

# Frequently asked questions – Equity investments

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## Frequently asked questions

The following answers provide general information only. Some equity investment programs may be more complex in practice or have specific requirements. It is important that entities also review and apply the relevant:

- legislation
- government policies
- Australian Accounting Standards (AAS).

## Equity investments

### **Q1. What is an equity investment by the Australian Government?**

An equity investment is where the government takes an ownership interest in an entity in anticipation of future returns (via dividends and/or capital returns). The entity must be outside the General Government Sector (GGS).

### **Q2. Why does the government undertake equity investments?**

Equity investments are made to support the achievement of government policy objectives – the purpose of an equity investment could be to:

- put money aside for future expenditure (e.g. Future Fund, which is a financial asset fund set up to provide for unfunded superannuation liabilities)
- undertake an activity as a separate business (e.g. Australia Post)
- participate in an international organisation as an equity subscriber (e.g. the International Development Association, which offers concessional loans and grants to the world's poorest developing countries).

### **Q3. Are equity investments by the government a recent development?**

No. Equity investments have been used in Australian public policy for many decades.

### **Q4. Are there non-government shareholders in government owned businesses?**

There are no prohibitions on the government accepting outside shareholders in a business that it owns and controls. For example, prior to the sale of the government's controlling interest in Telstra, Telstra had outside shareholders and its shares were listed on the Australian Stock Exchange.

### **Q5. What is the Australian Government's biggest equity investment program?**

The government's biggest equity investment program is the Future Fund. The Future Fund includes equities in the mix of investments that it makes to meet its objective to assist in funding future public sector superannuation payments.

### **Q6. How does the government approve a new equity investment in a government-owned business?**

New equity investments in government-owned businesses are approved by the government as part of its ongoing processes.

**Q7. Is there an assessment process for proposals to invest equity in a government-owned business?**

Yes. The government will usually consider a business case (a study of the relevant business prospects) before making the investment. The government will often publicly release part of the business assessment, excluding commercially sensitive information.

**Q8. What terms and conditions apply to equity investments in a government-owned business?**

There is a threshold requirement that an investment will only be recorded as an asset if there is an expectation the government's investment in the business will be returned – see Q10 for the [threshold return test](#).

Many government-owned businesses are Government Business Enterprises (GBE) and are required to follow the GBE guidelines. Other terms and conditions, including dividend policy, are determined on a case by case basis, as outlined in the GBE Guidelines.

**Q9. Does the government monitor the performance of government-owned businesses?**

Yes. While most government-owned businesses have boards that make their own business decisions, performance is monitored jointly by the responsible government department and the Department of Finance.

## Accounting for equity investments

**Q10. How does the threshold return test work and what is its basis?**

The government treats an investment in a government-owned business as equity if it meets a minimum level of financial return – the threshold return. This minimum level of financial return is the rate of inflation, known as a return in 'real' terms.

The return is calculated by comparing the current values of equity injections provided by the government, with the current value of returns that the government will receive in the form of dividends, capital returns and proceeds of sale (if any).

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.

**Q11. How does the government record equity investments in its accounts?**

In GGS accounts, equity investments are recorded as financial assets, in the same way that commercial businesses record equity investments.

**Q12. Does making an equity investment affect the underlying cash balance (UCB)?**

Making an equity investment, as long as it meets the threshold return test, does not initially affect the UCB. This is because transactions in financial assets have no impact on the UCB. Similarly, when the government redeems or sells its equity in a business, it does not affect the UCB.

### **Q13. Does any aspect of an equity investment affect the UCB?**

Yes. Dividends received on the investment are classified as government revenue and improve the UCB.

The interest on money the government borrows to finance an investment in a government-owned business is a government expense, and worsens the UCB. However, as the government borrows globally and not for individual programs, the interest expense for equity investments is not itemised separately.

### **Q14. How does the government value equity investments?**

Equity investments are valued at market value. The accounting term for this is “fair value”.

Equity investments in GBEs in the GGS are calculated using discounted cash flows, if these can be reliably measured. If not, the investment is recorded at its share of the net assets (assets less liabilities, adjusted to fair value) of the business.

Examples of circumstances when it might not be possible to reliably determine future cash flows include where it is a new business (a “start-up”), or a business that has significant fluctuations in profit because of the market in which it operates.

### **Q15. How are changes in the fair value of equity investments treated?**

A change in the value of an equity investment does not change:

- the amount of the government’s holdings in these investments
- the nature of the investment
- the classification of the funds by the entity that has received it.

Because this is only a valuation change, it is included in the operating statement in a separate category called “other economic flows” along with other changes in asset or liability valuations caused by factors such as changes in exchange rates or interest rates.

Valuation changes do not impact the UCB.

### **Q16. Can the government write-down the value of its equity investments?**

Under the AAS the government cannot unilaterally write-down any assets, including equity investments – the government only writes down equity investments where the AAS provide for this.

