

The Treasury

Mixed Ownership Model for Crown Commercial Entities: Treasury Advice Information Release

4 September 2012

Release Document

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Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people
- [2] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information, or who is the subject of the information
- [3] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.



CROWN OWNERSHIP
MONITORING UNIT

Treasury Report: Accounting for Mixed Ownership

Date:	21 November 2011	Report No:	T2011/2433
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Indicate if you require a more detailed briefing.	None
Minister for State Owned Enterprises (Hon Tony Ryall)	Indicate if you require a more detailed briefing.	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Brian McCulloch	Director, Commercial Transactions	[1]	✓
Nicola Haslam	Senior Accounting Policy Advisor	[1]	

Minister of Finance's Office Actions (if required)

None.

Enclosure: No

Treasury Report: Accounting for Mixed Ownership

This report summarises the likely accounting treatment of mixed ownership in the Financial Statements of the Government, should the Government decide to implement mixed ownership of State owned enterprises.

The Government has announced that the Crown would retain a controlling interest in the mixed ownership firms. As a result, these firms will be fully (100%) consolidated, on a “line-by-line” basis, in the financial statements, as they currently are, with the portion attributable to the minority interest shown separately.

The table in the Appendix to this report summarises the main direct and indirect implications, both of the immediate effect of a sale, and of ongoing mixed ownership. These changes are to the current position rather than to the fiscal forecasts, which include new capital spending in the next five budgets being funded from the existing balance sheet.

The key implications are:

- Core Crown Expenses and the current OBEGAL measure are largely unaffected by a sale, except for indirect transaction costs (e.g. scoping studies), which would marginally worsen the OBEGAL deficit in the year of sale. On an ongoing basis, there is just a second-order effect to the extent that the sale proceeds help to reduce the Crown's finance costs, thus slightly improving OBEGAL. Consideration is currently being given to introducing a new indicator of “OBEGAL excluding minority interests”. This new indicator would be affected by the loss of the proportion of OBEGAL surplus now retained by minority interests.
- The Operating Balance includes the above effects, as well as the deficit being decreased (or increased) by any gain (or loss) in the year of sale. On an ongoing basis, the operating balance deficit would be worsened (or improved) by the proportion of the mixed ownership firm's operating surplus (or deficit) attributable to the minority interest.
- Total Net Worth would be increased by the amount of net sale proceeds.

There would also be consequential impacts on residual cash and net debt.

Recommended Action

We recommend that you:

- a **Indicate** if you require a more detailed briefing at this stage.

Yes/No.

Dr Brian McCulloch
Director, Commercial Transactions

Hon Bill English
Minister of Finance

Hon Tony Ryall
Minister for State Owned Enterprises

APPENDIX: ACCOUNTING FOR MIXED OWNERSHIP: SUMMARY OF EFFECTS

The following table describes the likely fiscal impacts of the proposed Mixed Ownership Model.

The table assumes:

1. The current definition of OBEGAL remains unchanged (i.e. includes total revenue and expenses of State-owned Enterprises (SOE's)).
2. Proceeds are used to reduce debt (rather than increase financial assets).
3. The gain (or loss) on sale is net of transaction costs directly attributable to that sale.
4. The gain (or loss) on sale will be recognised in the gains and losses section of the operating statement.

