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Financial Distribution Policy for Government Businesses

Policy & Guidelines Paper

Preface

The *Financial Distributions Policy for Government Businesses (Financial Distributions Policy)* is a component of the NSW Government's Commercial Policy Framework. The Framework's suite of policies aims to replicate in Government businesses the disciplines and incentives that lead private sector businesses toward efficient commercial practices.

The purpose of the *Financial Distributions Policy* is to outline the Government's expectations for the payment of dividends by Government businesses. 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 (SOCs). 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 in particular to clarify the critical link between the financial distributions and capital structure policies for Government businesses operating in a capital scarce environment.

The *Financial Distributions Policy for Government Businesses,* 2016 edition, supersedes the previously issued TPP14-4 and TC14-9. This revised policy applies to Government businesses from 1 July 2017, i.e. in relation to Statements of Corporate Intent for 2017-18 and financial years thereafter.

The revised *Financial Distributions Policy* supports the Government's broader policy goals, in particular maintaining the State's triple-A credit rating.

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NSW Treasury
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Note
General inquiries concerning this document should be initially directed to your relevant Government business' Treasury contact or the Commercial Assets section.
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Purpose of the policy

The *Financial Distributions Policy for Government Businesses (Financial Distributions Policy)* is a component of the NSW Government's Commercial Policy Framework. The Framework's suite of policies aims to replicate in Government businesses the disciplines and incentives that lead private sector businesses toward efficient commercial practices.

The key objective of the *Financial Distributions Policy* is for the Government to receive an appropriate return on its equity in Government businesses.

The policy seeks to:

- recognise the opportunity cost associated with the Government's equity investment
- balance consideration of returns to shareholders with capital structure
- maintain financial flexibility for the Government business to meet its financial commitments, including operating costs, capital expenditure and debt commitments
- enhance the transparency of, and accountability for, financial performance of Government businesses
- limit any special advantage or disadvantage a Government business may have over non-government competitors where applicable, in accordance with competitive neutrality principles.

Application of the policy

This policy applies to State Owned Corporations (SOCs) and other Government businesses as described in Appendix 1.

The *Financial Distributions Policy* operates together with other policies within the Commercial Policy Framework, in particular the *Capital Structure* and *Reporting and Monitoring* policies for Government businesses. Appendix 2 provides further details.

Financial distributions

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

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

Section 59B of the *Public Finance and Audit Act 1983* also provides the Treasurer with powers to determine a financial distribution, which is wider in scope than dividends determined, for example, under the *Corporations Act 2001* (Cth)[1].

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1 This policy is not intended to confine or restrict the powers of the Treasurer under section 59B of the Public Finance and Audit Act 1983 to require a prescribed statutory authority to pay such amount by way of dividend as the Treasurer may determine and notify to the statutory authority.

Other payments to Government

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

Dividends

The Government expects its businesses to pay distributions in the form of dividends.

SOCs and other businesses subject to the *Capital Structure Policy* are expected to pay dividends that over the medium term maintain their Target Capital Structure and Target Credit Rating under the *Capital Structure Policy for Government Businesses.* The forecast dividend profile will be derived from these considerations.

For Government businesses that are not subject to a Target Capital Structure, the forecast dividend profile agreed with the Shareholders should ordinarily be expressed as a dividend payout ratio, i.e. as a percentage of 'Distributable Net Profit After Tax' (NPAT)[2]. A dividend payout ratio of 70 per cent of distributable NPAT is to be used as the initial reference point for discussion.

The Government may, from time to time, as agreed in Cabinet or as part of the Budget, have specific expectations or considerations in regard to dividends 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 scheme.

Roles, responsibilities and timeframes under the *Financial Distributions Policy* are outlined in Appendix 3 and further guidance on the legislative and administrative requirements in relation to financial distributions is provided in Appendix 4.

Dividend scheme and forecast dividend profile

A Government business' dividend scheme and forecast dividend profile, in line with the Government's expectations, should be agreed as part of the Statement of Corporate Intent (SCI)[3] process. These should cover at least three financial years and be set taking into consideration the Target Capital Structure and Target Credit Rating, where applicable.

