competitive neutrality
- balance consideration of returns to shareholders with capital structure.

Financial Distributions

Financial distributions transfer a share of the owners' equity in the Government business to the owner. The payments made by Government businesses under this policy comprise:

- dividends which represent a return on the owners' equity investment
- capital repayments which involve a return of the owner's equity investment.

Dividends

Generally, a dividend is paid annually by the business to the shareholders. The dividend represents a distribution of a share of the profits or earnings generated by the business¹. This type of dividend is provided for under a shareholder dividend policy.

The Government may also seek a special dividend payable from Government businesses in regard to a particular event. Intermittent events may require the arrangement of such a dividend payable during the year (e.g. sale of major individual asset, Government policy decisions and/or a significant change in financial or strategic circumstances). This type of dividend can be separate to the dividend that is paid annually and it is not expected to be maintained over the foreseeable future.

Capital Repayments

Capital repayments represent a return of the Government's equity in a particular business². They are generally determined in accordance with NSW Treasury's Capital Structure Policy and are applied in order to achieve, or maintain, a commercially based capital structure. Where the proceeds from the sale of a significant part or whole of the business are returned to shareholders this would also be typically categorised as a capital repayment.

¹ The classification of the dividend payment for Government Financial Statistics purposes is subject to ABS definitions.

² The classification of capital repayments for Government Financial Statistics purposes is subject to ABS definitions.

Other payments to Government

Government businesses also make interest payments on borrowings obtained from NSW Treasury Corporation (TCorp) and are required to pay tax equivalents and Government guarantee fees. These payments 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.

Application

The Financial Distribution Policy applies to all Government businesses. The term 'Government business' includes:

- Public Trading Enterprises (or Public Non-financial Corporations under ABS classifications), including State Owned Corporations that 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 have market goods or services, do not receive significant Budget funding, and operate under the Commercial Policy Framework.

Commercial business units of general government agencies are to apply the principles and practises of the policy³. Individual business units are to have in place arrangements that recognise that profit generated from commercial activities should have a return to the State Budget and are not retained solely within their Departmental budget or netted off against other business unit results. These business units may be subject to other aspects of the *Commercial Policy Framework*, including the requirement to make certain payments consistent with competitive neutrality requirements and the preparation of a Statement of Business Intent.

This policy applies to financial distributions payable in respect of the 2013–14 financial year and financial years thereafter.

Shareholders

In the context of Government businesses, the term 'shareholders' refers to Ministers of State who act as representatives of the people of New South Wales.

- For SOCs, under the *State Owned Corporations Act 1989* these Ministers are known as voting shareholders. The Treasurer is one of the voting shareholders for each of the SOCs, with another Minister nominated by the Premier. For SOCs, the Portfolio Minister is not the other voting shareholder.
- For other non-corporatised Government businesses the 'shareholder' role is shared by the Treasurer and relevant Portfolio Minister.

³ Commercial business units of general government agencies in accounting terms cannot make payments called 'dividends' as they are not a stand-alone entity.

Board

Board refers to the governing board or where the Government business does not have a board, the Chief Executive Officer/Managing Director.

Dividend Policy

The shareholders and board are to set a dividend policy for the business. The principles underlying the approach in setting the dividend policy are that:

- Government businesses are expected to make annual dividend payments.
- The dividend policy is to take into account the shareholders' general preference for annual dividends (rather than capital repayments) and for a reasonably stable stream of total dividend payments from its Government businesses.
- Dividend policy is set by negotiation between the shareholders and the board of each business. However, shareholders have the ability to make the final decision on the dividend policy following this negotiation.
- NSW Treasury acts as the financial adviser to the shareholders during this negotiation process.
- The dividend policy provides guidance to the Board. The final dividend declared is based on a recommendation by the Board and the shareholders' approval of the dividend to be declared.