Several accounting standards detail requirements for the write-down of assets under various circumstances. In essence, these require evidence of the need to write-down the value and prescribe the methods for calculating the write-down.

### **Q17. How do equity investments affect the government’s debt position?**

Net debt is the sum of interest bearing liabilities less the sum of selected financial assets (cash and deposits, advances paid, and investments, loans and placements). While equity is not included in the calculation of net debt, changes in selected financial assets associated with equity investments affect net debt.

Equity investments affect the government’s net debt position in several ways. For example, when:

- the government borrows money to invest in equity in government-owned businesses, net debt worsens (because borrowings increase)
- the government redeems or sells equity in government-owned businesses, net debt improves (because cash increases)
- if an investment fund, such as the Future Fund sells:

- selected financial assets to increase its holdings of equities, net debt worsens
- equity to increase its holdings of selected financial assets, net debt improves.

#### Q18. What assurance arrangements support the government in correctly accounting for equity investments?

The government's assurance arrangements include that:

- under subsection 42(2) of the *Public Governance, Performance and Accountability Act (PGPA) 2013*, annual financial statements (which include equity investments) must comply with AAS
- the Auditor-General:
  - audits the government's accounts every year and examines both equity values and the dividends received from them
  - has the power to undertake audits of the performance of government programs
- the Australian Bureau of Statistics (ABS) may review the classification of items when compiling Government Finance Statistics.

#### Q19. Where do equity investments appear in the 2021-22 Consolidated Financial Statements (CFS) and Budget Paper 1 (BP1) of the 2023-24 Budget?

Australian Government budget financial statements appear in Statement 10: *Australian Government Budget Financial Statements* in BP1 2023-24. Financial statements of actual outcomes appear in the Monthly Financial Statements, Final Budget Outcome and Consolidated Financial Statements.

Since the government has many millions of transactions each year, the financial statements provide a high-level summary of those financial transactions to present a concise overall picture of government finances. As a consequence, equity investments are not separately itemised.

The following is a quick guide to the lines in 2021-22 CFS and 2023-24 Budget where the most common transactions and balances in equity investments are included:

Equity investment information	2021-22 CFS and 2023-24 Budget, BP1 Reference
Amount of equity investments held	<b>Balance sheet</b> – <i>Equity investments</i> (page 165, CFS and page 353, Table 10.2, BP1)
Amount of equity invested/repaid during a year for government –owned business	<b>Cash flow statement</b> - <i>Net cash flows from investments in financial assets for policy purposes</i> (page 167 CFS, and page 355, Table 10.3, BP1)
Amount of equity invested/repaid during a year for the Future Fund and other investment funds	<b>Cash flow statement</b> – <i>Net cash flows from investments in financial assets for liquidity purposes</i> (page 167 CFS, and page 355, Table 10.3, BP1)
Dividend revenue received	<b>Cash flow statement</b> – <i>Dividends, distributions and income tax equivalents</i> (page 167 CFS, and page 355, Table 10.3, BP1)
Dividend revenue due each year (accrual accounting)	<b>Operating statement</b> – <i>Dividend and distribution income</i> (page 162, CFS, and page 351, Table 10.1, October BP1) and <i>Interest and dividend and distribution revenue</i> (Note 2C, page 66, CFS and Note 5, page 374, BP1)
Valuation changes each year on government-owned businesses	<b>Operating statement</b> – <i>Revaluation of equity investments</i> (page 162, CFS and page 352, Table 10.1, BP1)
Valuation changes each year on other equity investments	<b>Operating statement</b> – <i>Other gains/(losses)</i> (page 162, CFS and page 351, Table 10.1, BP1)

Amounts expected to be provided as an equity injection in government-owned businesses, or equity redeemed – that is, the new amounts invested or repaid each year –are included in *Table 3.4: Reconciliation of general government sector underlying and headline cash balance estimates* (page 109 of BP1, 2023-24 Budget).

The list of government-owned businesses that currently satisfy the technical definition of a “public corporation” appears at *Table A10.1: Entities outside the general government sector – 2022-23* (page 389 of BP1, 2023-24 Budget).

Further information about the accounting and valuation of individual equity investments is usually located within the financial statements of the administering government department, rather than the Budget Papers or MYEFO. An exception to this is where an equity injection will be made or redeemed during the forthcoming budget year which, as noted above, is reported in *Table 3.4: Reconciliation of general government underlying and headline cash balance estimates* (page 109 of BP 1, 2023-24 Budget).

The Future Fund publishes quarterly portfolio updates, which are available on its website. The Future Fund website also includes information about its investment policy and practices.

*Disclaimer: These questions and answers provide simplified and general advice. Equity investment programs and the accounting for them can be more complex in practice. They may be governed by legislation, government policy and accounting standards, which must be reviewed to obtain full information about equity investments.*