While the process for the dividend scheme and dividend profile is largely consultative, Shareholders[4] may determine dividend matters, including the declared dividend for each financial year, following consultation with the business.

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[2] Distributable NPAT is assessed and agreed between the Board and Treasury and included in the dividend recommendation by the Board. Requests for business specific adjustments to derive distributable NPAT should be provided to Treasury at the time of the dividend scheme negotiations and dividend recommendation (including a statement of the estimated amount of, and reasons for, each adjustment).

[3] In the absence of a SCI (or SBI) there should be an agreement in writing on the dividend scheme.

[4] The Treasurer solely determines financial distributions for non-SOC Government businesses in accordance the PF&A Act.

Other limitations on dividends

Ordinarily, the dividend amount is capped by the balance of retained earnings at year-end. Shareholders may specify further business specific considerations, in writing which must be considered when determining the dividend.

Recommendation and approval of dividend

The Board is to provide a dividend recommendation to Shareholders for the current financial year during May each year[5] .

Treasury, on behalf of the Shareholders, before the end of the financial year will then advise the Government business of:

- Shareholder approval of the dividend recommendation; or
- Shareholder approval of a dividend different to that recommended by the Board, providing the basis for the alternative dividend[6].

The declared dividend for the financial year will be the dollar amount specified in the Shareholders' approval and no further variation is allowed.

Payment of dividend

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

Ordinarily dividends are paid in two instalments on dates to be determined by the Treasurer:

- first instalment, comprising fifty per cent of the declared dividend, ordinarily paid prior to 1 August after year end.
- second instalment, comprising the remaining balance of the total declared dividend, ordinarily paid prior to 1 December after year end.

With Treasurer's approval, dividends may be paid on terms other than above. The letter of approval will specify both the source and the timing of these payments including whether it is made in one financial year or spread across multiple financial years.

Capital repayments

Capital repayments, as negotiated between Shareholders and the Board, may be made at any time following approval by Shareholders.

Capital repayments can be, but are not limited to:

- payments to Shareholders in order to achieve an appropriate capital structure determined in accordance with the Capital Structure Policy and/or capital structure reviews of the business.
- return of proceeds from the sale of a significant part of the business to shareholders.

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5 Or another time advised by Treasury e.g. to coincide with Budget estimate submissions.

6 In the event that the Shareholders' approval for a SOC specifies an alternative dividend recommendation, the Treasurer may elect to determine this by way of s 59B of the Public Finance and Audit Act 1983. Appendix 4 provides advice on this and other legislative bases for determining financial distributions.

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

Accounting for dividends and capital repayments

It is Treasury policy that Government businesses are to recognise dividends in the year to which they are declared and approved by Shareholders, even though payment may not occur until the following year.

Shareholder approval of the dividend to be declared by 30 June creates a present obligation that the dividend will be paid[7]. Government businesses are to ensure that Treasury has adequate time to arrange Shareholder approval of all dividend and capital repayments, before 30 June in the financial year to which they relate, so that the Government business can recognise these amounts in their financial statements at year-end.

7 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.

Appendix 1: Application of the policy

Statutory State Owned Corporations listed in Schedule 5 of the *State Owned Corporations Act 1989* are to apply the *Financial Distributions Policy* as a business subject to the Target Capital Structure under the *Capital Structure Policy*.

Companies wholly owned by the Government and established under the *Corporations Act 2001* (Cth) will be included as a business subject to the Target Capital Structure regime based on an assessment of each business by Treasury. Dividends are to be determined under the Corporations Act.

Non-corporatised Public Trading/Finance Enterprises (PTEs/PFEs) should apply the principles and practices of the policy to the extent practicable and agree their dividend scheme annually with Treasury and state the agreed policy and targets in their Statement of Business Intent (SBI).

General Government businesses or commercial business units of a general Government agency that operate under the Commercial Policy Framework 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 businesses pay distributions in lieu of dividends[8].

8 A commercial business unit of a general Government agency cannot make payments called "dividends" as they are not a stand-alone agency.

Appendix 2: Relationship with other commercial policies

The *Financial Distributions Policy* operates together with a number of other policies within the Commercial Policy Framework.