The dividend policy is agreed annually between the shareholders and board of each business. It is to cover at least three financial years, but is subject to shareholder approval of the dividend to be declared each year. The dividend policy and dividend target are to be set in the:

- Statement of Corporate Intent (SCI) for State Owned Corporations
- Statement of Business Intent (SBI) for other Government businesses or
- where a business does not have a SCI/SBI, there should be an agreement in writing on the dividend policy signed by the shareholders and board of the business.

Dividend target is preferred to be expressed as a dividend payout ratio, i.e. as a percentage of distributable net profit after tax. The setting of a dividend payout ratio under the policy provides greater certainty to businesses regarding the shareholder's expectations and enhances the transparency of, and accountability for, financial performance.

The Government may, from time to time, as agreed in Cabinet or as part of the Budget, have specific dividend policy expectations or considerations that must be taken into account for a particular business (or a group of businesses). Where this is the case, these are to be included in the dividend policy.

In the absence of a specific Government dividend policy for a particular business (or group of businesses), a dividend payout ratio of 70 per cent is to be used as the initial reference point in dividend policy negotiations.

Dividends should not generally be adjusted for the provision of any agreed Community Service Obligations (CSOs) or other agreed non-commercial activities. These should be funded on a transparent basis through the State Budget process as a grant from the Portfolio Department rather than funded from within Government businesses.

The negotiation of the dividend policy is to be supported by appropriate strategic, performance and financial information provided to the shareholders and NSW Treasury. Generally, information provided during the negotiation for the SCI/SBI encompasses the requirements for informed decision making by the shareholders. However, the shareholders and NSW Treasury reserve the right to seek additional information.

Profit available for distribution

Dividends are negotiated with reference to Distributable Net Profit After Tax (NPAT) of the business. NPAT is as per the entity's tax expense (except where circumstances require agreement to use the nominal tax rate of 30 per cent). For non-tax paying entities references to NPAT throughout the policy are taken to refer to Net Operating Result.

Basing the payment of a dividend on the Distributable NPAT of the business recognises that profit available for distribution can differ from profit determined under accounting standards.

Distributable NPAT is assessed and agreed between NSW Treasury and the Board on a case-by-case basis and included in the dividend recommendation by the Board. Generally, adjustments to derive Distributable NPAT relate to certain non-cash accounting transactions. Currently recognised adjustment items are provided in Appendix 2 and will be updated each year in the SCI and SBI Guidelines. Business specific adjustments are to be provided to NSW Treasury at the time of the dividend policy negotiation and dividend recommendation (including a statement of the estimated amount of, and reason for each adjustment).

Constraints on the payment of dividend

The annual dividend payment is constrained by a number of factors:

- the dividend amount is capped by the balance of retained earnings at year-end
- dividends should not generally be paid out of asset revaluation surpluses
- any other business specific considerations that have been specified in writing and approved by the shareholders.

Special dividends may be paid from other sources. The shareholders' approval will include the conditions and source of payment.

Recommended Dividend by the Board

The board is to provide a dividend recommendation to the shareholders for the current financial year. The dividend recommendation is to include:

- Distributable NPAT specifying the intended adjustments to NPAT based on forecast financial results
- the dividend policy that forms the basis for the recommendation
- any specific conditions relating to dividends for the business such as those that have been specified in writing or included in a SOC's share dividend scheme
- the dividend recommended in relation to the financial year
- any special dividend to be paid that has been approved by the shareholders during the year
- total dividend recommended
- reasons for variations from existing estimates of that dividend.

The Board should consider the constraints on the payment of dividend and the implications for cash reserves and solvency when providing the dividend recommendation to shareholders.

The board is to provide a dividend recommendation letter to the shareholders contemporaneously with the provision of Budget estimates⁴, as further detailed in Appendix 3.

Shareholder approval of the dividend to be declared

Before the end of the financial year the shareholders will approve the dividend to be declared for the financial year:

The Treasurer, on behalf of the shareholders, will then advise the business of:

- approval of the dividend recommendation or
- shareholder approval of an amendment to the payment of a dividend different to that recommended by the board, providing the basis for the alternative dividend.

