March 2023

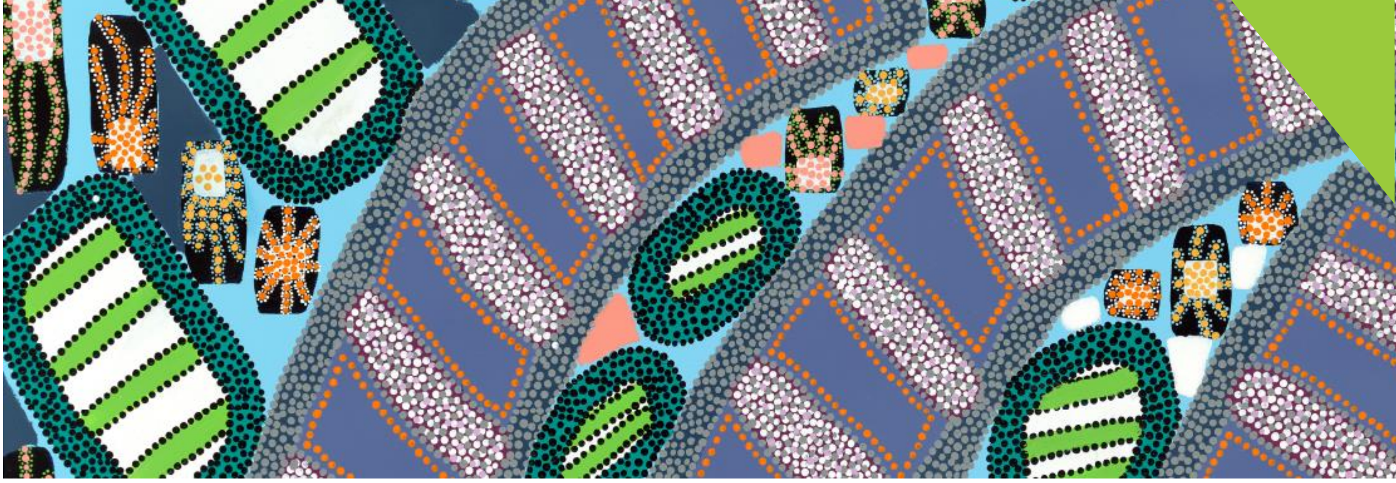
TPG21-10

NSW Treasury Policy and Guidelines:

Capital Structure and Financial Distribution Policy for Government Businesses

NOTE: This document is a draft only.

It is not official policy and is not an official NSW Treasury publication and does not have official status until it has been approved and cleared for publication.



Acknowledgement of Country

NSW Treasury acknowledges that Aboriginal and Torres Strait Islander peoples are the First Peoples and Traditional Custodians of Australia, and the oldest continuing culture in human history.

We pay respect to Elders past and present and commit to respecting the lands we walk on, and the communities we walk with.

We celebrate the deep and enduring connection of Aboriginal and Torres Strait Islander peoples to Country and acknowledge their continuing custodianship of the land, seas and sky.

We acknowledge the ongoing stewardship of Aboriginal and Torres Strait Islander peoples, and the important contribution they make to our communities and economies.

We reflect on the continuing impact of government policies and practices, and recognise our responsibility to work together with and for Aboriginal and Torres Strait Islander peoples, families and communities, towards improved economic, social and cultural outcomes.

Artwork: ‘Regeneration’ by Josie Rose 2020

Key information

Treasury Policy and Guidelines (TPG) is relevant to?	☒ GSF Agencies ☒ General Government Sector ☒ Public non-financial corporation ☒ Public financial corporation ☒ State Owned Corporations ☐ Other
	☐ Executive agencies related to Departments
	☒ Subsidiaries of the NSW Government established under the Corporations Act 2001
Date issued	10 December 2021
Review date	December 2026
Replaces	This policy replaces the following policies: • TPP16-03 Capital Structure Policy for Government Businesses • TPP16-04 Financial Distribution Policy for Government Businesses
Publishing entity	NSW Treasury
Related instruments	Legislative instruments: • Government Sector Finance Act 2018 • State Owned Corporations Act 1989 • Corporations Act 2001 Policies and Guidelines under the Commercial Policy Framework: • TPP18-02 Performance Reporting and Monitoring Policy for • Government Businesses • TPG22-20 Government Guarantee Fee Policy for Government • Businesses • TPP19-02 Guidelines for Community Service Obligations
Document approver	Secretary, NSW Treasury
Contact	Commercial Policy, NSW Treasury Email: Commercialpolicy@treasury.nsw.gov.au

Revision history

Document version number	Approval Date	Author	Approver	Description
Version 1.1	31/03/2023	Commercial Policy	Executive Director, Commercial Assets	Update to Practice Guide 3: Timing of capital structure and dividend process.

Contents

Overview

This policy outlines the requirements for a government business to maintain a capital structure that meets the Government's expectations while providing an appropriate return on the Government's equity investment.

Purpose

This policy seeks to:

- ensure the efficient allocation of capital in government businesses
- align the capital structure of government businesses with the strongest performers among their industry peers
- recognise the opportunity cost associated with the Government's equity investment
- balance financial distributions to the Government with a capital structure that supports an investment-grade standalone credit rating
- maintain financial flexibility for government businesses while strengthening financial and operational performance
- enhance the transparency of, and accountability for, financial performance of government businesses
- limit any special advantage or disadvantage government businesses may have over their non-government competitors in accordance with competitive neutrality principles.