Capital Structure Policy

The *Financial Distributions Policy* and the *Capital Structure Policy for Government businesses* (*Capital Structure Policy*) are inextricably linked. Under the *Capital Structure Policy*, capital repayments are a form of financial distribution that may be used to achieve the Target Capital Structure. The *Capital Structure Policy* outlines the Government's expectations for the mix of debt and equity used to fund a Government business. Government businesses are expected to maintain an efficient capital structure consistent with the Target Credit Rating. Once the capital structure has been determined, it will influence dividends. The dividend scheme must take into consideration the agreed Target Capital Structure. Further, dividend payments are used to maintain the business' capital structure within the approved range.

Reporting and Monitoring Policy

The effective monitoring of Government businesses is a key element of the Commercial Policy Framework. The *Reporting and Monitoring Policy for Government Businesses* aims to enhance accountability in the management and control of Government businesses and provide clarity on reporting and monitoring requirements. It requires Government businesses to agree with Shareholders a Statement of Corporate/Business Intent (SCI/SBI), which includes agreement on the dividend scheme and forecast dividend profile, and provide regular reports on performance against targets agreed in their SCI/SBI. Further, it requires continuous disclosure of any information which may materially impact the operational and financial standing of the business.

A Social Program Policy for NSW Government Trading Enterprises

The Social Program policy is designed to improve the appropriateness and effectiveness of social policy expenditure. Where a Government business agrees to provide a community service obligation or other non-commercial activity, dividends should not be adjusted to fund these activities. Funding should be provided on an open and transparent basis through the State Budget process as a grant from the Portfolio Department which should be used to pay for the services purchased from the Government business (or other provider).

Appendix 3: Roles and responsibilities

Timing (Note 1)	**Role** (Note 2)	**Responsibility**
February - April	Confirm existing or negotiate revised Target Capital Structure (if applicable), dividend scheme and forecast dividend profile in SCI and Business Plan.	Shareholders and Board with support from Treasury and Management
May	Submit agreed dividend scheme and forecast dividend profile to Treasury	Board / Management
May	Provide current year dividend recommendation letter to Shareholders (Note 3).	Board
By 30 June	Approve the recommended dividend amount to be declared or alternative dividend to be declared (Note 3). Advise business.	Treasurer or Shareholders (as appropriate) Treasury
June	Submit SCI and Business Plan (which incorporate the dividend scheme and forecast dividend profile) to Treasury for signing by Shareholders.	Board / Management
By 31 July after year end	Pay in arrears the first instalment, comprising 50% of the declared dividend.	Board / Management
By 31 November after year end	Pay in arrears the second instalment, comprising the remaining balance of the total declared dividend.	Board / Management

1. Or another time advised by Treasury e.g. to coincide with Budget submissions.
2. The Statement of Corporate Intent Guidelines released by Treasury annually will provide more detailed guidance.
3. Critical date that must be met in order to recognise dividends in the year in which they are declared. The dividend will be the dollar amount specified in the shareholders' approval and <u>no further variation is allowed</u>.

Appendix 4: Legislative and administrative requirements

Legislative basis for financial distributions

The *Public Finance and Audit Act 1983* (PF&A Act) provides the legislative basis for certain financial distribution payments. Under section 59B of the PF&A Act, the Treasurer has the power to require a prescribed statutory authority to pay such amounts by way of dividend as the Treasurer may determine and notify to the statutory authority. Prescribed authorities include:

- statutory SOCs that are deemed so for this purpose under section 35A (3) of the *State Owned Corporations Act 1989* (SOC Act) and *PF&A Regulation 2015* section 16
- statutory authorities scheduled under the PF&A Act.

Statutory SOCs

Under section 20S(1) 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. This differs for energy services SOCs, 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 dividends declared for a statutory SOC (or any of its subsidiaries) are to be paid to the Treasurer for payment into the Consolidated Fund under section 20S(4) of the SOC Act.

In addition, the Treasurer may determine the dividend of a statutory SOC under the PF&A Act (if prescribed) e.g. in the event that the shareholders' approval specifies an alternative dividend recommendation. If the Treasurer requires the dividend payment to be made under the PF&A Act provisions, the Treasurer under section 20S(5) of the SOC Act is to publish notice in the Gazette setting out the amount of the dividend paid and the reasons for requiring the payment be made pursuant to the PF&A Act.

