

**EXAMINATION OF SELECTED AUDITOR-GENERAL'S FINANCIAL AUDIT
REPORTS 2021**

Organisation: NSW Treasury

Date Received: 8 September 2022

NSW Treasury

Policy and Guidelines: Returns on Equity Investments

TPG22-28

6 September 2022

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Acknowledgement of Country

We acknowledge 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



Contents

- Returns on Equity Investments.....2**
- Purpose2
- Overview2
 - GFS principles and the expectation of a realistic rate of return.....3
 - NSW threshold for a realistic rate of return3
- Definitions.....3

Key information	
Treasury Policy and Guidelines (TPG) is relevant to?	<input type="checkbox"/> Government Sector Finance Agencies <input type="checkbox"/> General Government Sector <input type="checkbox"/> Public non-financial corporation <input type="checkbox"/> Public financial corporation <input checked="" type="checkbox"/> State Owned Corporations <input type="checkbox"/> Other
	<input type="checkbox"/> Executive agencies related to Departments
	<input type="checkbox"/> Subsidiaries of the NSW Government established under the Corporations Act 2001
Date issued	6 September 2022
Review date	6 September 2027
<input type="checkbox"/> Replaces <input type="checkbox"/> Replaced by	New Guidance
Issuing/Publishing entity	NSW Treasury
Related instrument(s)	
Document approver	Chief Finance and Operations Officer
Contact	Accounting Policy and Legislation, Financial Operations Group accpol@treasury.nsw.gov.au
Document contains	
<input checked="" type="checkbox"/> MANDATORY POLICY compliance set out by NSW Treasury.	
<input type="checkbox"/> RECOMMENDED POLICY reflecting best practice standards.	
<input type="checkbox"/> GUIDANCE/ADDITIONAL INFORMATION to provide clarity or explain requirements in detail.	

Revision history				
Document version number	Approval Date	Author	Approver	Description
V1	6/09/2022	Anne Bible, Principal Financial Analyst	Chief Finance and Operations Officer	

Returns on Equity Investments

Purpose

This guidance applies to the treatment of contributions from the General Government Sector (GGS) to State Owned Corporations (SOCs) for the purposes of:

- Preparing the budget papers and budget aggregates
- Preparing the Annual Consolidated State Financial Statements under s7.17 of the *Government Sector Finance Act 2018* (GSF Act).

It is important that State Owned Corporations (SOCs) also review and apply the relevant:

- legislation
- government policies and circulars e.g. Treasury Commercial Policy Framework
- Australian Accounting Standards (AAS)

This guidance does not apply to NSW government owned corporations that are not also State Owned Corporations (SOCs). Further guidance for government owned corporations that are not also SOC is under development.

Overview

In accordance with Government Finance Statistics (GFS) published by the Australian Bureau of Statistics (ABS)¹, this guidance considers the key criterion of ‘*realistic rate of return*’, when determining whether a transfer from an agency in the GGS to a SOC should be treated as either:

- (a) An increase in equity in the SOC; or
- (b) A capital grant to the SOC.

Applying the principles outlined in this guidance in practice will depend on the circumstances in each case and often requires significant judgement. Advice on the application of the principles to specific arrangements can be provided by Treasury’s Accounting Policy team.

Please note that all SOC are Public Non-financial Corporations (PNFCs) for the purposes of entity sector classification in the State’s Accounts. This guidance does not apply to PNFCs or Public Financial Corporations (PFCs) that are not also State Owned Corporations (SOCs).

The *Australian System of Government Finance Statistics: Concepts, Sources And Methods – 5514.0 – 2015* is referred to as the ABS GFSM in this paper.

¹ the ABS GFSM (ABS GFS Manual): 5514.0 - Australian System of Government Finance Statistics: Concepts, Sources and Methods, 2015

GFS principles and the expectation of a realistic rate of return

The relevant GFS principle that deals with returns is as follows:

Paragraph 13.63 ABS GFSM (emphasis added)

*“When a public sector unit intervenes by means of a capital injection other than a loan to the corporation in distress, the statistical **treatment depends on whether a realistic return can be expected on this investment or not...a realistic rate of return on funds is indicated by the intention to earn a rate of return that is sufficient to generate dividends or holding gains at a later date and that there is a claim on the residual value of the corporation...**”*

NSW threshold for a realistic rate of return

The minimum expected return to a corporation (SOC) on additional funding that is being provided to a corporation (SOC) via an equity or capital injection must be at least equal to **the long-term inflation rate** target as defined by the Reserve Bank of Australia².