Changes and amendments

This policy:

- consolidates and replaces *Capital Structure Policy for Government Businesses* [TPP16-03] and *Financial Distribution Policy for Government Businesses* [TPP16-04]
- requires government businesses to align their capital structure with the strongest performers among their industry peers (where applicable)
- requires government businesses to improve efficiency to strengthen financial and operational performance
- aligns with the *Government Sector Finance Act 2018* (GSF Act)
- clarifies the process and requirements related to financial distributions.

Summary of principles and requirements

The policy is based on five overarching principles. Each principle is supported by a number of requirements summarised in the table below. The relevant legislative requirements for borrowings and financial distributions are detailed in **Appendix 2**. Defined terms are included in **Appendix 3**.

Principle 1: Align capital structure with the strongest performers among industry peers

Requirement 1.1: Government businesses should seek to align their Target Capital Structure with the strongest performers among their industry peers.

Requirement 1.2: Government businesses should reflect the Target Capital Structure agreed with Treasury in their Statement of Intent and Business Plan.

Requirement 1.3: Government businesses must coordinate with Treasury to obtain the Treasurer or appropriate delegate's approval to increase their borrowing limit where required to achieve the Target Capital Structure.

Principle 2: Maintain a credit rating at or above the Minimum Credit Rating

Requirement 2.1: Government businesses should ensure their capital structure allows them to maintain a standalone credit rating at or above Baa2 / BBB (Moody's / Fitch or Standard & Poor's) (**Minimum Credit Rating**), unless a different level is determined by Treasury following consultation with the business.

Requirement 2.2: Government businesses should obtain a standalone credit rating annually to provide assurance to Treasury that they remain at or above the Minimum Credit Rating.

Principle 3: Deliver a return on government's equity investment through payment of dividends

Dividend Expectations

Requirement 3.1: Government businesses must aim to pay dividends annually, except where the shareholder determines a payment is not required.

Requirement 3.2: Government businesses should reflect the shareholder's expectations or considerations regarding dividends in both their forecast dividend profile and dividend to be declared.

Dividend Process

Requirement 3.3: Government businesses should agree with the shareholder a forecast dividend profile that covers ten subsequent financial years as part of the Statement of Intent and Business Plan process.

Requirement 3.4: Government businesses should agree with the shareholder the dividend payout ratio or an alternative approach to determining the forecast dividend profile.

Requirement 3.5: Government businesses must recommend to the shareholder the dividend to be declared for the current financial year in a Dividend Recommendation Letter.

Principle 4: Improve efficiencies to strengthen financial performance

Requirement 4.1: Government businesses should agree with Treasury on efficiency targets annually and reflect them in their Statement of Intent and Business Plan.

Requirement 4.2: Government businesses should undertake regular external efficiency reviews at least once every five years.

Principle 5: Advise of material changes in circumstances on a timely basis

Requirement 5.1: Government businesses should advise Treasury as soon as possible of any change to their circumstances that may impact their ability to meet the principles and requirements of this policy.

Application of the policy

This policy applies to State Owned Corporations (SOCs) and other government businesses as set out in the table below.

Types of Government Businesses	Application of the principles and requirements in the policy
Statutory SOCs	All principles and requirements apply.
Non-SOC Public Non-Financial Corporations (Non-SOC PNFCs) **Public Financial Corporations** (PFCs)	• Principles 1 and 2 apply where Treasury determines the business should adopt a Minimum Credit Rating and a Target Capital Structure.[1] • Principle 3 applies if the shareholder[2] determines the business should pay a financial distribution, as communicated by Treasury.[3] • Principles 4 and 5 apply (application of Requirement 4.2 to be determined by Treasury).
General Government businesses	• The requirements under Principle 3 apply to the extent practicable if Treasury determines the business should pay a financial distribution.[4] • Principles 4 and 5 apply (application of Requirement 4.2 to be determined by Treasury).
Companies wholly owned by the Government and incorporated under the *Corporations Act 2001*	• Principles 1 and 2 apply where Treasury determines the business should adopt a Minimum Credit Rating and a Target Capital Structure. • The application of Principle 3 is subject to the company's Constitution and the Government's expectations on financial distributions from the company. • Principles 4 and 5 apply (application of Requirement 4.2 to be determined by Treasury).

1 Treasury determines the adoption of a Minimum Credit Rating and a Target Capital Structure regime by a government business based on various criteria including the characteristics of its business activities, capital intensity of the business's operations, the riskiness of its operating revenues and expenses, and government policies.

2 For non-SOC government businesses without a shareholder, 'shareholder' refers to the Treasurer and the responsible Minister, except for the purposes of determining payments of financial distributions, which is limited to the Treasurer. The term 'shareholder' is used throughout this policy for simplicity. A more detailed definition of 'shareholder' is provided in the Glossary.

3 Non-SOC PNFCs and PFCs should apply the requirements under Principle 3 of the policy to the extent practicable.

4 Certain General Government businesses with profits generated from commercial activities should have arrangements returning their profits to the State Budget. These businesses pay distributions in lieu of dividends.

