

STATEMENT OF CORPORATE INTENT 2012-2014



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This statement has been submitted by the Board of KiwiRail in accordance with Section 14 of the State-Owned Enterprises Act, 1986. It sets out the Board's intentions and objectives to June 2014.



KiwiRail, a State Owned Enterprise, was formed in 2008 when the Crown purchased the rail and ferry operations from Toll NZ Ltd and the mechanical services operations from United Group in 2009, to combine with the Crown owned rail network ONTRACK. The outcome was a vertically integrated, state owned, rail and ferry business similar to that in place in the early 1990s.

KiwiRail has since developed a strategic plan (Turnaround Plan) with the objective to build, over 10 years, a business able to meet its long run investment requirements, following an initial investment period from the Crown. This prioritised investment plan includes upgrading the network, rolling stock, plant, equipment, facilities and systems.

The plan will be delivered by improving reliability, timeliness and providing more flexible services underpinned by the implementation of an organisation-wide customer focused culture. This will attract more freight and enable yield growth.

The 2011 financial year was the first full year of implementing the Turnaround Plan (TAP). Like many businesses, the last 12 to 18 months have been remarkably challenging with a flat economy following the Global Financial Crisis and unprecedented, tragic events such as the Christchurch earthquakes and Pike River Coal mine explosion. Overall these have had a negative impact on our performance; however, we have been encouraged by many aspects of the past year including substantial support from our customers resulting in excellent growth in our domestic and import/export (IMEX) freight markets. We have also made strong progress on our asset investment plans. Further insights into key performance outcomes for the 2011 financial year are included in section 5 of this statement.

Progress has also been made in other areas where KiwiRail has responsibility. We have completed negotiations with the Greater Wellington Regional Council (GWRC) on the transfer of above rail assets (Passenger trains, suburban stations, etc.) with effect from 30 June 2011. We have also commenced an extensive review of the KiwiRail balance sheet to determine the most appropriate commercial carrying value of assets. Major projects have continued to be managed by KiwiRail such as the Wellington Regional Rail Programme (WRRP), Auckland network electrification and development, and Auckland Electric Multiple Units (EMUs) procurement.

This Statement of Corporate Intent (SCI) reconfirms KiwiRail's commitment to the TAP albeit on a slightly modified delivery path to that outlined last year, as we accommodate a lower funding profile through fully absorbing our debt costs and adjusting for the 2011 financial year EBITDA shortfall. The fundamental drivers used to develop the original plan are still intact such as long run freight demand projections and modal shift opportunities on the network backbone (Auckland to Christchurch).

KiwiRail operates as a single entity with multiple business units. Key elements of the business are:

- **KiwiRail Freight** – provides rail freight services and locomotives for passenger services. This includes:
 - The movement of bulk freight such as export coal, milk, steel, meat, horticultural products and forestry
 - The movement of containerised freight for import and export and domestic full container load customers
 - Auckland Metro Maintenance, which provides locomotive engineers and maintains rolling stock (through KiwiRail Mechanical) for Veolia Auckland Transport Ltd
- **Interislander** – operates the ferry passenger and freight services. This includes:
 - Three “roll-on, roll-off” ferries (two of which have rail capacity) carrying rail freight, commercial vehicles, passenger vehicles and foot passengers
- **KiwiRail Passenger** – provides urban passenger services in Wellington and long distance passenger rail services. This includes:
 - Tranz Scenic, which operates the TranzAlpine, Coastal Pacific, Overlander and Capital Connection long distance passenger services as well as special charter services
 - Tranz Metro, which provides urban passenger services under contract to the Greater Wellington Regional Council (GRWC)
- **KiwiRail Mechanical** which includes:
 - The Hillside and Hutt Workshops, for heavy engineering maintenance and specialised manufacturing
 - Maintenance and service repairs to rolling stock (locomotives, wagons, EMUs, DMUs and carriages) for Freight, Tranz Scenic, and the Wellington and Auckland Metro operations
- **KiwiRail Network**
 - Maintains the rail network and controls the operation of trains on the network
- **KiwiRail Corporate**
 - Provides support services to all business units
 - Manages KiwiRail’s extensive property portfolio including both operational and commercial property holdings

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NATURE AND SCOPE OF THE BUSINESS

The business activities of KiwiRail over the next three years will be:

- To own and operate a national rail network
- To provide for the transport of bulk and consolidated freight
- To provide inter-island ferry services (forming the 'bridge' between the North and South Islands) for rail, commercial freight, and passenger services and their vehicles
- To provide rail passenger services in metropolitan areas and long distance services for both domestic and tourist markets
- To manage and develop property holdings for rail operations and appropriate third party land use
- To develop, where appropriate, rail and ferry services and intellectual property in expanded markets
- To undertake or participate in business activities which add value for customers and leverage the capabilities of KiwiRail.

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CORPORATE RESPONSIBILITY COMMITMENT

KiwiRail's commitment to corporate responsibility has been defined across five impact areas:

- To deliver to our customers what we have promised; we will listen to them and involve them in our solutions and innovations
- To be a good employer, treating our people fairly and with respect, and valuing their diversity. We are committed to creating a workplace that makes people want to join, stay and work to their full potential. Our commitment to the safety and well-being of our people is a priority
- To work with our suppliers to develop long term partnerships based on best practice procurement methods which reflect mutually agreeable codes of conduct
- To recognise the environmental, social and economic needs of the communities we work in and endeavour to be a good neighbour. We will involve relevant communities in initiatives we implement
- To help protect the environment by better understanding, managing and measuring our environmental impacts and minimising the carbon intensity of our services. We will do this by commissioning new, more fuel efficient locomotives, increasing our focus on fuel saving behaviour and opportunities to improve efficiency, and the completion of some of the big Metro Projects including Auckland metro electrification. Targeted reductions in GHG emissions per NTK from rail freight traction energy are shown in Table 7.1(v).

KiwiRail Group Financial Performance	2011 Forecast	2011 SCI Target	2010 Actual
External Revenue (\$m)	667.4	685.2	650.4
EBITDA (\$m)	100.3	120.8	77.8

While our EBITDA performance is forecast to be \$20.5 million short of the plan target of \$120.8 million, New Zealand experienced extraordinary circumstances during the 2011 financial year that affected many businesses, including KiwiRail. Of the EBITDA shortfall, \$11 million is directly attributed to the impact of the Christchurch earthquake on our passenger and freight services and the loss of Pike River Coal volumes following the tragic explosion. A further \$4.9 million relates to the recently announced Mechanical restructure.