If the returns were not expected to meet the threshold return at the time the equity investment was made, some or all of the payment would be treated as an expense (grant expense), not as equity. The amount treated as grant expense would depend on the expected level of return, relative to the investment.

Definitions

Term	Definition
AASB 1049	Accounting Standard AASB 1049 <i>Whole of Government and General Government Sector Financial Reporting</i> specifies the requirements for whole of government general purpose financial statements and General Government Sector (GGS) financial statements of each government. This Standard requires compliance with other applicable Australian Accounting Standards except as specified in this Standard. It also requires compliance with the ABS GFS where such compliance would not conflict with Accounting Standards.
Australian Bureau of Statistics (ABS)	The Australian Bureau of Statistics is the independent statutory agency of the Australian Government responsible for statistical collection and analysis and for giving evidence-based advice to federal, state and territory governments.
ABS GFSM	The Australian Bureau of Statistics (ABS) publication <i>Australian System of Government Finance Statistics: Concepts, Sources and Methods</i> as updated from time to time.
Corporation (for GFS purposes)	Government Finance Statistics (GFS) considers a corporation as an entity that is capable of generating a profit or other financial gain for its owner, is recognised by law as a separate legal entity from its owners, and is set up for the purpose of engaging in market production. There is no requirement for incorporation through the <i>Corporations Act, 2001</i> when determining whether an entity is a corporation for GFS purposes.

² <https://www.rba.gov.au/inflation/inflation-target.html>

Term	Definition
General Government Sector (GGS)	An ABS classification of entities that provide public services (such as health, education and police), or perform a regulatory function. General government entities are funded mainly by taxation (directly or indirectly).
Government Finance Statistics (GFS)	A system of financial reporting developed by the International Monetary Fund and used by the Australian Bureau of Statistics to classify the financial transactions of governments and measure their impact on the rest of the economy.
Government Sector Finance Act (GSF)	<p>The <i>Government Sector Finance Act 2018</i> (GSF Act) creates the financial management framework for the government sector in New South Wales that promotes and supports sound financial management, budgeting, performance, financial risk management, transparency and accountability in the government sector. This Act will eventually replace four other Acts:</p> <ul style="list-style-type: none"> • The GSF Act replaced the <i>Public Authorities (Financial Arrangements) Act 1987</i> from 1 December 2018. • With the commencement of the GSF Act financial reporting provisions on 1 July 2021, the <i>Public Finance and Audit Act 1983</i> (PF&A Act) financial reporting provisions have been repealed. Remaining provisions of the PF&A Act relate to the powers and functions of the Auditor-General and establishing the Audit Office, and the Public Accounts Committee. On 1 July 2021 the PF&A Act was renamed as the <i>Government Sector Audit Act 1983</i>. <p>It is scheduled to repeal the <i>Annual Reports (Departments) Act 1985</i> and <i>Annual Reports (Statutory Bodies) Act 1984</i> and commence the GSF Act annual reporting provisions on 1 July 2023.</p>
Public Financial Corporation (PFC)	An ABS classification of government-controlled entities that have one or more of the following functions: (a) that of a central bank; (b) the acceptance of demand, time or savings deposits, or (c) the authority to incur liabilities (such as insurance) and acquire financial assets in the market on their own account.
Public Non-financial Corporation (PNFC)	An ABS classification of government-controlled entities where user charges represent a significant proportion of revenue and the agencies produce goods and/or services on a commercially orientated basis.
State Owned Corporation (SOC)	Certain NSW government entities with a corporatised governance structure similar to that of a publicly listed company. A SOC is established under enabling Act. NSW SOC's are scheduled under the <i>State Owned Corporations Act 1989</i> (Schedule 5). SOC's have a PNFC classification.

52 Martin Place
Sydney NSW 2000

W: treasury.nsw.gov.au

GPO Box 5469
Sydney NSW 2001

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