Principle 1: Align capital structure with the strongest performers among industry peers

Capital funding for government businesses is provided from two sources: debt and equity. The capital structure of a business refers to the relative levels of debt and equity. The Government invests equity in its businesses through the direct investment of capital and indirectly in the form of retained earnings.

Industry benchmarking

Requirement 1.1: Government businesses should seek to align their Target Capital Structure with the strongest performers among their industry peers.

Government businesses should benchmark their capital structure against industry peers and work with Treasury to identify adjustments to their capital structure that more efficiently allocate the Government's capital. Where required, Treasury will support the business to adopt a capital structure more in line with the strongest performers in the peer set. Treasury recognises this change may take multiple years to implement.

The Target Capital Structure may be expressed as the ratio of net debt to Regulatory Asset Base (RAB) for a regulated SOC or as net debt to equity for other government businesses for the purposes of this policy.

The capital structure of a government business may differ from its industry peers for a number of reasons. For example, this may be due to the different approaches by public and private regulated businesses in generating non-regulated revenue. Treasury and the business will consider these factors when determining a Target Capital Structure.

To achieve its Target Capital Structure, a government business may be required to take on more debt and/or to distribute excess capital in the form of dividends and/or capital repayments. The business and Treasury should ensure taking on additional debt will not adversely impact the business's ability to meet its obligations and withstand shocks.

Practice Guide 1 in Appendix 1 provides guidance on industry benchmarking processes for determining the Target Capital Structure.

Requirement 1.2: Government businesses should reflect the Target Capital Structure agreed with Treasury in their Statement of Intent and Business Plan.

Treasury, on behalf of the shareholder, will agree the Target Capital Structure with the business as part of the Budget and Statement of Intent and Business Plan process or where specifically required. Where agreement cannot be reached, the shareholder will determine the Target Capital Structure of the business.

Requesting approval for an increased borrowing limit

Requirement 1.3: Government businesses must coordinate with Treasury to obtain the Treasurer or appropriate delegate's approval to increase their borrowing limit where required to achieve the Target Capital Structure.

Government businesses must obtain Treasurer approval for borrowings in the form of a financial arrangement approval under section 6.23(1) of the GSF Act. In practice, this financial arrangement approval typically sets a borrowing limit for the business (i.e. the maximum amount of borrowings to be held by the business). The Treasurer's power under this section may be delegated and subdelegated under section 9.8 of the GSF Act.

A business may need to increase its existing borrowing limit to achieve the Target Capital Structure. In this circumstance, the business will coordinate with Treasury to prepare a letter requesting an approval of an increased borrowing limit from the Treasurer or the delegate under section 6.23(7) of the GSF Act. In the letter, the business should explain how the increased limit will support it to achieve the Target Capital Structure. Treasury will advise the business of the approved borrowing limit.

Appendix 2 includes detailed legislative requirements for borrowings by GSF agencies.

Principle 2: Maintain a credit rating at or above the Minimum Credit Rating

Treasury expects government businesses to maintain a credit rating at or above the Minimum Credit Rating, unless otherwise agreed with Treasury.

Minimum Credit Rating

Requirement 2.1: Government businesses should ensure their capital structure allows them to maintain a standalone credit rating at or above Baa2 / BBB (Moody's / Fitch or Standard & Poor's) (**Minimum Credit Rating**), unless a different level is determined by Treasury following consultation with the business.

The credit rating of a business is an assessment of its creditworthiness, reflecting a range of factors including the business's competitive and regulatory environment, operational characteristics, capital program and overall financial situation. The standalone credit rating of a business is forward looking and based on the evaluation of the historical and forecast operating and financial performance of the business.

Treasury expects government businesses to maintain their standalone credit rating at or above a Minimum Credit Rating. The Minimum Credit Rating for government businesses is set at Baa2 / BBB (Moody's / Fitch or Standard & Poor's). This rating level provides a buffer for businesses to avoid dropping below investment grade (i.e. below Baa3 / BBB-).

Treasury may determine a Minimum Credit Rating other than at Baa2 / BBB for a business given its specific circumstances.

Requirement 2.2: Government businesses should obtain a standalone credit rating annually to provide assurance to Treasury that they remain at or above the Minimum Credit Rating.

Government businesses required by Treasury to have a Minimum Credit Rating should obtain a standalone credit rating annually. This must be obtained from the rating agency contracted by Treasury to provide this service for government businesses.

Under certain circumstances, Treasury may agree with a business not to obtain a standalone credit rating for a specific year after assessing its costs and benefits.[5]

Capital structure and credit rating

Treasury expects that the capital structure of a government business will allow it to maintain a standalone credit rating at or above the Minimum Credit Rating.

In some circumstances, moving to a Target Capital Structure more aligned with industry peers may lead to a business's standalone credit rating temporarily falling below the Minimum Credit Rating. Where this is the case (or for any other reason), the shareholder and the business will agree to a course of action and timeframe to move the business to the Minimum Credit Rating. The action includes making further efficiency improvements against the agreed targets (see **Principle 4**).

In limited circumstances, the shareholder may consider a path to return the business to the Minimum Credit Rating via an adjustment to the business's capital structure through:

- reducing dividends against the levels in the forecast dividend profile, and/or
- a capital injection within a timeframe approved by the shareholder.

Situations that may warrant these types of adjustments to the business's capital structure include where an unanticipated or otherwise unfunded and substantial requirement for capital investment results in a business's standalone credit rating temporarily falling below the Minimum Credit Rating.