Excluding the factors above, our rail freight team has performed well with the domestic and IMEX categories growing revenue by over 8.6% compared to the 2010 financial year. Our bulk category has also grown with good performances in forestry, offset by lower coal volumes and lower liquid milk demand through the dry summer in the lower north island.

Our Interislander business is performing to plan with growth in rail freight and commercial vehicle markets, offset by a softer passenger market.

Expenditure has been well managed, with additional costs accommodated, as we continue to drive customer service standards through undertaking initiatives such as "road bridging" and replacement ferry capacity to cover network outages through planned and unplanned events (such as the Christchurch earthquakes and Kaikoura slip).

Asset Investments:

In line with our 2011 financial year objectives we progressed a range of capital expenditure projects to improve service reliability, capacity and/or efficiency:

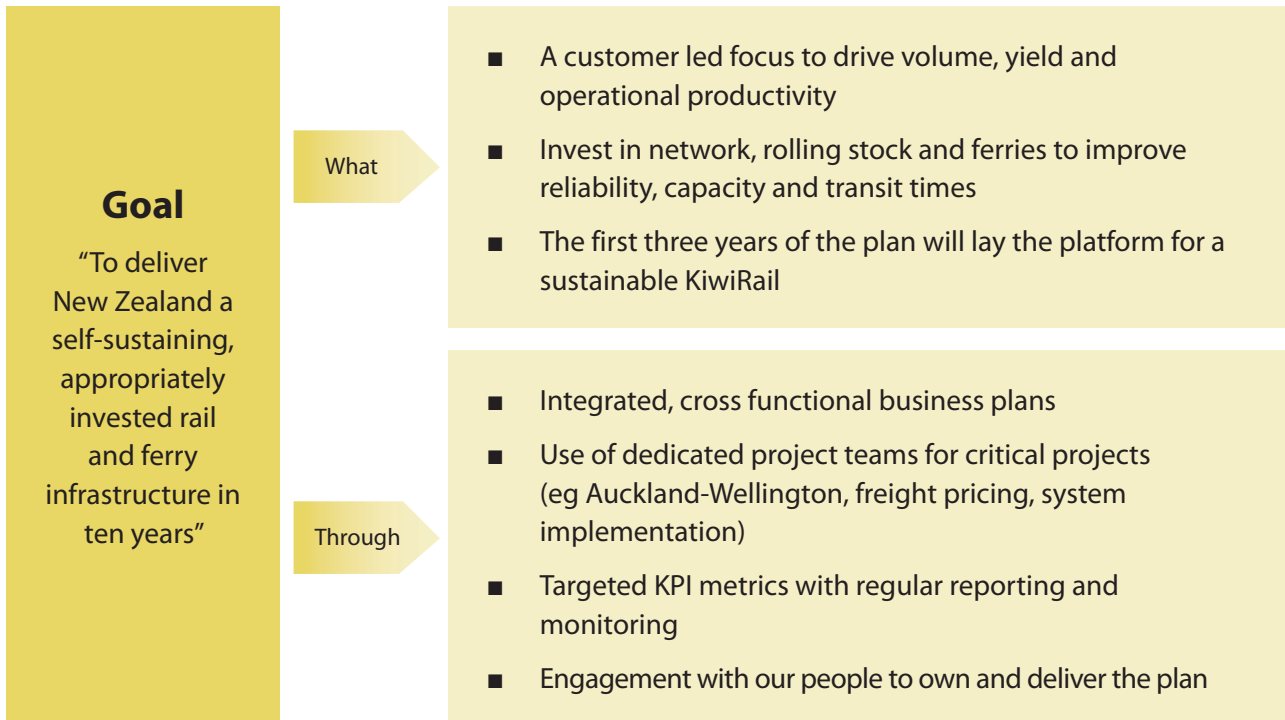
- *MV Aratere* - a 30m extension of the ship along with power and bow improvements to be back in service by September 2011
- Locomotives – the first 20 new DL locomotives have arrived and will progressively enter service through the first quarter of the 2012 financial year
- Flat deck Wagons – 535 new wagons in construction for delivery for the upcoming 2012 financial year peak rail freight season
- Intermodal Containers - construction and delivery of 258 curtain sided, caged containers in time for the 2012 financial year peak
- North/South Junction Tunnels – successful lowering and upgrades to the tunnels between Paekakariki and Pukerua Bay
- Network Renewals – completed to plan, with resulting improvements on our temporary speed restriction (TSR) limits
- Exploring partnership opportunities for the Tranz Scenic operations
- Agreed with GWRC and Auckland Transport (in conjunction with the Ministry of Transport) a network capital programme to improve the metro rail assets
- Auckland Office – all Auckland city and North Shore office based staff relocated to one site in Stanley Street.

Other Activities:

- The WRRP project was completed through the 2011 financial year
- The Auckland Electrification and Rail network developments are well advanced
- The Auckland EMU procurement has been reduced to two final parties
- A comprehensive review of the KiwiRail Balance Sheet has been progressed
- An agreement to transfer above rail assets to GWRC has been completed
- Minor Line reviews in progress with the Napier/Gisborne, Northland and Northern Wairapa communities.



"Backbone of integrated transport networks"



The TAP continues to be the basis of this SCI. While on-going performance of all our businesses units is important, the most critical growth is expected to come from the Rail Freight business. This is underpinned by a customer focused strategy to deliver cost effective, time reliable rail services that meet customer time gate and transit time expectations in each of the key freight market segments. Our capital investment programme and operating plans have been prioritised to deliver the required improvements to the capacity, reliability and efficiency of our assets and services. This will be supported by building a service oriented culture that focuses on engagement, performance, productivity and personal accountability.

The 2011 financial year has been the starting point with wagons, locomotives and containers all in delivery, as well as the extension of the *MV Aratere*, a vital link in the Main Trunk corridor. These are all planned to be in operation in time for the upcoming 2012 financial year peak rail freight season. Over the period of this SCI we intend to continue this modernisation of equipment with on-going container procurement and a further 60 new locomotives and 950 wagons. Not only will this improve reliability, but also decrease fuel and maintenance costs as we focus more on planned, rather than unplanned, maintenance.

When considering our outlook for the Rail Freight business three key aspects are important: what are the growth projections of the commodity based, primary producers (coal, dairy, forestry); is the rail network ready to carry the projected growth of those industries (where rail is a viable transport mode); and in the domestic market, are we meeting our customers' (and potential customers') needs to make us their line haul carrier of choice. Our strategy reflects the need to create a viable and efficient rail industry capable of meeting its share of freight traffic which is projected to grow by at least 75 percent by 2031.

