



DIVIDEND POLICY
GUIDELINES FOR
GOVERNMENT
BUSINESS
ENTERPRISES

Treasurer's Instruction GBE 13-114-03

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PREFACE

The *Dividend Policy Guidelines for Government Business Enterprises* provide the guidelines for the payment of dividends by Government Business Enterprises (GBEs), in accordance with provisions of the *Government Business Enterprises Act 1995* (GBE Act), to ensure an appropriate return is made to the Government as owner.

These guidelines require, as a standard benchmark, a dividend distribution target of at least 50 per cent of after tax profit. These guidelines also provide that when considered appropriate by the Treasurer and the Portfolio Minister, alternative dividend distribution arrangements may be approved.

This policy supersedes the former *Dividend Policy for Government Business Enterprises*, issued in 1997, and applies to dividends payable in respect of the 2004-05 financial year and financial years thereafter.

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1 INTRODUCTION

Government businesses should achieve returns comparable to alternative investments of similar risk, and dividends should be at an appropriate level to reflect these returns.

The Government maintains a large equity investment in the portfolio of Government businesses as a result of the historic direct injection of capital and through indirect investment in the form of retained earnings. Each equity investment in a Government business carries an opportunity cost, being the benefit the Government forgoes from an alternative use of the equity. Accordingly, the Government expects its businesses to achieve returns that are comparable to alternative investments of similar risk, and for dividends to be at an appropriate level to reflect these returns. The Shareholder Value Added framework provides a measure of the required profitability for Government businesses.

Government businesses are not subject to share market and capital market scrutiny and thus do not have the incentives provided by share price movements and credit ratings to reflect the preference of the providers of equity and debt capital. The *Dividend Policy Guidelines for Government Business Enterprises*, therefore, convey the Government's dividend preferences and expectations to provide GBEs with the framework and discipline for making dividend payments.

Unlike dividends, guarantee fees and income tax equivalents do not represent nor constitute a return on the Government's equity investment.

Dividends represent a return on the Government's equity investment and are paid by GBEs from profits. In addition to dividends, the GBE Act requires GBEs to pay to the Government guarantee fees and income tax equivalents. Unlike dividends, guarantee fees and income tax equivalents are expenses incurred by GBEs, which are paid on the basis of competitive neutrality principles. The payment of these expenses does not represent nor constitute a return on the Government's equity investment - dividends are viewed in isolation of these expenses when assessing the annual performance of a GBE. The Government only considers total receipts from GBEs for the purposes of State Budget management.

2 ORDINARY DIVIDEND

2.1 Standard Benchmark

GBEs are required to adopt a dividend distribution target of at least 50 per cent of after tax profit.

As a standard benchmark, GBEs are required to adopt a dividend distribution target of at least 50 per cent of after tax profit.

In considering an appropriate annual dividend, Boards should have regard to the Government's preference for GBE profits to be distributed as cash, rather than retained as equity, given this is the prime means by which the Government can realise a return on its equity investment. It is therefore expected that GBEs will adopt a dividend distribution target in excess of the standard benchmark when appropriate, for example, when after tax profit is not required for capital adequacy or when after tax profit will not be used for investing in value adding opportunities.

From time to time, the Government may amend its dividend distribution requirements for GBEs.

2.2 Capital Considerations

The dividend paid by a GBE impacts on the available level of equity and therefore influences the GBE's capital structure, being the mix of debt and equity used to finance assets. A higher debt/equity ratio increases interest payments, reduces financial flexibility and the ability for the GBE to pursue identified value adding opportunities, and increases the exposure to interest rate fluctuations. At the same time, given the cost of equity is generally higher than that of debt, excessively low levels of gearing will provide a high cost of capital, thereby limiting the range of value adding opportunities available to the business.

The adequacy of a GBE's capital structure, and the impact of a dividend payment on the capital structure, is also important in the assessment of solvency, being the excess of assets over liabilities and the ability for the GBE to meet commitments as they fall due.

The consideration of an appropriate dividend arrangement by a Board should have regard to the progression towards, or maintenance of, an appropriate capital structure for the GBE.

The consideration of an appropriate dividend arrangement should have regard to the progression towards, or maintenance of, an appropriate capital structure. In developing a dividend policy, Boards should as a minimum consider:

- what is an appropriate level of debt/equity for the business; and
- what capital expenditure is required over the coming financial years and how this should be financed.

Information on the above should be supported by a capital structure review, which GBEs are required to conduct in accordance with Ministerial Charters.

When considered appropriate by the Treasurer and Portfolio Minister, a dividend distribution target alternative to the standard benchmark will be negotiated with the Board, on the basis of capital considerations of the GBE.

2.3 Profit Volatility and Dividend Smoothing

GBEs should manage transitory changes in earnings such that a reasonably stable stream of dividends is achieved.