Principle 3: Deliver a return on government's equity investment through payment of dividends

The Government expects annual investment returns from government businesses in the form of dividends[6].

Dividend expectations

Requirement 3.1: Government businesses must aim to pay dividends annually, except where the shareholder determines a payment is not required.

A government business should distribute an appropriate portion of their profits or earnings across time. The amount of annual dividend is subject to the shareholder's expectations or considerations under Requirement 3.2 and the approach to determining the dividends under Requirement 3.4.

There may be circumstances where the shareholder agrees with the business that payment of a dividend is not required for a period of time. For example, to repair the business's balance sheet after a shock. Treasury will discuss this with the business during the annual negotiation of dividends as part of the Budget and Statement of Intent and Business Plan process.

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[5] The annual standalone credit rating is also used to determine the Government Guarantee Fee payable to the Government. TPP14-03 *Government Guarantee Fee Policy* allows certain government businesses not to obtain the rating on an annual basis or to obtain an estimate of their standalone credit rating from the contracted rating agency or Treasury. This is because the cost of a rating assessment may be relatively high for a business with a low debt level.

[6] References to 'dividends' include distributions in lieu of dividends paid by certain General Government businesses where these distributions are not a return on the Government's equity investment, since these businesses do not have equity funding from the Government but receive funding from the State Budget. The term 'dividends' has been used throughout this policy for simplicity.

The payment of a dividend should not place additional pressure on prices, service quality or future reliability of the business.

Requirement 3.2: Government businesses should reflect the shareholder's expectations or considerations regarding dividends in both their forecast dividend profile and dividend to be declared.

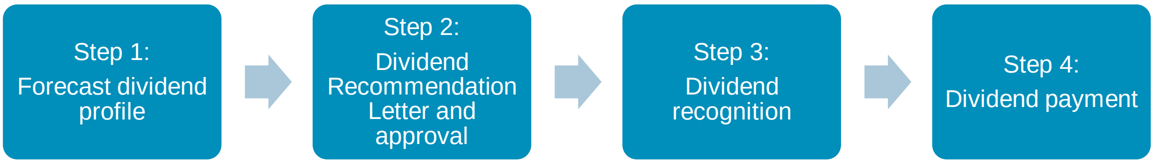
The shareholder may have specific expectations or considerations that a business or a group of businesses must consider for their forecast dividend profile and dividend to be declared. These include the expectations or considerations relating to government policies, fiscal challenges, strategic initiatives, capital investment programs, and industry best practice.

The shareholder may determine dividend matters, including the dividend to be declared for each financial year, following consultation with the businesses.

The legislative basis for dividends is outlined in **Appendix 2**.

Dividend process

The dividend process consists of four steps as outlined in the chart below. **Practice Guide 3** in Appendix 1 provides indicative timing for the annual dividend process. Treasury may advise alternative timing, for example to coincide with Budget timing.



Step 1: Forecast dividend profile

Requirement 3.3: Government businesses should agree with the shareholder a forecast dividend profile that covers ten subsequent financial years as part of the Statement of Intent and Business Plan process.

The forecast dividend profile is determined through a consultative process between the business and Treasury. The government business's Statement of Intent and Business Plan and Budget submissions should reflect the agreed forecast dividend profile.

The business must explain in the Statement of Intent and Business Plan how the forecast dividend profile has been determined, including the agreed approach discussed in Requirement 3.4 and any dividend expectations or considerations in accordance with Requirement 3.1 and 3.2.

Treasury recognises the uncertainties for long-term forecasts across ten years. Government businesses should ensure the dividend forecasts are as accurate as possible.

Requirement 3.4: Government businesses should agree with the shareholder the dividend payout ratio or an alternative approach to determining the forecast dividend profile.

For businesses that have a Target Capital Structure, the forecast dividend profile should be primarily based on achieving and maintaining the Target Capital Structure and a credit rating at or above the Minimum Credit Rating.

For other businesses, a dividend payout ratio should be discussed and agreed with Treasury. A ratio of 70 percent may be used as the initial reference point for discussion. The dividend payout ratio is ordinarily expressed as dividends to distributable Net Profit After Tax (NPAT).

Step 2: Dividend recommendation and approval

Requirement 3.5: Government businesses must recommend to the shareholder the dividend to be declared for the current financial year in a Dividend Recommendation Letter.

The business must send a letter to the shareholder explaining how the recommended dividend to be declared has been determined (including where the dividend amount is nil), and including any specific considerations in accordance with Requirement 3.2 (**Dividend Recommendation Letter**).

Treasury will, on behalf of the shareholder, advise the government business before the end of the financial year of:

- approval of the dividend recommended, or
- approval of a dividend different to that recommended by the business and providing the basis for the alternative dividend.[7]

The dividend declaration in the business's year-end financial statements must be the dollar amount specified in the shareholder's approval. No further variation is permitted.

Practice Guide 4 in Appendix 1 of this policy provides detailed guidance on this process.

Step 3: Dividend recognition

The government business can only recognise the dividend for the current financial year when it is approved by the shareholder. **Practice Guide 3** in Appendix 1 provides indicative timing of dividend recommendation, approval, and recognition that the business must follow to ensure that Treasury has adequate time to arrange shareholder approval of the dividend to be declared before the end of the financial year.