Additionally, we are closely monitoring wider transport industry developments as shipping lines and ports make decisions on where calls are made and what size vessels are utilised.

The rail network requires on-going maintenance and, in some areas, upgrades to improve capacity or speed. The freight and network teams are working closely to prioritise these capital works to ensure those that improve customer service and safety are undertaken first. This is also helping to provide adequate windows of access for work to be carried out on the track while keeping customer disruptions to a minimum.

Tourism continues to be seen as critical to both the Interislander and the Tranz Scenic business providing world class travel experiences. As one of New Zealand's biggest tourism operators an increased emphasis on improving the experience element of our travel products will be a key part of our TAP. We will continue to canvas the market to see if any rail passenger partners can add to our performance in this sector.

KiwiRail also provides network access for metro passenger services in Wellington and Auckland. We are committed to working with local authorities accountable for developing integrated passenger transport solutions by giving visibility to the expected future costs to maintain the network at an appropriate level for the services we are asked to support.

The investment in KiwiRail, announced by the Government in May 2010, marked the beginning of the TAP that will create a business capable of standing on its own financially. Our plan and first year performance has been further endorsed with the second \$250m investment being announced in the May 2011 budget.

The first three financial years (2011-2013) lays the platform for the long term sustainability of KiwiRail and this investment will be driven by our customers' requirement for KiwiRail to continue to be the backbone to their integrated transport needs.

To succeed, KiwiRail must take into account:

- The views of our customers who say they need an efficient and reliable rail network to serve their businesses and meet future freight growth
- The need to develop partnerships and alliances with our customers, stakeholders and suppliers
- The need to restore rail's relevance – eroded through lack of maintenance investment that has resulted in poor transit times and unreliable services
- That we will need the support and engagement of our staff.

Key elements of our future business approach:

ONE: GROWTH IN FREIGHT VOLUME AND REVENUE QUALITY DRIVEN BY MEETING CUSTOMER SERVICE REQUIREMENTS

Freight is critical to the financial success of KiwiRail. It currently generates more than 75 percent of KiwiRail's revenue from carrying bulk commodities, import-export goods and domestic freight. The predicted near doubling of the freight task over the next thirty years and the opportunity to increase rail's market share on some routes, underpins its importance to the business.

As shown in Table 7.2(a) on page 19, in the first year of the TAP (2011 financial year) the Freight business expects to achieve year on year external revenue growth of \$29.6 million, an 8.0% improvement on the 2010 financial year. We have targeted continued Freight external revenue growth of \$55.3 million (2012 financial year), \$67.9 million (2013 financial year) and \$39.3 million (2014 financial year) through a mix of volume and yield initiatives underpinned by improved time reliability across all services, improved transit times, ferry capacity on the Main Trunk, and the introduction of new premium domestic train services.

TWO: WE NEED TO MAINTAIN A SUSTAINABLE, CONNECTED NETWORK

The KiwiRail network extends over 4,000 km – a mixture of main lines, secondary lines and minor lines. Growing the business depends on us maintaining a connected network. This doesn't necessarily mean the network as it is today. Minor lines that carry little or no traffic will only survive if they have proven future potential and/or an imminent anchor customer.

In July 2010 we announced the mothballing of the Stratford-Okahukura Line after earlier consultation with the Taranaki and King Country communities and discussion with customers and staff. We concluded that there was not enough business at the moment to justify the line being retained. If new business does not emerge before June 2012, the line will close permanently.

We have also begun the process of consultation with local communities on the future of the Napier-Gisborne, North Auckland and North Wairarapa Lines. The future of these lines relies on the emergence or identification of significant new traffic. A decision on their future will be made by June 2012.

THREE: INVESTMENT IN ROLLING STOCK, INFRASTRUCTURE AND FERRY CAPACITY IS CRITICAL TO IMPROVING RELIABILITY, TRANSIT TIMES AND CAPACITY

Under-investment in rolling stock and rail infrastructure over many years has reduced the time reliability of rail services and with it, rail's ability to compete. Targeted investment in locomotives, wagons and rail infrastructure will restore the time reliability of rail services and give the Freight business the opportunity to meet expected growth in the bulk and IMEX markets, and win back domestic market share. Growth in domestic market share also requires reducing transit times on the Main Trunk and increasing ferry rail deck capacity.

RAIL INFRASTRUCTURE

Our core network capital expenditure is part of the TAP programme outlined in Table 7.1(d) on page 16.

After investing \$197.2 million in the 2011 financial year, we plan to invest \$207.1 million in 2012, \$214.5 million in 2013 and \$239.5 million in 2014 in Network renewals and upgrades to improve reliability and speed on the core network as reported in Table 7.2(c). The key physical outputs for that expenditure are reported in Table 7.1(j).

ROLLING STOCK

Excluding the new DL locomotives and container flat top wagons, the youngest diesel locomotives in the fleet are 30 years old and the average age of wagons is between 25 and 30 years. Adding new locomotives, wagons and containers to the fleet is critical to improving transit times and reliability, realising productivity gains and growing Freight revenue.

The first year of the Turnaround Plan (2011 financial year) saw \$69.4 million invested in new rolling stock and containers with:

- 20 DL locomotives expected to be fully operational by August 2011
- 535 container flat-top (CFT) wagons expected to enter service by September 2011
- 258 intermodal containers are expected to be in service by September 2011.

We plan to purchase an additional 950 wagons, 60 locomotives and 500 intermodal containers over the next three years to retire out of life expired rolling stock and to meet our demand requirements.

The specific numbers of wagons and locomotives to be purchased are reported in Table 7.1(i) with the investment values included in capital expenditure forecasts reported in Table 7.2(c).

MAIN TRUNK

Increasing the amount of domestic freight carried on the Main Trunk is critical to the growth of the Freight business. While other routes are busy, in many cases, rail has already claimed significant modal share, or growth depends on some other factor – like economic growth.

Rail carries approximately 18 percent of domestic traffic between Auckland and Christchurch, compared to 1995 when it carried approximately 60 percent. We intend to focus on removing Auckland and Wellington metropolitan bottlenecks and making the North Island Main Trunk network more robust to ensure those levels are achieved again.

Over the next two years we expect to improve by two hours the transit times and reliability of premium rail services between Auckland and Wellington. Greater rail deck capacity will also be needed from Interislander to support freight business growth on this route.