As dividends are an important source of revenue for the State Budget, the Government expects GBEs to manage transitory changes in earnings such that a reasonably stable stream of dividends is achieved.

It is recognised that sometimes, reported profit may not be supported by cash flows. For example, in circumstances where investments are required to be measured at net market values, and changes in the investment values are required to be brought to account in the reporting period in which the change occurs, this can potentially impose large volatility in the net operating position without a supporting change to cash flows. Similarly, an actuarial adjustment of superannuation liabilities, or an asset revaluation, can generate variation in reported profits but not affect cash flows.

For the purposes of recommending a dividend, there may be times when it is considered appropriate by the Board to more closely align a dividend recommendation to an adjusted net operating profit after tax to reflect the operating cash flows generated by the business for the reporting period. This may be appropriate when intermittent events, such as an actuarial liability adjustment, a significant asset revaluation or a change in accounting standards, artificially increase or decrease operating profits without a supporting movement in cash flows.

For GBEs subject to large volatility in the annual operating result, the adoption of a suitable dividend smoothing arrangement may be appropriate.

For GBEs where there is a high chance that each year the annual operating result will be subject to largely volatility (eg through mark-to-market accounting of financial instruments), it may be appropriate for the dividend arrangement to include a suitable smoothing arrangement, for example:

- applying a distribution target to a moving five year average profit after tax; or
- adopting an annual minimum dividend in dollar terms.

A dividend smoothing arrangement operates by enabling a GBE to retain a comparatively high share of profits in surplus years for distribution in years when lower profits are achieved, thereby achieving greater stability of dividend payments. Dividend smoothing, by nature, may occasionally

require a GBE to pay a dividend in excess of current year profits, which would be met through earnings previously retained. Currently, this can only be achieved through special dividend arrangements. Although an anticipated amendment to the GBE Act will enable for the payment of an ordinary dividend from retained earnings in such circumstances.

A GBE must consult with the Treasurer and Portfolio Minister when it is considered that the adoption of a dividend smoothing arrangement would be beneficial.

2.4 Administrative Arrangements

2.4.1 Corporate Plan

Section 39 of the GBE Act requires GBEs to prepare a corporate plan. The Treasurer's Instructions require the corporate plan to include an estimate of the dividend that is likely to be recommended under section 83 of the GBE Act, in respect of the current financial year. The corporate plan is also to cover a minimum of three financial years, and contain a summary of the projected financial results in each financial year covered by the corporate plan.

GBEs are encouraged to include in the corporate plan information they consider appropriate for the determination by the Treasurer and Portfolio Minister of a dividend distribution arrangement, such as, details on what is an appropriate level of debt/equity for the business, how capital expenditure is proposed to be financed, and whether any forecast profit volatility should be addressed through a dividend smoothing arrangement.

GBEs are strongly encouraged to consult with Treasury during the corporate planning process when the Board is considering a deviation from the standard dividend distribution benchmark.

A corporate plan is to be provided to the Treasurer and Portfolio Minister 60 days before the end of the financial year, that is, by 30 April.

2.4.2 Determining a Dividend Distribution Arrangement

The consideration of an appropriate dividend distribution arrangement will occur during the corporate plan review process. Treasury will analyse the corporate plan, including capital programs, capital structure, profitability and earnings volatility and in consultation with each GBE, provide advice to the Treasurer and Portfolio Minister on whether, for the period of the corporate plan, the standard dividend distribution benchmark for calculating the annual dividend is satisfactory (ie dividend distribution target of at least 50 per cent of after tax profit) or whether an alternative arrangement should be considered. The dividend preferences of shareholders for the period of the corporate plan will also be considered when examining an appropriate dividend distribution arrangement for each GBE.

The Treasurer and Portfolio Minister will approve the dividend distribution arrangement for each GBE for the period of the corporate plan

In considering and approving each GBE's corporate plan, the Treasurer and Portfolio Minister will also approve the dividend distribution arrangement for the period of the corporate plan.

Further consideration of the methodology for calculating an annual dividend may occur at any stage if the financial circumstances of the GBE change significantly or if the dividend preferences of shareholders are revised. If a major revision of shareholder dividend preferences is anticipated for any particular financial year, the Treasurer and Portfolio Minister will seek to inform businesses during the corporate plan development process, to enable the revision to be accounted for within corporate plans.

2.4.3 Dividend Determination

Within 60 days following the end of each financial year (ie 29 August), the Board must advise the Treasurer and the Portfolio Minister of its recommendation for a dividend payable by the GBE in respect of the results for the financial year to which the dividend relates (section 83(1) of the GBE Act). The recommendation for the dividend payable should be in accordance with the approved dividend distribution arrangement.

Within 60 days of receiving a recommendation for a dividend payable, the Treasurer and Portfolio Minister will, under section 84(1) of the GBE Act:

- approve the recommendation;
- direct that no dividend be paid; or
- direct that an amount of dividend different from that recommended by the Board be paid.