The shareholder approval of the dividend to be declared by 30 June creates a present obligation that these payments will be made, even though the payments may occur in the following year. Government businesses should recognise the approved capital repayments and dividend to be declared in their financial statements at the end of financial year, in accordance with Australian Accounting Standards.

This *Step 3: Dividend recognition* also applies to capital repayments discussed in the section below.

Step 4: Payment of dividend

Dividends are typically paid in arrears. Dividends declared are to be paid to the Treasurer, on behalf of the State in accordance with the legislative provisions discussed in **Appendix 2**.

Ordinarily, government businesses pay dividends in two instalments:

- prior to 1 August after year end, 50 percent of the total declared dividend
- prior to 1 December after year end, the remaining balance of the total declared dividend.

Treasury will advise the business of the shareholder's approval of dividend recommended and if different to above the timing of these payments.

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[7] If the approval for a SOC specifies an alternative dividend amount, the Treasurer may elect to determine this by way of section 5.4 of the GSF Act as discussed in Appendix 2 of this policy.

With the approval by the shareholder, government businesses may pay dividends on terms other than the above.

Other financial distributions

Financial distributions transfer a share of the owner's equity in a government business to the Government, and comprise:

- 'dividends' which represent a return on the owner's equity investment, as discussed in the section above
- 'capital repayments' which involve a return of the owner's equity investment.[8]

Capital repayments, as negotiated between the business and Treasury, may be made at any time following approval by the shareholder.

Capital repayments are to be paid to the Treasurer, on behalf of the State, when and as determined by the shareholder (as advised by Treasury) or may be paid as otherwise provided for under relevant legislation.

The legislative basis for financial distributions is outlined in **Appendix 2**. This policy does not preclude the Treasurer's power to direct the payment of financial distributions by any GSF agency to the Treasurer under section 5.4 of the GSF Act.

Other payments to Government

Government businesses may also make tax equivalent payments, interest payments and pay Government Guarantee Fees on borrowings obtained from NSW Treasury Corporation. These payments do not constitute financial distributions under this policy. Rather, these payments represent expenses incurred by government businesses in accordance with competitive neutrality principles.

Principle 4: Improve efficiencies to strengthen financial performance

Government businesses should seek opportunities to improve their revenue and operational efficiencies where possible to support stronger financial performance. This will strengthen their dividend payments to the shareholder and will ultimately benefit the community.

While this principle focuses on strengthening financial performance through improved efficiency, businesses may also wish to discuss with Treasury opportunities to diversify or increase their revenue. Where appropriate, businesses are encouraged to invest in innovative practices and technologies that help drive long-term efficiencies.

Requirement 4.1: Government businesses should agree with Treasury on efficiency targets annually and reflect them in their Statement of Intent and Business Plan.

Treasury expects businesses to demonstrate in their Business Plan their past efficiency performance and forecast efficiency targets, including the measures of efficiency and methods for assessing

[8] Detailed definitions of 'dividend' and 'capital repayment' are provided in the Glossary.

efficiency improvements.[9] Treasury and the business will negotiate and agree on achievable efficiency targets over the forward years as part of the annual Statement of Intent process or as required. The results of an external review in Requirement 4.2 may inform agreement with Treasury on efficiency targets.

Requirement 4.2: Government businesses should undertake regular external efficiency reviews at least once every five years.

Government businesses should engage an appropriately qualified expert to undertake an efficiency review at least every five years, or as otherwise agreed with Treasury. This will support the business to identify opportunities to operate more efficiently. Treasury may require a government business to undertake an efficiency review more frequently than this. Treasury should be consulted in determining the scope and rigour of the efficiency review, be provided with access to information during the course of the review, and be provided with the outcomes of the review.

The **Practice Guide 2** in Appendix 1 provides guidance on external efficiency reviews.

Efficiency improvements and dividend payments

The stronger profitability generated by the business through efficiency improvements will support it to increase its dividend payments over time.

Additionally, internal changes or external events may impact on the operating and financial position of a business and its ability to pay forecast dividends. In these circumstances, the business should consider options to improve their operational efficiency to avoid reducing dividend payments.

Principle 5: Advise of material changes in circumstances on a timely basis

Requirement 5.1: Government businesses should advise Treasury as soon as possible of any change to their circumstances that may impact their ability to meet the principles and requirements of this policy.

Government businesses should advise Treasury as soon as possible of any material change to their circumstances that may affect their ability to meet the principles and requirements of this policy including achieving and maintaining their Target Capital Structure and a standalone credit rating at or above the Minimum Credit Rating, achieving agreed efficiency targets, and delivering dividends at the forecast level.

These internal and external changes in circumstances may include changes to a business's operations, strategic direction, legislation, regulation and competitive environment. Treasury will work with the business to determine the impacts of and adaptions to these changing circumstances.

9 Treasury Annual Guidelines on the Statement of Intent and Business Plan will provide guidance on the information regarding efficiency targets that businesses should include in their Business Plan.

Relationship with other policies in the Commercial Policy Framework

This policy forms part of Commercial Policy Framework and should be read in conjunction with the following policies.

TPP18-02 Performance Reporting and Monitoring Policy for Government Businesses

Refer to this policy to ensure the appropriate reporting of capital structure and financial distribution related matters.