The investment for these improvements are part of the Network and Interislander investment totals in table 7.2(c) and the annual freight train transit time and reliability improvements targets are covered in table 7.1(k) and (l). This includes:

- The Backbone Service Improvement Project (BSIP) was established to coordinate and drive the range of activities required across KiwiRail's business to achieve the planned step change in transit time and reliability between Auckland and Wellington. Work during the 2011 financial year focused on:
 - Network projects to improve reliability by lowering and upgrading the North/South Junction tunnels, and removing permanent and temporary speed restrictions
 - Detailed analysis and planning to determine the optimal mix and timing of operational changes and investment projects to achieve the two hour reduction in transit time. This has resulted in a change to the timing of implementing transit times reductions from those stated in last year's SCI. As shown in Table 7.1, we plan to implement changes to premium train timetables to reduce their transit times between Auckland and Wellington by 100 minutes by June 2012 and 120 minutes by June 2013 (compared to a target of 120 minutes by June 2012 in last year's SCI). Key initiatives for enabling these transit time reductions include establishing a new dedicated premium train service by November 2011, changes to pre-departure processes to ensure trains depart on-time, and implementing the highest priority Network capital projects to eliminate temporary and permanent speed restrictions, reconfigure terminals, and complete major curve easements, track realignments and bridge replacements.
- The extension of the *MV Aratere* to provide increased rail deck capacity, commercial vehicle and passenger space is expected to be completed by September 2011. The business case for converting the *Kaitaki* (or another suitable vessel) to a rail capable vessel and modifying terminal infrastructure to accommodate it will be considered during the 2012 financial year
- The May 2011 announcement by the Government that it is investigating the use of Clifford Bay as a new sea terminal reinforces our strategy of improving transit times between Auckland and Christchurch. A Clifford Bay terminal would reduce rail transit times between Wellington and Christchurch by 90-120 minutes.

FOUR: WE MUST DEVELOP NEW COMMERCIAL MODELS TO IMPROVE RETURNS FROM PASSENGER BUSINESSES

LONG DISTANCE PASSENGER

Few tourists or New Zealanders use long distance trains as a means of travel from place to place. However, they value trains as a travel experience. Future growth in long distance passenger travel depends on improving the quality of that experience through continued improvement to customer service. This will be underpinned by:

- The manufacture of 17 new rail carriages at KiwiRail's Hillside workshops for the TranzAlpine and Coastal Pacific services adding even greater comfort to a world class rail experience. Table 7.2(c) highlights Tranz Scenic capital expenditure, including the cost for the progressive delivery of the 17 new carriages between August 2011 and April 2012
- Pursuing a strategic partnership with an entity who is interested in investing to assist the further modernisation of our passenger fleet and strengthening of operations.

METRO PASSENGER

During the 2011 financial year significant progress was made by the Crown, KiwiRail and Regional Councils to implement the Metropolitan Rail Operating Model. This seeks to put metro rail on a sustainable basis, allow operating services to be fully contested, and ensure KiwiRail does not subsidise the operation of networks for commuter service in Wellington or Auckland. The three key initiatives commenced in the 2011 financial year to meet these objectives were:

- Transferring ownership of KiwiRail's Wellington-based EMU rolling stock and associated inventory, shelters and stations (other than Wellington Station), EMU maintenance facilities and associated plant and equipment to entities controlled by the GWRC on 30 June 2011
- Negotiating track access agreements with the Auckland and Wellington Regional Councils to fully recover metro network costs
- Wellington metro train operations and rolling stock maintenance services are provided to GWRC by Tranz Metro and Mechanical Services. In the 2011 financial year we began negotiations to replace existing contracts with performance based contracts which will be short term in anticipation of contestability. The key issue for KiwiRail is to conclude an agreement that balances risks and rewards to generate an appropriate commercial return from these activities.

FIVE: CONTINUED IMPROVEMENT IN PRODUCTIVITY IS ESSENTIAL

Productivity can always be improved and we must always challenge ourselves to make the necessary changes. In the 2011 financial year we:

- Established a Group procurement function to drive effectiveness and efficiency in our supplier engagements. Major contracts executed in the 2011 financial year included electricity, sleepers and container flat top wagon supply. Going forward we will continue to drive supplier value by actively managing categories of spend. We will also streamline procure to pay processes across the Group to reduce internal procurement costs
- Completed a productivity review with independent support on the Network business unit covering both operational and capital productivity
- Successfully piloted a work-face programme with front-line Network staff in the Southern region measuring and delivering self-initiated productivity improvements. The programme will be extended to the Central and Northern regions in the 2012 financial year.

In the 2012 financial year we will also:

- Finalise plans for the reconfiguration of and investment in Mechanical Services workshop and depot facilities to align with future work programmes and introduce more efficient maintenance systems for rolling stock
- Introduce the first 20 DL locomotives and 535 CFT wagons into operational service. This will enable us to begin capturing the operating benefits from the capital investment programme through, for example, more fuel efficient locomotives, a more homogenous rolling stock fleet and associated benefits with more efficient inventory levels
- Improve Interislander fuel efficiency through the upgrade to MV Aratere's generators, bow and

propellers, and the introduction of fuel flow meters and monitoring software on all ships

- Develop a trial to introduce single man remote shunting operations
- Explore new technologies and practices in shunt applications
- Continue to drive improvements in labour productivity across the business through changes to work practices and culture.

Productivity targets are reported in Table 7.1(p), (q) and (r).

SIX: EFFECTIVE CORPORATE SUPPORT AND BETTER USE OF COMMERCIAL PROPERTY HOLDINGS

KiwiRail was created through the integration of a number of different businesses (ex Toll, United Group and ONTRACK). In the 2012 financial year we will complete a review of corporate functions (Information Systems, Human Resources, Finance, Property and Legal) to determine the most efficient manner for delivering these services across the business.

Our Human Resources function will help drive people engagement and provide training support, as well as best practice health and safety advice.

The Information Systems team has centralised resources to be more effective and efficient as we invest in new technology tools such as an asset management system, a freight management and billing system, as well as a consistent, group wide finance platform.

The Finance team will look to centralise some technical and transactional activity while leaving dedicated finance teams within the business units to support their management teams as they look to drive performance and productivity.

KiwiRail owns and operates significant property assets. These include buildings and vacant land next to the rail corridor. Some sites, particularly in the major cities, lend themselves to commercial developments. Others complement our Freight business and have business potential for development by freight customers.

In the 2011 financial year we commenced a review of KiwiRail's property portfolio. A master plan for all significant parcels of land will be completed in the 2012 financial year identifying land surplus to requirements for sale, and development opportunities to maximise their value to KiwiRail.