2.4.4 Payment of a Dividend

A dividend determined in accordance with section 84 of the GBE Act shall be paid by the GBE after the financial year to which it relates on or before 31 December, or as otherwise directed by the Treasurer.

3 OTHER DIVIDENDS

3.1 Special Dividend

The Government may seek a special dividend from a GBE, which is payable from accumulated profits and/or capital reserves and represents a return of the Government's equity investment.

The Government may seek special dividends payable from accumulated profits and/or capital reserves, as provided by the GBE Act. The special dividend is unrelated to current year profits, and is in the nature of a return of excess reserves, capital or provisions to the Government, as owner.

In order for a special dividend to be paid under the GBE Act, the Treasurer and the Portfolio Minister must direct the Board, by notice provided to it, to pay a special dividend (section 86(1)). Before making such a direction, both Ministers must consult with the GBE and be satisfied that the GBE has sufficient liquid assets to meet its contingent and financial needs after it pays the special dividend. A direction to pay a special dividend takes effect only when it is approved by both Houses of Parliament (section 86(6) of the GBE Act).

3.1.1 Payment of a Special Dividend

A special dividend determined in accordance with section 86 of the GBE Act shall be paid by the GBE after the financial year to which it relates on or before 15 June, or as otherwise determined by the Treasurer.

3.2 Interim Dividend

Section 85 of the GBE Act provides that the Government may seek an interim dividend payable from the estimated profits of a GBE for the first six months of a financial year, after provision is made for any tax equivalents payable in respect of that period.

At any time after the completion of the first six months of the financial year, the Treasurer and Portfolio Minister, jointly, may require a Board by notice provided to it, to make a recommendation for the payment of an interim dividend on account of the dividend that may become payable for that financial year. Within 30 days after receiving notice, the Board must make a recommendation for the payment of an interim dividend to the Treasurer.

Within 30 days after receiving a recommendation from the Board, the Treasurer and Portfolio Minister, jointly, must:

- approve the recommendation;
- direct that no interim dividend be paid; or
- direct that an amount of interim dividend different from that recommended by the Board be paid.

3.2.1 Payment of an Interim Dividend

An interim dividend determined in accordance with section 85 of the GBE Act shall be paid by the GBE in the financial year to which it relates on or before 15 June, or as otherwise determined by the Treasurer.

4 TRANSITIONAL ARRANGEMENTS

These dividend policy guidelines apply to dividends payable in respect of the 2004-05 financial year and financial years thereafter. Therefore, Boards should include in the 2004-05 corporate plan the dividend distribution policy on the basis of these guidelines.

For Hydro Tasmania and Forestry Tasmania, which have specific dividend arrangements that expire in 2005-06 and 2006-07 respectively, these arrangements will continue to apply until their expiration. Following their expiration, dividend arrangements will be established in accordance with these policy guidelines.

For Tascorp and the MAIB, which have specific dividend arrangements with no defined expiration date, these arrangements will be applied for the determination of dividends payable in respect of the 2003-04 financial year. Commencing the 2004-05 financial year, these specific dividend arrangements will be rolled into arrangements in accordance with the new dividend policy guidelines. This will not necessarily mean there will be any change to those arrangements.

5 SUMMARY ADMINISTRATIVE ARRANGEMENTS

The following table summarises the administrative arrangements for the determination and payment of an ordinary dividend by GBEs.

No	Requirement	Due Date
1	<p>Submission of corporate plan to the Treasurer and Portfolio Minister.</p> <p>Corporate plan to include:</p> <ul style="list-style-type: none"> • A summary of projected financial results for a minimum of three years. • An estimate of the dividend that is likely to be recommended under section 83 of the GBE Act. • Any information considered appropriate for the determination by the Treasurer and Portfolio Minister of a dividend distribution arrangement. 	30 April
2	<p>Treasury analysis of corporate plan, including capital programs, capital structure, profitability and earnings volatility.</p> <p>Corporate plan consultation with GBE.</p> <p>Treasury recommendation to the Treasurer and Portfolio Minister of whether the standard dividend distribution benchmark for calculating the annual dividend is satisfactory (ie dividend distribution target of at least 50 per cent of after tax profit) or whether an alternative arrangement should be considered.</p>	30 April – 30 June
3	Approval of corporate plan, including the methodology for the calculation of an annual dividend for the period of the corporate plan.	As a general rule, within eight (8) weeks following the receipt of the corporate plan
4	Recommendation to the Treasurer and Portfolio Minister of a dividend payable in respect of the previous financial year.	29 August
5	Approval by the Treasurer and Portfolio Minister of the recommended dividend payable, or a direction that no dividend be paid, or a different dividend be paid.	Within 60 days of receiving a recommendation for a dividend payable
6	Dividend payable.	31 December