TPP14-03 Government Guarantee Fee Policy for Government Businesses

The guarantee fee of a business is calculated with reference to its standalone credit rating. A government business subject to the guarantee fee must obtain its standalone credit rating in accordance with the requirements outlined in the Government Guarantee Fee Policy.

TPP19-02 Guidelines for Community Service Obligations

Government businesses may be required to provide a community service obligation or other non-commercial activity under a Ministerial direction or an agreement with a government department or agency that is responsible for the relevant policy objective. Businesses may be reimbursed for this activity by the government department or agency. Businesses cannot adjust their dividends to fund these activities.

Appendix 1: Practice Guides

Practice Guide 1: Industry benchmarking for determining the Target Capital Structure

This Practice Guide provides guidance on industry benchmarking processes for determining the Target Capital Structure. The annual Statement of Corporate Intent and Statement of Business Intent Guidelines issued by Treasury will contain further guidance on how business should communicate to Treasury the industry benchmarking they have undertaken.

Step 1: Determining industry peers

This policy does not strictly define the term 'industry'. In determining industry peers, a government business could consider:

- businesses who operate in the same sector and conduct similar business activities, and
- businesses who conduct different activities or operate in different sectors but share some important characteristics that make them good peers. For example, a water business may consider an energy business as a peer in certain respects as they are both regulated utilities.

Industry peers may be private or public businesses in Australia or other jurisdictions.

In selecting the most appropriate peers, the business should consider and recognize the differences between them and businesses in their peer set, including differences of size, business activities, ownership structure, regulatory framework, and legal, accounting and tax systems.

Step 2: Benchmarking capital structure against industry peers

Businesses should adopt the same methodology for calculating their gearing ratio as is used by the agency that provides them with a standalone credit rating.

The alignment of a business's capital structure with the strongest performers in its peer set will need to account for any key characteristics of the business or the environment in which it operates that significantly differs from those of its peers. These characteristics may qualify differences between the capital structure for the business and the strongest performers in its peer set.

In recognition of these differences, a range of metrics in addition to the gearing ratio should be included in the benchmarking exercise to qualify and support drawing appropriate comparisons with the strongest performers in the peer set. These metrics may include business strategies, revenue streams, standalone credit ratings and credit ratings by alternative rating agencies, measures of operational efficiency, and other metrics measuring financial and operational performance.

Step 3: Determining the Target Capital Structure and a path transitioning towards it

While seeking to align the Target Capital Structure with the strongest performers in the peer set, the business should ensure that:

- they maintain a standalone credit rating at or above the Minimum Credit Rating, and
- moving to the Target Capital Structure will not adversely impact the business's ability to meet its obligations and withstand shocks.

The business may need to conduct modelling and scenario analysis to determine a Target Capital Structure aligned with the strongest performers in its peer set based on its forecast financials.

Businesses should provide Treasury with details of the industry benchmarking process undertaken for determining the Target Capital Structure. Treasury will evaluate the Target Capital Structure and the basis on which it has been determined. Where the evaluation by Treasury differs from the business's, Treasury will negotiate and agree with the business a Target Capital Structure and path transitioning towards it.

Businesses should discuss with Treasury any additional considerations apart from industry benchmarking that may be used in determining a Target Capital Structure.

Practice Guide 2: External efficiency review

This Practice Guide provides guidance on how an external review of a business's efficiency should be approached in terms of timing, costs, scope and outcomes.

1. Timing and costs

Treasury will agree with the business the timing of a once-in-five-year external efficiency review following consideration of the business's efficiency targets and supporting information provided in the Business Plan.

The review should be conducted by an organisation that is independent of both the business and the Government. The cost of the review will be funded by the business.

2. Scope of the external review

The business should consult with Treasury in determining the scope and rigour of that review.

The scope of the review may cover:

- verification of previous internal or external reviews
- identifying opportunities to improve the efficiency of a specific business activity or project
- a comprehensive bottom-up or top-down approach.

The purpose of the review is to support the business to identify opportunities to improve their OPEX and CAPEX efficiency.

3. External review to support efficiency improvements

Once the results of the external review become available, the government business should determine actions to improve its efficiency and analyse the financial and operational impacts of undertaking these actions. The business should ensure that achieving efficiencies will not adversely impact its quality of service. The review will inform forecasts for OPEX and CAPEX, and the capital structure and financial distributions to be negotiated with Treasury during the next Statement of Intent and Business Plan process.