We see a vital link between freight customers who have facilities located on our corridor and their long term commitment to rail. During the 2011 financial year we concluded heads of agreements for the lease of land to allow Mainfreight to develop freight transfer facilities in Wellington, Palmerston North and Invercargill.

Where appropriate we will also facilitate the development of freight transfer facilities on KiwiRail land by third party developers. A development agreement for the first of these facilities for Peter Baker Transport in Dunedin was concluded in the 2011 financial year.

Table 7.2(c) includes investment capital for these commercial opportunities (as well as funding for the refurbishment of existing property facilities and major information systems work).

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BUSINESS OBJECTIVES & PERFORMANCE TARGETS

The primary objective of the 10 year strategic TAP is for KiwiRail to be financially self-sufficient by the 2020 financial year, with internally generated cash flow delivering commercial returns on assets employed in its cash generating businesses, while funding the long-run sustainable cost of the rail infrastructure capital programme without on-going need for funding from the Crown. Section six of this SCI sets out the key elements of our strategy to achieve this objective.

The key performance measures and targets underlying the delivery of those elements of the TAP over the next three years are set out below.

TABLE 7.1

Financial Metrics (\$m)	SCI Horizon				
	2010 Actual	2011 Forecast	2012 Budget	2013 Plan	2014 Plan
(a) Total External Revenue	650.4	667.4	737.0	820.4	872.7
(b) EBITDA	77.8	100.3	139.5	178.4	211.5
(c) NPAT before grant income ¹	(260.6)	(203.0)	(178.8)	(138.9)	(101.6)
(d) TAP Capital Expenditure	246.7	377.9	411.1	435.4	440.5
(e) Metro Project Capital Expenditure	314.7	263.7	327.1	200.1	288.1
(f) Metro Renewals Capital Expenditure	10.1	19.4	21.3	30.3	24.5
Key Sales Metrics					
(g) Freight NTK (m)	3,919	4,272	4,601	4,927	5,071
(h) Freight AVG Yield (C/NTK)	7.9	7.7	8.3	8.5	8.8
Key Investment Outcomes					
(i) Rolling Stock Replacement ²					
- Wagons (no. of new units)	55	535	0	400	550
- Locomotives (no. of new units)	20	0	20	20	20
(j) Network Renewals					
- New Sleepers Laid (000)	53	106	116	124	124
- New Rail Laid (km)	19	21	50	50	50
- Lines Distressed (km)	218	264	250	250	250
- Span Metres Replaced	550	169	716	500	500
- Timber Piers Replaced	92	71	105	90	90
- Culverts Replaced	108	173	71	100	100
- Level Crossing Upgrades ³	6	14	11	8	8
(k) Auckland-Wellington Transit Improvements					
- Premium Train Reduction (minutes)	na	0	100	20	0
Customer Service Performance					
(l) Freight (%<30min)	79%	79%	90%	90%	90%
(m) Metro (%<3min)	82%	84%	90%	95%	95%
(n) Scenic (%<3min)	63%	70%	80%	90%	92%
(o) Interislander (%<15min)	89%	77%	90%	94%	95%

			SCI Horizon		
	2010 Actual	2011 Forecast	2012 Budget	2013 Plan	2014 Plan
Productivity Measures					
(p) Total Labour Costs as % of Revenue	39%	40%	42%	39%	39%
(q) Freight OPEX to Revenue Ratio	0.72	0.71	0.69	0.66	0.64
(r) Interislander OPEX to Revenue Ratio	0.87	0.85	0.85	0.84	0.81
Health and Safety					
(s) LTIFR (per million man hours)	6.3	6.1	4.4	3.0	2.5
(t) MTIFR (per million man hours)	45	49	42	38	32
Staff Engagement					
(u) Engagement Index	67	75	79	83	85
Corporate Responsibility					
(v) GHG emissions per NTK from rail freight traction energy (gms)	34.1	33.7	32.8	31.7	30.7

Note 1: For consistency the 2010 figure has been restated to remove the \$90.0 million operating support grant which is no-longer received. In addition the one-off, non cash, \$107.6 million loss on the disposal of Metro assets to Greater Wellington Regional Council in 2011 has been removed for the purposes of comparability.

Note 2: Year in which commitment is made to purchase rolling stock.

Note 3: In addition to the 14 level crossing upgrades completed in 2011, a further 14 projects are under construction at 30 June 2011.

As a diverse business, KiwiRail has many reportable financial and non-financial metrics, many of which are applicable to the particular business unit. The measures reported above capture the most important drivers of the TAP:

Table 7.1

Reference	Description of Performance Measure
(a) (g) (h)	Driving revenue, particularly in the Freight division, is critical to the success of the TAP. While KiwiRail is looking for revenue improvements across all operational business units, a step change is planned through volume and yield improvements on rail freight. For this reason we have also reported separately the NTK (net tonne kilometres) volume targets for Freight.
(l)	We have built our plan around meeting our customers' expectations. To manage this, we expect to significantly improve our service standards. On our key freight services not only are we driving time improvements, we are also looking to deliver a 90 percent time reliable service for trains. Significant one-off events including the Christchurch earthquakes and the Manawatu Gorge and Kaikoura slips mask the level of the underlying improvement in reliability in 2011.
(b) (c)	EBITDA growth is a critical element of the funding required in the investment programme we have planned. We are looking to drive EBITDA significantly over the next three years.
(d) (i) (j) (k)	The capital plan has been separated between TAP expenditure and purpose-funded major Metro project and renewals expenditure. The TAP capital will create the platform to provide reliable assets to meet our customer expectations. We have outlined a number of expected deliverables for the rolling stock and Network renewals expenditure. One key metric critical to improving our domestic freight category performance is transit time between Auckland and Wellington. Over the next two years we are looking for at least two hours improvement for premium freight services.