Company SOCs

For a company SOC[9], Schedule 2 clause 5 of the SOC Act requires the amount of the dividend and payment to be agreed between the Shareholders and the Board. Where they fail to agree, the voting Shareholders may determine the matter, by written notice, after consultation with the Board.

[9] Currently, there are no company SOCs scheduled under the SOC Act.

Dividend Recommendation letter

The Board is to provide a dividend[10] recommendation letter to the Shareholders concurrently with the provision of Budget estimates.[11] The dividend recommendation is to include, but is not limited to, the following:

- the dividend scheme 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 business' dividend scheme
- distributable NPAT specifying the intended adjustments to NPAT based on forecast financial results, where relevant
- the dividend recommended in relation to the financial year
- total dividend recommended
- reasons for variations from existing estimates of that 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.
- The recommended dividend is not expected to place additional pressure on prices, service quality or future reliability.

[10] Financial distribution, rather than dividend, for certain government businesses.

[11] Early to mid-May or another time advised by Treasury to coincide with Budget estimates submissions.

Glossary

Board: the governing board as provided in the business' enabling legislation or the *State Owned Corporations Act 1989;* or where the Government business does not have a governing board, the Chief Executive Officer/Managing Director undertakes the role of the Board.

Capital repayment: a return of the Government's equity in a particular business generally determined in accordance with NSW Treasury's Capital Structure Policy and 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. The classification of capital repayments for Government Financial Statistics purposes is subject to Australian Bureau of Statistics definitions.

Distributable Net Profit After Tax (NPAT): NPAT adjusted for material non-cash items (including any associated tax effect) as agreed with Treasury. For non-tax paying entities references to NPAT are to taken to refer to "Net Operating Result."

Dividend: annual distribution of a share of the profits or earnings generated by the business paid to the shareholders. The classification of the dividend payment for Government Financial Statistics purposes is subject to ABS definitions. The Government may also seek other dividends that can be separate to the annual dividend and it is not expected to be maintained over the foreseeable future. For example a dividend may be payable in regard to a particular event such as the sale of major individual asset, a Government policy decision and/or a significant change in financial or strategic circumstances.

Dividend Scheme: a statement of the expected dividends to be paid by the government business. Certain non-SOC Government businesses will have a distribution scheme, rather than dividend scheme, relating to the payment of their financial distribution.

Government businesses: in New South Wales include:

- Public Trading Enterprises (PTE) or Public Non-financial Corporations under Australian Bureau of Statistics (ABS) classifications;
- Public Financial Enterprises (PFE) or Public Financial Corporations under ABS classifications; and
- General Government (under ABS classifications) agencies or business units of an agency that supply market goods and services; do not receive significant Budget funding and have been identified by Treasury as a Government business.

Shareholders for:

- State Owned Corporations: the Treasurer and another Minister nominated by the Premier as a voting shareholder under the *State Owned Corporations Act 1989*.
- Non-corporatised Government businesses: the Treasurer and the relevant Portfolio Minister undertake the role of shareholders. For determining distributions the Treasurer acts solely as the shareholder given his powers under the PF&A Act.
- Companies established under the *Corporations Act 2001* (Cth): Minister(s), typically the Treasurer, holding shares for and on behalf of the Crown.

State Owned Corporation (SOC)**:** Government business (PTE or PFE) distinguished by its corporatised status having been listed in Schedule 5 of, and subject to, the *State Owned Corporations Act 1989.*

Statement of Corporate Intent (SCI): an agreement under the *State Owned Corporations Act 1989* between the SOC Board and Shareholders that holds the Board accountable for performance to the Shareholders and Parliament. The SCI is supported by a Business Plan. Other Government businesses are required to provide Treasury with a Statement of Business Intent (SBI) and a Business Plan, under the Commercial Policy Framework which is an agreement between the business and the Treasurer and Portfolio Minister (or their representatives). The term SCI is used to refer to the applicable Government business agreement, be that either the SCI or SBI.

Target Credit Rating: stand-alone credit rating of Baa2/BBB (Moody's/Standard & Poor's); or an alternative Target Credit Rating as determined by Treasury in consultation with the Government business under this policy.