The dividend for the financial year will be the amount as specified in the shareholders' approval and there will be no further variation. In the event that the shareholders' approval specifies an alternative dividend recommendation, the Treasurer may elect to determine this by way of section 59B of the Public Finance and Audit Act 1983.

Payment of Dividend

Annual dividends are paid in arrears. The dividend payment made during a particular financial year relates to the business' performance from the previous year.

⁴ Currently early to mid-May. The actual date will be advised by Treasury each year. This date will coincide with Budget estimates submissions.

Dividends declared and payable to shareholders are to be paid to the Treasurer, on behalf of the State, for payment into the Consolidated Fund in two instalments.

First instalment of the annual dividend is payable, comprising 50 per cent of the declared dividend, on a date to be determined by the Treasurer, but prior to 1 August after year end.

Second instalment of the annual dividend is payable, comprising the remaining balance of the total declared dividend, on a date to be determined by the Treasurer, but prior to 1 December after year end.

Special dividends are to be paid to the Treasurer, on behalf of the State, for payment into the Consolidated Fund, when and so determined by the Treasurer.

Accounting for dividends

It is NSW Treasury policy that Government businesses are to recognise dividends in the year to which they relate, even though payment may not occur until the following year.

Under Australian Accounting Standards, entities can only recognise dividends declared *before* the end of the reporting period as a liability. Dividends are regarded as declared when they are appropriately authorised and no longer at the discretion of the entity.

The shareholders' approval of the dividend to be declared prior to 30 June creates a present obligation in the affected entity that a dividend will be paid. As discussed previously, the dividend for the financial year will be the dollar amount as specified in the shareholders' approval and there will be no further variation.

Businesses are to ensure that NSW Treasury has adequate time to make arrangements to ensure appropriate shareholder approvals for the all dividend and capital repayments are made and signed before 30 June in the financial year to which they relate, so that the business can recognise at year-end these payments in their financial statements.

Capital repayments

Capital repayments may be made at any time as negotiated between shareholders and the board. Capital repayments arise from transactions related to return of owner's equity to the Consolidated Fund. They can be, but are not limited to:

- Payments to owners in order to achieve an appropriate capital structure determined in accordance with the Capital Structure Policy and/or capital structure reviews of the business.
- 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.

Capital repayments are to be paid to the Treasurer, on behalf of the State, for payment into the Consolidated Fund, when and so determined by the Treasurer (See Appendix 1).

Appendix 1 – 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. Under section 59B of the PF&A Act, the Treasurer has the power to require a prescribed statutory authority to pay to the credit of the Consolidated Fund, such amount by way of dividend as the Treasurer may determine and notify to the statutory authority.

Prescribed authorities include:

- statutory SOC's which are deemed so for this purpose under section 35A (3) of the *State Owned Corporations Act 1989* and PF&A Regulation 2010 section 16
- other, non-corporatised statutory authorities, scheduled under the PF&A Act.

Generally, dividend payments from the non-corporatised Government businesses and all capital repayments are made under the PF&A Act. For annual dividends for non-corporatised businesses, the shareholders' approval of the dividend to be declared also represents the Treasurer's determination under section 59B of the PF&A Act.

In addition, the Treasurer may determine the annual dividend of a statutory SOC under the PF&A Act, in the event that the shareholders' approval specifies an alternative dividend recommendation.

Statutory SOC's

Under section 20S(1) of the *State Owned Corporations Act 1989* (SOC Act) a statutory SOC is to have a share dividend scheme, as provided in the SOC's constitution, in a form approved by the Treasurer. This differs for energy service SOC's, whose share dividend scheme is to be determined by the voting shareholders in consultation with the board under Schedule 2 clause 4 of the *Energy Services Corporations Act 1995* (ESC Act).

In practice, the Statement of Corporate Intent (SCI) in conjunction with the board's dividend recommendation and the shareholder's approval of the dividend to be declared forms a SOC's share dividend scheme for the purposes of the SOC Act and ESC Act.