Practice Guide 3: Timing of capital structure and dividend process

Activities	Timing	Who	Description
Statement of Intent and Business Plan Guidelines	By December	Treasury	Provide detailed guidance on the Statement of Intent and Business Plan process for the following financial year.
Confirmation / Agreement	Jan - Apr	Shareholder and Board with support from Treasury and Management	1) Confirm existing or agree to the revised Target Capital Structure. 2) Provide and confirm dividend expectations, confirm or agree approach to determining dividends, and agree forecast dividend profile. 3) Agree efficiency targets.
Preliminary Business Plan	March	Board / Management	Include financial projections (including the current financial year's estimated dividend amount to be declared) based on the negotiations at that time.
Review and Consideration	Mar – Apr	Treasury in consultation with the business	1) Review financial projections in the Preliminary Business Plan. 2) Provide guidance on the Government's dividend expectations.
Agreement (In-principle)	Apr – early May	Treasury and Management / Board	Agree on the financials for inclusion in the Statement of Intent and Business Plan, Budget submission and Dividend Recommendation Letter.
Dividend recommendation	May	Board	Submit the Dividend Recommendation Letter to the shareholder through Treasury.
Acceptance of dividend recommendation	June	1) Shareholder 2) Treasury	1) Approve, or advise otherwise, the dividend to be declared. 2) Advise the business the decision by shareholder.
Final Statement of Intent and Business Plan	June	Board / Management	Submit the Statement of Intent and Business Plan to Treasury, including: • Minimum Credit Rating and Target Capital Structure • forecast dividend profile with the agreed approach and dividend expectations • efficiency targets.
Accounting recognition of dividends	30 June	Management	Recognise the dividend declared in the year-end financial statements to reflect a present obligation to pay a dividend.
Signed final Statement of Intent	By 30 Sep	Shareholder and Board	Final Statement of Intent signed by businesses and delivered to Treasury for shareholder signing
Standalone credit rating	Annually	Management of the business	Obtain standalone credit rating to ensure the business could maintain a credit rating at or above the Minimum Credit Rating with the forecasts to be included in Statement of Intent and Business Plan.
Dividend payments	See description	Management of the business	Pay dividends on the terms as listed in *Step 4: Dividend payments* under *Dividend Process* or a different schedule as agreed with shareholder.

Practice Guide 4: Dividend Recommendation Letter and approval

The Dividend Recommendation Letter for the government business is from their accountable authority to either the shareholder(s) or the Treasurer as applicable, based on the type of the business shown below.

<table>
<tr><th>Type of Government Business</th><th>Accountable Authority</th><th>Shareholder / Treasurer</th></tr>
<tr><td>Statutory SOCs</td><td>Board</td><td>Voting Shareholders</td></tr>
<tr><td>Non-SOC PNFCs and PFCs with a governing board</td><td>Board</td><td>Treasurer</td></tr>
<tr><td>Non-SOC PNFCs and PFCs without a governing board</td><td rowspan="2">Accountable Authority as per section 2.7 of GSF Act</td><td rowspan="2">Treasurer</td></tr>
<tr><td>General Government businesses</td></tr>
<tr><td>Companies</td><td>Board or as per business's Constitution</td><td>Shareholding Minister(s)</td></tr>
</table>

Dividend Recommendation Letter – Content Checklist

The Dividend Recommendation Letter is to include the following:

- the amount of the dividend recommended (including nil dividend) in relation to the financial year
- a statement that explains the determination of the recommended dividend amount, which should include where applicable, the dividend payout ratio applied or consideration of the Minimum Credit Rating and Target Capital Structure
- any specific expectations or considerations relating to the determination of the dividend
- where applicable distributable NPAT specifying the intended adjustments to NPAT based on the estimated financial results of the year
- where applicable, the impacts of dividend payments on the business's credit rating
- reasons for variations if the dividend amount in the letter is different from previous estimates
- payment schedule if different from the timing listed in *Step 4: Payment of Dividend* of this policy.

The Letter should also include the following statement on behalf of the Board:

- the recommended dividend is not expected to place additional pressure on prices, service quality or future reliability.

Appendix 2: Legislative basis for borrowings and financial distributions

Borrowings

Government Sector Finance Act 2018

The Treasurer may give written approval for a GSF agency to enter into a financial arrangement under section 6.23(1) of the GSF Act. SOCs are GSF agencies under section 2.4. Under section 6.7, a financial arrangement includes a borrowing as defined in section 6.8.

The Treasurer may, by a written notice, revoke or vary a financial arrangement approval under section 6.23(7).

Borrowings for GSF agencies must be obtained from the New South Wales Treasury Corporation under section 6.24(1) except if as provided by under that section. The Treasurer may give written approval for borrowings of a specified kind to be obtained from a specified entity under section 6.24(3) of the GSF Act.

Financial distributions

The table below provides a summary of the legislative basis of financial distributions for different types of government businesses.

Types of Government Businesses	Relevant Legislation
Statutory SOCs	*State Owned Corporations Act 1989* is the prevailing legislative mechanism to authorise the dividend scheme. *Government Sector Finance Act 2018* can be enacted where a specific circumstance necessitates.
Non-SOC PNFCs and PFCs	*Government Sector Finance Act 2018*
General Government businesses	*Government Sector Finance Act 2018*
Companies	*Corporations Act 2001* (and any other relevant State legislation that operates concurrently with the *Corporations Act 2001*)

GSF Agencies

Government Sector Finance Act 2018

The Treasurer may direct a GSF agency (or part of a GSF agency) to pay financial distributions to the Treasurer under section 5.4 of the GSF Act.

Section 5.4(3) and (5) require the Treasurer to consult both the accountable authority and responsible Minister for the GSF agency about proposed directions and must, within 30 days after giving a direction, publish a notice in the Gazette setting out the amount of the financial distributions to be paid. In practice, in determining the dividends, the Treasurer consults the accountable authority and responsible Minister on dividend expectations, and the approach to determining the dividends and forecast dividend profile as part of the Budget and Statement of Intent process.

Section 5.4 of the GSF Act prevails if there is a contradiction between the GSF Act and an entity's enabling legislation.