(e)	<p>Although the major Developing Auckland Rail Transport (DART) projects were largely completed during the 2011 financial year there are a number of smaller, but very significant, projects to complete in the 2012 financial year to ensure that all the benefits of DART are realised. These include the redevelopment of the Papakura Station to allow the changeover of Diesel and Electric Multiple Units and to reduce conflicts with freight; alterations at Britomart Station to provide greater flexibility and maximise the number of services run per hour; and network wide adjustments to the track to facilitate the operation of the new EMUs.</p> <p>The Auckland Electrification Project (AEP) continues apace, with a significant portion of the new state of the art signalling system commissioned and operative and this will be completed in the 2012 financial year. The Traction works are in progress with most of the western line foundations and masts installed and conductors to be erected in 2012. These works will be completed by August 2013 in good time for the arrival and commissioning of the new EMU fleet. The procurement of the EMUs is on target for a contract to be awarded in September 2011 with delivery commencing in 2013. The establishment of the EMU Maintenance Depot has commenced with the development of a concept design and construction of the building and installation of all the equipment expected to be completed by mid 2013.</p> <p>The Wellington Region Rail Programme (WRRP) has been completed with only minor works remaining. The delivery and commissioning of the first EMUs was achieved in early 2011 and these will progressively come into service in 2012.</p>
(f)	<p>In addition to funding from GWRC, \$88.4 has now been secured from the Ministry of Transport for KiwiRail to complete an extensive refurbishment of the remaining Wellington electrical traction system and an upgrade of the associated signalling over the next eight years. Discussions are continuing with both GWRC and Auckland Transport regarding long term metro renewal and maintenance funding in parallel with performance based agreements.</p>
(m)	<p>On our Tranz Metro services, passenger growth will only return when they have confidence in the reliability of that service. As WRRP is completed and the Matangi fleet is introduced, a 95 percent or better on time performance target is a key objective.</p>
(n)	<p>Tranz Scenic passenger growth is reliant on continued improvements in customer service to ensure a top quality tourist experience, including a 92 percent or better on time performance target.</p>
(o)	<p>The Interislander over recent years has maintained a very high standard of time reliability. In the 2011 financial year this was adversely affected by all three of Interislander's ships having a dry dock during the year and the introduction of the <i>Monte Stello</i> to cover for the <i>MV Aratere</i> during its extension and upgrade. The Interislander's reliability will continue to be adversely affected during the first quarter of the 2012 financial year before returning to targeted levels when the <i>MV Aratere</i> returns to service in September 2011.</p>
(p) (q) (r)	<p>Driving continued productivity improvements throughout our business is a fundamental element of the TAP and returning KiwiRail to financial self-sufficiency by 2020. Key initiatives underlying 2012 financial year productivity improvements are discussed on page 14.</p>
(s) (t)	<p>KiwiRail takes health and safety performance extremely seriously. We operate a heavy engineering transport operation that presents many risks for accident and injury. We will continue to drive the safety message and improve our workplace safety record and have our staff return home as they came to work. KiwiRail has recently signed up to the Zero Harm programme.</p>
(u)	<p>Every year KiwiRail completes a staff engagement survey. Given the importance of an engaged workforce to deliver our plan, a strong engagement result is required.</p>
(v)	<p>As part of its corporate responsibility commitment we plan to reduce the carbon intensity of freight services.</p>

KiwiRail has committed to providing greater segment visibility of our business. To that end, we have included key financial measures for our business units in the following table.

TABLE 7.2

BUSINESS UNIT SUMMARY (\$m)			SCI Horizon		
	2010 Actual	2011 Forecast	2012 Budget	2013 Plan	2014 Plan
(a) External Revenue					
Freight	367.1	396.7	452.0	519.9	559.2
Interislander	120.2	122.9	130.1	133.8	138.6
Passenger					
- Tranz Scenic	28.3	21.5	28.9	32.0	35.1
- Tranz Metro ³	63.0	65.5	47.1	48.8	50.4
Mechanical ³	27.9	9.0	19.8	25.3	25.4
Network ^{1,3}	13.7	20.0	26.8	27.8	30.2
Corporate ¹	30.2	31.8	32.3	32.8	33.8
	650.4	667.4	737.0	820.4	872.7
(b) EBITDA					
Freight ²	104.7	117.8	152.3	181.6	208.9
Interislander	19.8	19.1	24.5	28.6	33.3
Passenger					
- Tranz Scenic	5.1	(1.0)	4.2	6.6	8.9
- Tranz Metro	11.3	11.5	4.4	4.4	4.6
Mechanical	6.5	(2.2)	0.4	2.3	(1.1)
Network ^{1,2}	(82.6)	(58.0)	(58.0)	(56.5)	(54.8)
Corporate ¹	13.0	13.1	11.7	11.4	11.7
	77.8	100.3	139.5	178.4	211.5
(c) TAP Capital Expenditure					
Freight	63.4	102.7	121.9	157.0	155.7
Interislander	3.6	23.0	30.1	35.8	13.9
Passenger					
- Tranz Scenic	5.3	22.4	20.8	0.5	3.2
- Tranz Metro	3.9	3.7	0.0	0.0	0.0
Mechanical	0.4	2.1	3.6	8.8	9.0
Network ¹	157.5	197.2	207.1	214.5	239.5
Corporate ¹	12.6	26.8	27.6	18.8	19.2
	246.7	377.9	411.1	435.4	440.5

Note 1: Corporate includes Property, Information Technology, Human Resources, Finance, Legal, and Health and Safety. This differs from the 2010 Annual Report as Property revenue was reported within the Network business unit.

Note 2: Network and Freight EBITDA differs from that reported in the 2010 Annual Report in that Track Access costs have not been allocated to Freight (from Network) in the above statement.

Note 3: From 2012 Metro track access and maintenance costs are charged directly from the Network and Mechanical Business Units to GWRC.



As a SOE, KiwiRail is also required to report a number of specific financial metrics. These are shown in the table below based on KiwiRail's existing balance sheet structure and accounting methodologies.

The current balance sheet and financial metrics are not typical of a SOE due to KiwiRail's heavy reliance on shareholder investment support through the first five years of the TAP before underlying earnings become positive. Furthermore, the TAP does not contemplate KiwiRail generating a commercial return on the book value of rail infrastructure and corridor land in the foreseeable future.

As discussed below, we are well progressed on a review to determine whether KiwiRail's balance sheet should be restructured to better align asset values with the underlying economics and commercial value of the business. At the completion of this exercise, if a restructure is recommended this SCI will be re-issued once the resulting asset values are finalised.