The concept of share dividend schemes for statutory SOC's does not affect the operation of section 59B of the PF&A Act. However, if the Treasurer requires the dividend payment to be made instead under the PF&A Act provisions, the Treasurer under section 20S(5) of the SOC Act is to provide reasons why the payment is to be made pursuant to the PF&A Act rather than the share dividend scheme under the SOC Act or ESC Act.

Company SOC's

Currently, there are no company SOC's scheduled under the SOC Act.

For a company SOC, the SOC Act under Schedule 2 clause 5 requires the amount of the dividend and payment to be agreed between the shareholders and the board. Where they fail to agree, the voting shareholder may determine the matter, by written notice, after consultation with the board.

Treasurer's legislative power

This policy is not intended to confine or restrict the powers of the Treasurer under section 59B of the PF&A Act, section 20S of the SOC Act and Schedule 2 clause 4 of the ESC Act. Section 59B(1) of the PF&A Act is a very wide notion of dividend, much broader than the usual legal meaning or *Corporations Act 2001* meaning of dividend, and is not restricted to the notion of 'dividends' and 'capital repayments' as described in this policy.

Under section 59B of the PF&A Act, the Treasurer has the power to determine a dividend⁵ and is under no obligation to consider the recommendation of the other shareholder or board.

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⁵ for prescribed authorities, see previous page.

Appendix 2 – Dividend Policy

Statement of Corporate/Business Intent

Statement on Dividend Policy

“Dividends for the 20XX-XX financial year will be provided on the basis of a dividend payout ratio of X% of the Distributable Net Profit After Tax (NPAT). The shareholder’s approval of the dividend to be declared is subject to the shareholders’ consideration of the board’s recommended dividend for the 20XX-XX financial year, prior to 30 June 20XX”

“Dividends for the 20XX-XX financial year will be provided on the basis of <insert agreed wording agreed with Treasurer/Shareholders>.

The shareholder’s approval of the dividend to be declared is subject to the shareholders’ consideration of the board’s recommended dividend for the 20XX-XX financial year, prior to 30 June 20XX”

Distributable NPAT

‘Distributable NPAT’ is defined as:

- i. Net profit after tax as defined by Australian Accounting Standards.
- ii. Agreed adjustments for material non-cash items including any associated tax effect.

Adjustments to NPAT to derive Distributable NPAT may include:

- fair value movements of financial instruments in net profit;
- the change in accounting estimate for superannuation interest expense calculations for defined benefit schemes under AASB 119 from 2013-14 (refer below); and
- other specific non-cash accounting transactions that individual SOCs and/or businesses may agree with NSW Treasury.

Changes to AASB 119 Employee Benefits effective from 1 July 2013 affect agencies with defined benefits superannuation liabilities that are not assumed by the Crown. The calculation of Distributable NPAT for the purposes of dividends may reverse the increase in the net superannuation interest expense (and reduction in before tax operating result) that arises from the change in accounting estimate.

For non-tax paying entities references to NPAT are to taken to refer to Net Operating Result.

Appendix 3 – Dividend Recommendation Letter

A dividend recommendation letter is to be provided by the board to the shareholders in mid-May each financial year⁶. It will contain the basis for, and recommended dividend for the financial year ending 30 June 20XX.

The dividend letter is to include, but is not limited to, the following:

- current forecast amount of NPAT for the financial year
- current forecast amount of Distributable NPAT for the financial year
- details of the types of adjustments made to determine Distributable NPAT and a statement providing a breakdown of the forecast value and reason for each adjustment
- the dividend policy that forms the basis for the recommendation
- the dividend recommended in relation to the financial year
- any special dividends that have been approved by the shareholders for the current financial year
- total dividend recommended and
- reasons for variations from target dividend.

The dividend recommendation letter is to include the following statement on behalf of the board that:

- the dividend is to be paid from agreed sources
- any dividend policy specific conditions for the business such as those that have been specified in writing or included in a SOC's share dividend scheme and
- the recommended dividend is expected to be paid from profits and as such, is not expected to place additional pressure on prices, service quality or future reliability.

⁶ The actual date will be advised by Treasury each year. This date will coincide with Budget estimates.