Statutory State Owned Corporations

State Owned Corporations Act 1989

Under section 20S of the 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. For energy services SOCs, section 20S of the SOC Act does not apply, rather a share dividend scheme is to be determined by the Voting Shareholders in consultation with the board under Schedule 2 section 4 of the *Energy Services Corporations Act 1995.*

The dividends declared for a statutory SOC (or any of its subsidiaries) and payable to Voting Shareholders, are to be paid to the Treasurer, on behalf of the State, for payment into the Consolidated Fund under section 20S(4) of the SOC Act.

The Treasurer may direct a statutory SOC to pay financial distributions under the GSF Act. For example, if the shareholders' approval specifies an alternative dividend, in which case section 5.4 of the GSF Act may apply.

The SOC Act operates concurrently with the GSF Act in relation to statutory SOCs. Nothing in section 20S of the SOC Act affects the operation of section 5.4 of the GSF Act.

Appendix 3: Glossary

Term	Meaning
Accountable authority	Accountable authorities for GSF agencies as per section 2.7 of the *Government Sector Finance Act 2018.*
Board	The governing board as provided in the business' enabling legislation or the *State Owned Corporations Act 1989*. Certain government businesses do not have a governing board. 'Board' for these businesses refers to the accountable authority under the *Government Sector Finance Act 2018*, who is generally the head of the agency.
Capital repayment	A return of government's equity investments in a particular business generally determined in accordance with Principles 1 and 2 of this policy 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. The classification of capital repayments for Government Financial Statistics purposes is subject to Australian Bureau of Statistics definitions.
Credit rating	An evaluation of the creditworthiness of a business. The term 'credit rating' in this policy includes credit rating and its equivalences named differently by rating agencies.
Distributable Net Profit After Tax (NPAT)	NPAT adjusted for material non-cash items (including any associated tax effect) as agreed with Treasury. Non-tax paying entities have Net Operating Result, rather than NPAT.
Dividend	Annual distribution of a share of the profits or earnings generated by the business paid to the shareholders. The term 'dividend' in this policy also includes distributions in lieu of dividends paid by certain General Government businesses where these distributions are not a return on the Government's equity investment. The classification of dividends for Government Financial Statistics purposes is subject to Australian Bureau of Statistics definitions.
Dividend Recommendation Letter	A letter provided by the board of a business to the shareholder requesting shareholder approval of the recommended dividend to be declared for the current financial year.
Forecast dividend Profile	A government business's projected dividends, in line with the Government's expectations, over ten subsequent financial years.
Dividend scheme	Dividend scheme as per section 20S of the *State Owned Corporations Act 1989*.

Term	Meaning
Gearing ratio	A measure of a business's capital structure, which may be expressed as the ratio of net debt to Regulatory Asset Base (RAB) for a regulated SOC or as net debt to equity for other government businesses for the purposes of this policy.
Government businesses	In New South Wales, these include: • Public Non-Financial Corporations (PNFC) under ABS classifications. • Public Financial Corporations (PFC) under ABS classifications. • Businesses in the General Government sector (under ABS classifications) or part of a General Government agency that supply market goods and services, do not receive significant Budget funding and have been identified by Treasury as a General Government business. • Companies wholly owned by the government and incorporated under the *Corporations Act 2001* A list of all NSW Government entities, including the classification of the entities by sector, is available in the Classification of Agencies appendix to the annual NSW Budget Statement.
Minimum Credit Rating	A standalone credit rating of Baa2 / BBB (Moody's / Fitch or Standard & Poor's), unless a different level determined by Treasury following consultation with the business.
Regulatory Asset Base (RAB)	The value of assets calculated by the regulators to determine the prices the business could charge for its regulated services during the regulatory period.
Responsible Minister	Responsible Minister for GSF agencies as per section 2.6 of the GSF Act.
Statement of Intent	Under *Performance Reporting and Monitoring Policy for Government Businesses* [TPP18-02], it is defined as a: • Statement of Corporate Intent for SOCs that is agreed between the SOC Board and Voting Shareholders; or • Statement of Business Intent for other government businesses that is agreed between the business and the Treasurer and the responsible Minister (or their representatives). The Statement of Intent is supplemented by a Business Plan.
Shareholder	Certain government businesses may not have a shareholder(s) under legislation. The term 'shareholder' is used throughout the policy for simplicity. In this policy the term 'shareholder' is used for: 1) Statutory SOCs to refer to the Treasurer and another Minister nominated by the Premier as a Voting Shareholder under section 20H of SOC Act. The Premier can be nominated as a Voting Shareholder. 2) Non-SOC government businesses which do not have shareholder(s) to refer to the Treasurer and the responsible Minister. For determining the payment of financial distributions, the term 'shareholder' refers to the Treasurer given the Treasurer's power

Term	Meaning
	under section 5.4 of the GSF Act, but the Treasurer is not acting as a shareholder. 3) Companies incorporated under the *Corporations Act 2001* to refer to a Minister(s) holding shares for and on behalf of the State.
Statutory State Owned Corporations	State Owned Corporations listed in Schedule 5 of the *State Owned Corporations Act 1989*
Target Capital Structure	A capital structure agreed by a business and the Shareholder for the business to achieve or to maintain. It may be expressed for the purpose of this policy as the ratio of net debt to Regulatory Asset Base (RAB) for a regulated SOC or as net debt to equity for other government businesses.