	Immediate effect on sale	Subsequent to sale
Operating Statement		
Core Crown expenses	<ul style="list-style-type: none"> Increased for transaction costs not directly attributable to the sale (e.g cost of scoping studies). 	<ul style="list-style-type: none"> Reduction in finance costs from debt reduction.
OBEGAL ¹	<ul style="list-style-type: none"> Deficit increased by any increase in for transaction costs not directly attributable to the sale (both core Crown and SOE expenses). 	<ul style="list-style-type: none"> Deficit reduced by decrease in finance costs.
Operating balance ²	<ul style="list-style-type: none"> Deficit increased by any increase in expenses for indirect transaction costs (both core Crown and SOE expenses). Deficit decreased (or increased) by gain (or loss) on sale³ 	<ul style="list-style-type: none"> Deficit reduced by decrease in finance costs. Deficit increased (or decreased) by the proportion of the SOE operating surplus (or deficit) attributable to minority shareholding.
Financial Position		
Total Crown assets	<ul style="list-style-type: none"> No change 	<ul style="list-style-type: none"> No further change.
Total Crown liabilities	<ul style="list-style-type: none"> Borrowings would reduce by the amount of sale proceeds. 	<ul style="list-style-type: none"> No further change.
Net worth attributable to the Crown	<ul style="list-style-type: none"> Increase (or decrease) by the gain (or loss) on sale. 	<ul style="list-style-type: none"> Increase (or decrease) reduced by the proportional increase (or decrease) in the net worth of SOE that is attributable to the minority interest.
Net worth attributable to minority interests	<ul style="list-style-type: none"> Increase by the book value of portion of SOE sold. 	<ul style="list-style-type: none"> Increase (or decrease) for proportional increase (or decrease) in the net worth of SOE.
Total net worth	<ul style="list-style-type: none"> Increased by the amount of sale proceeds. 	<ul style="list-style-type: none"> No further change.
Other Fiscal Indicators		
Residual cash	<ul style="list-style-type: none"> Cash deficit decreased (or surplus increased) by the amount of sale proceeds (assuming proceeds are passed back to the centre). 	<ul style="list-style-type: none"> Cash deficit increased (or surplus decreased) by the proportion of dividends paid to minority interests (previously paid to the Crown). Cash deficit decreased (or surplus increased) by reduced finance costs.

¹ Total Crown operating balance before gains and losses

² Total Crown operating balance after gains and losses

³ Costs directly attributable to the sale may be deducted from the sale proceeds when calculating any gain or loss on sale

	Immediate effect on sale	Subsequent to sale
Other Fiscal Indicators		
Net debt ⁴	<ul style="list-style-type: none"> Decreased by the amount of net sale proceeds. 	<ul style="list-style-type: none"> Decrease (or increase) for ongoing residual cash impacts.
Gross debt ⁵	<ul style="list-style-type: none"> Decreased by the amount of net sale proceeds. 	<ul style="list-style-type: none"> Decrease (or increase) to the extent ongoing residual cash impacts the borrowing programme.

Points to note:

1. The companies partially divested under the Mixed Ownership Model will continue to be fully consolidated in the Government's financial statements. This treatment reflects that the Crown maintains control of these companies. As a result, 100% of the company's revenue, expenses, assets, and liabilities are disclosed in the financial statements. The minority interest portion of this revenue, expenses, assets, and liabilities is also disclosed.
2. Given the minority interest portion is likely to become material, consideration is currently being given to whether an "OBEGAL (excluding minority interests)" measure is disclosed instead of, or as well as, the current "OBEGAL indicator". If "OBEGAL (excluding minority interests)" was disclosed the impacts would be as follows:

	Immediate effect on sale	Subsequent to sale
Operating Statement		
OBEGAL (excluding minority interests)	<ul style="list-style-type: none"> Deficit increased by any increase in expenses (both core Crown and in the SOE). 	<ul style="list-style-type: none"> Deficit reduced by decrease in finance costs. Deficit increased (or decreased) by the proportion of the SOE OBEGAL surplus (or deficit) attributable to minority shareholding.

3. Dividend income from SOE's does not impact on the operating balance as they are fully consolidated at a total Crown level. However, dividend receipts do impact residual cash as this is a core Crown measure.
4. The above table reflects changes to the current fiscal performance and position of the Crown rather than the fiscal forecasts. The latest forecasts include the estimated impact of current Government policy that new capital initiatives in the next five years will be funded from the existing balance sheet. This assumption results in a reduction in net debt and the consequential reduction in finance costs. The impact of the Mixed Ownership Model on fiscal forecasts will therefore be the difference between the impacts in the table above and what is currently forecast.

For example, it is probable that the cash proceeds of the Mixed Ownership Model will precede the funding requirements for new capital initiatives. Therefore, debt is likely to reduce sooner than currently forecast.

⁴ Net core Crown debt excluding the New Zealand Superannuation Fund and advances

⁵ Gross sovereign-issued debt excluding Reserve Bank settlement cash