TABLE 7.3

Ratio of Shareholder's Funds to Total Assets	SCI Horizon				
	2010 Actual	2011 Forecast	2012 Budget	2013 Plan	2014 Plan
Shareholder's Funds to Total Assets	93.7%	93.1%	93.6%	94.2%	96.1%
The Crown's Investment in KiwiRail (\$m)					
Total Shareholder's Funds (TSF)	12,419	12,638	13,074	13,418	13,877
Average Shareholder's Funds (ASF)	12,487	12,528	12,856	13,246	13,648
Financial Performance Measures for SOE Portfolio					
Crown Investment in KiwiRail					
- Total Shareholder's Return	na	na	TBC once balance sheet restructure finalised		
- Dividend Yield	Nil	Nil	Nil	Nil	Nil
- Dividend Payout	Nil	Nil	Nil	Nil	Nil
- Return on Equity	-1.9%	-1.8%	-1.4%	-1.0%	-0.7%
- Return on Equity Adjusted for IFRS fair valuation movements and asset revaluations	-13.6%	-10.8%	-7.2%	-4.9%	-3.1%
Profitability/Efficiency Measures					
- Return on Capital Employed	-9.3%	-7.5%	-4.9%	-3.2%	-1.8%
- Operating Margin	12.0%	15.0%	18.9%	21.7%	24.2%
Leverage/Solvency Measures					
- Gearing Ratio (net) ¹	0.04	0.04	0.04	0.04	0.04
- Interest Cover ¹	2.60	2.74	4.01	5.14	6.13
- Solvency (current assets/current liabilities) ^{1,2}	0.96	0.50	0.38	0.38	0.37

Note 1: Assumes existing DMO debt is rolled over on a twelve monthly basis as it matures.

Note 2: Current liabilities include the current portion of DMO debt maturing within the next financial year given the assumption stated in note 1 above.



FUNDING, CAPITAL STRUCTURE & VALUE OF THE CROWN'S INVESTMENT

In May 2010 the Government announced its support for the TAP objectives with a \$750 million investment in principle over the first three years of the TAP (the 2011 – 2013 financial years). The Crown has formally appropriated the first \$500 million of this funding, which together with internally generated EBITDA, funds KiwiRail's capital investment programme.

The capital projects underlying the Crown's 2011 financial year investment of \$250 million included:

- Extending and upgrading the *MV Aratere* by inserting a 30 metre section of hull structure into the middle of the ship, replacing the bow and propellers and upgrading the ship's power supply
- Part of the Network track and structures renewals programme, and the lowering and upgrade of tunnels on the on the 3.1 km stretch of the North Island Main Trunk just north of Wellington known as the North/South Junction
- The purchase of container flat top freight wagons and containers
- Part of the refurbishment programme for existing locomotives and wagons.

The capital projects underlying the Crown's 2012 financial year investment of \$250 million include:

- The purchase of the second tranche of 20 DL locomotives and intermodal containers
- Part of the refurbishment programme for existing locomotives and wagons
- Part of the Network track and structures renewals and upgrade programme.

Funding Assumptions for 2013 and 2014

The financial forecasts included in Tables 7.1 and 7.3 for the 2013 and 2014 financial years are based on a number of important funding and capital structure assumptions.

The TAP assumes the Crown invests approximately \$1.1 billion to support the 10 year \$3.8 billion TAP capital programme. As outlined above, the Government has announced its in principle commitment to \$750 million of equity funding over the first three years of the plan. We have assumed the Crown provides the third instalment of \$250 million in equity funding in the 2013 financial year.

For the balance, we have commenced discussions with the Government on funding arrangements beyond 2013. As these discussions are on-going we have prepared this SCI assuming the Crown provides \$243 million in equity funding in the 2014 financial year, consistent with the funding profile for the Crown's total investment of approximately \$1.1 billion as proposed by KiwiRail in the TAP. However it is important to note that the Government has made no commitment to this funding at the time this SCI was prepared. We will actively work with the Government to explore the most efficient way to meeting these funding requirements.

Balance Sheet Asset and Equity Values

The value of the Crown's investment in the KiwiRail Group at 30 June 2010 was reported in last year's SCI as the \$12.4 billion book value of shareholder equity. That value reflected the application of existing accounting methodologies to determine asset values:

- The Group being designated a Public Benefit Entity (PBE) for financial reporting purposes
- The fair value of fixed assets determined by applying the depreciated replacement cost (DRC) methodology for railway infrastructure, rolling stock, ferries and buildings, and the across-the-fence (ATF) methodology for land.

The balance sheet values and financial ratios shown in Table 7.3 have been prepared on the same basis, with the book value of KiwiRail's fixed assets at 30 June 2011 forecast to be \$13.3 billion and shareholder equity \$12.6 billion (including an asset revaluation reserve of \$10.5 billion).

As shown below, the KiwiRail Board has also estimated the discounted cash flow (DCF) value of the Crown's investment in the KiwiRail Group at 30 June 2011 as negative \$484 million, highlighting the significant variance between the current book and commercial value of KiwiRail's assets and shareholder equity. We are well progressed on a review to determine the most appropriate carrying value of KiwiRail's balance sheet to better align asset values with the underlying economics and value of the business. At the completion of this exercise, if a restructure is recommended this SCI will be re-issued once the resulting asset values are finalised.

DCF Value of the Crown's Investment in KiwiRail

The Board's estimate of the DCF value of the Kiwirail Group as at 30 June 2011 is negative \$484 million:

	\$m
DCF Enterprise Value	(30)
Net Debt at 30 June 2011	(454)
DCF Equity Value	<u>(484)</u>

The key points about the manner in which that value was assessed are:

- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire KiwiRail Group, including all subsidiaries, on an after tax basis
- The DCF / NPV was based on the nominal (i.e. inflation-adjusted) future cash flows set out in KiwiRail's three year Business Plan, with forward projections then also made about years 4 to 19 consistent with the TAP, and a terminal value of \$345 million was included in the terminal year. The growth assumption assumed in the terminal value was 2.25%
- A discount rate of 9.3% was assumed
- PWC have confirmed the mathematical accuracy of the discounted cash flow valuation calculations prior to approval of the DCF value by the Board
- The free cash flows underlying KiwiRail's negative \$30 million enterprise value include significant capital expenditure to address several decades of under investment in rail infrastructure and equipment. We have begun an exercise to evaluate the present value of this expenditure, and in future SCI we will look to separately identify the negative present value of "catch-up" capital expenditure and the positive value of "normalised" operations
- Delivery of the Turnaround Plan will result in continued improvement in the enterprise value of KiwiRail as the heavy investment in "catch-up" capital expenditure over the first five years of the plan is completed and EBITDA growth is realised.

9 ACCOUNTING POLICIES

The Corporation's detailed accounting policies are in Appendix One: Statement of Accounting Policies.

10 DIVIDEND POLICY

The TAP requires significant investment over a 10-year period. A significant amount of that investment is from the Shareholder. As such KiwiRail does not expect to make any dividend payments over the period of this SCI.

11 REPORTING TO SHAREHOLDING MINISTERS

KiwiRail will provide to Shareholding Ministers:

- An Annual Report and Half Yearly Report in accordance with sections 15 and 16 of the State-Owned Enterprises Act 1986. These will include a statement of financial performance, a statement of financial position, a statement of cash flows and such details as are necessary to permit an informed assessment of the Corporation's performance
- Continuous Disclosure reporting as required by the Crown Ownership Monitoring Unit (COMU)
- Regular reporting to COMU for performance monitoring during the TAP investment period
- Other information requested by Ministers in accordance with section 18 of the State-Owned Enterprises Act 1986.

