PUBLIC NON FINANCIAL CORPORATIONS

- COMMUNITY SERVICE OBLIGATIONS
- DIVIDENDS – CAPITAL STRUCTURE

POLICY GUIDELINES

GOVERNMENT OF SOUTH AUSTRALIA

OCTOBER 2004

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PUBLIC NON FINANCIAL CORPORATIONS OWNERSHIP FRAMEWORK

Policy Guidelines

October 2004

1. Introduction

These guidelines state the Government's policy framework for Community Service Obligations (CSOs), dividends and capital structure of Public Non Financial Corporations (PNFCs).

2. Application

Cabinet will consider the application of these guidelines to PNFCs on a case by case basis, commencing with SA Water and Forestry SA. The guidelines will not apply to core social service PNFCs that receive a substantial proportion of their funding from the budget. The guidelines will be introduced progressively from 2005-06.

3. Community Service Obligations (CSOs)

3.1 Policy Guidelines for CSOs

CSOs are defined in accordance with the definition adopted by the Steering Committee on National Performance Monitoring of Government Trading Enterprises, as follows:

A Community Service Obligation arises when a government specifically requires a public enterprise to carry out activities relating to outputs or inputs which it would not elect to do on a commercial basis, and which the government does not require other businesses in the public or private sectors to generally undertake or which it would only do commercially at higher prices.

Based on the definition above, the CSO policy incorporates the following key guidelines:

1. CSO payments will be made for all non-commercial activities that PNFCs are required to undertake.

2. The funding method will aim to ensure that there are incentives for the PNFC to provide CSOs efficiently.

3. CSO payments will be structured to have a minimum impact on incentives for the PNFC to provide commercial services.

4. Only 'best practice' avoidable costs will be funded. Best practice costs will be determined based on benchmarking and market testing where possible, and will recognise service quality parameters where these can be readily measured.

5. CSO payments will be transparent and clearly reported.

6. CSO amounts will be reviewed annually as part of the Budget process.

3.2 Identification and costing of CSOs

Avoidable cost methodology will be the basis for determining the costs of CSOs. The avoidable cost of providing a CSO is the sum of all the costs that could be avoided if the product or service were not provided.

A 'cost per unit of output' approach for each CSO will be determined as follows:

a) A '*cost per unit of output'* will be determined for each CSO activity by the PNFC. Output units would be units of the specific CSO service the PNFC is providing.

b) The Government would contract to purchase a level of output and agree on a price adjustment mechanism over time.

c) The business risks associated with variations in operational or replacement capital costs will be borne by the PNFC for the life of the contract.

Depending on the nature of the CSO (e.g. its degree of capital intensity) fixed long-term contracts, long-term contracts with set adjustment parameters, or short-term arrangements may be appropriate. The form of contract will be developed as part of the implementation phase.

4. Dividend policy

4.1 Policy Guidelines for dividends

The dividend policy framework incorporates the following key guidelines:

1. Dividends will be calculated with consideration of the capital structure targets for each PNFC.

2. Dividends will be paid based on actual, rather than budgeted, outcomes.

3. Dividends will be paid on an after tax profit rather than on a cash basis. Special dividends may be paid if determined to be appropriate by the Treasurer. Dividends will not exceed the accumulated surplus of the PNFC.

    - The effect of large once-off, accrual only transactions and increases in profit, that are not a result of the operational performance of the PNFC, will be considered on a case by case basis. This could include asset revaluation movements.

4. In determining their tax equivalent payments, PNFCs should seek to manage their taxation liabilities prudently, but must not adopt aggressive tax minimisation practices.

5. The dividend requirements of the Government as shareholder will be consistent with the approved capital structure bands for the PNFC.

6. There will be a consistent basis for the timing, process of payment and revision of dividends.

5. Capital structure

5.1 Policy Guidelines for capital structure

The capital structure of a PNFC will be determined based on the capital intensity of its operations and the riskiness of its operating revenue and expenses. Other criteria will also be considered, such as the impact of alternative asset valuation methods (eg historical cost, net present value, net market value) on business value, dividend requirements, credit rating objectives, the need for financial flexibility and the ability to finance approved capital expenditure.

Based on these factors, the policy position for capital structure incorporates the following key guidelines:

1. Capital structure bands will be determined for each PNFC. The width of the band will vary between PNFCs according to the volatility of cash flows and the characteristics of the market in which the business operates. A material bandwidth will be set to ensure the PNFC has sufficient operating and financial flexibility. In assessing the risk factors, the following types of risks will be considered:

    - Revenue risk
    - Input cost risk
    - Production risk
    - Regulatory risk

2. Capital structure bands will be set with sufficient width to allow for approved and unexpected capital expenditure, and changes in business operating conditions.

3. The capital structure plans approved by the Treasurer for each PNFC will be set for 4 to 5 years, with an annual review.