12 PROCEDURES FOR SHARE ACQUISITIONS

Purchase of shares in any company or interests in any other organisation will be subject to prior agreement with Ministers in accordance with the New Zealand Railways Corporation Act 1981 and the State-Owned Enterprises Act 1986 which provides that KiwiRail may, from time to time, with the approval of the Minister of Finance, subscribe for or otherwise acquire stocks, debentures, or any interest in any company, body corporate or business.

13 COMPENSATION FROM THE CROWN

KiwiRail expects to receive compensation from the Crown as per section 7 of the State-Owned Enterprises Act 1986 for public policy work and projects undertaken by the corporation which have a public good element or purpose and would not be undertaken on purely commercial grounds.



14 APPENDIX 1: STATEMENT OF ACCOUNTING POLICIES

REPORTING ENTITY

New Zealand Railways Corporation (“the Parent”) is a statutory corporation established pursuant to the New Zealand Railways Corporations Act 1981 and is included within the First Schedule of the State-Owned Enterprises Act 1986. “The Group” comprises the New Zealand Railways Corporation and its subsidiaries. The Group is domiciled in New Zealand. The Parent and the Group have been designated as a Public Benefit Entity.

The primary objective of the Group is to establish, maintain and operate, or otherwise arrange for, safe and efficient rail, road and ferry freight and passenger transport services within New Zealand in such a way that revenue exceeds costs, including interest and depreciation; and to provide for a return on capital as specified by the Minister of Finance from time to time.

BASIS OF PREPARATION

Statement of compliance

The financial statements comply with the New Zealand Railways Corporations Act 1981, the State-Owned Enterprises Act of 1986 and New Zealand equivalents to International Financial Reporting Standards, New Zealand Generally Accepted Accounting Practice and other applicable financial reporting standards as appropriate for public benefit entities.

Measurement base

The financial statements have been prepared on the basis of historical costs, modified by the revaluation of certain non-current assets and certain financial instruments (including derivative instruments).

Cost is based on the fair value of the consideration given in exchange for assets.

Accounting policies are selected and applied in a manner which ensures that the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions or other events is reported.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements. Unless otherwise specified, all dollar amounts in these financial statements and accompanying notes are stated in New Zealand dollars. The functional currency is New Zealand dollars.

NATURE OF BUSINESS AND PRINCIPAL ACTIVITIES

The Group carries out the following activities:

- Manage and operate the New Zealand rail network
- Provide rail operators with access to rail network
- Provide advice to the Crown on rail infrastructure issues
- Manage land on the rail corridor
- Operate Interislander ferries
- Operate Wellington metro and long distance rail passenger services
- Operate rail freight transport services in New Zealand
- Carry out engineering and mechanical services to the locomotives and other rolling stock.

CRITICAL JUDGMENTS

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses. These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions of accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Asset revaluations

The Group's land is held at fair value and other assets are carried at depreciable replacement cost. Assets are revalued annually on a cyclical basis by independent valuers. The valuation of land is based on over-the-fence methodology.

The remaining useful lives of property, plant and equipment represents management's best estimates of the useful lives of individual asset classes. When assets are revalued, the valuers provide updated expected remaining useful lives for the assets that have been revalued.

Employee entitlements

Independent actuaries are engaged to provide the valuation of employee entitlements. Reliance is placed on the expertise of the independent actuaries to provide accurate valuations of employee benefits. The two key assumptions used in calculating this liability include the discount rate and the salary inflation factor. The discount rate is the yield on 10 year government bonds as at the end of the financial year, which have terms to maturity that match, as closely as possible, to the estimated future cash outflows. The salary inflation factor is determined with consideration of historical salary inflation patterns.

Inventory obsolescence

Management relies on its knowledge of the business to calculate inventory obsolescence provisions. The bulk of inventory held is spare parts for rolling stock and the network. Due to the age of these assets, the parts held are often old and management relies on its knowledge of the business to identify items of inventory that are truly obsolete.

Impairment of Minor Lines

No impairment on the minor lines will be recognised until such time as the consultation with local communities is completed and alternative commercial uses for lines have been investigated.

SIGNIFICANT ACCOUNTING POLICIES

The following accounting policies have been consistently applied to all reporting periods presented in these financial statements.

(a) Consolidated financial statements

The consolidated financial statements of the Parent and its subsidiaries include the financial statements of subsidiary companies using the acquisition method of consolidation. The acquisition method of consolidation involves adding together like items of assets, liabilities, equity, income and expense on a line by line basis from the date that control commences to the date that control ceases and eliminating all significant intra-group balances and transactions. Subsidiary companies are those entities that are controlled directly or indirectly by the Parent.

The Parent values subsidiary companies at the time of acquisition as the identifiable assets and liabilities acquired measured at the aggregate of fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Unrealised

losses relating to impairment of subsidiaries are recognised in the Statement of Financial Performance.

(b) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable by the Parent and Group and represents amounts receivable for goods and services provided in the normal course of business, once significant risk and rewards of ownership have been transferred to the buyer after eliminating the sales within the Group.

- (i) Freight revenue is recognised based on the date of freight acceptance.
- (ii) Mechanical revenue is comprised of manufacturing revenue and maintenance revenue. Manufacturing revenue is recognised by reference to the stage of completion of the contract activity at the balance date, if the outcome of the contract can be reliably estimated. The stage of completion is assessed by reference to surveys of work performed. Manufacturing revenue includes revenue from design services. Maintenance revenue is recognised at the date that the maintenance service is provided.
- (iii) Interislander revenue is comprised of freight revenue and passenger revenue. Freight revenue is recognised based on the date of freight acceptance. Passenger revenue is recognised at the date of travel.
- (iv) Tranz Metro and Tranz Scenic revenue is recognised at the date of travel.
- (v) Property and Corporate revenue comprises rental income, Government funding for operating expenditure and other revenue. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging the operating lease are recognised on a straight-line basis over the lease term.
- (vi) Network revenue comprises track access revenue, Government funding for operating expenditure, and other revenue. Track access revenue is recognised on a straight line basis over the term of the relevant agreement.
- (vii) Interest income from call and term deposits is recognised as it accrues, using the effective interest method.
- (viii) Dividend income is recognised when the right to receive payment has been established.
- (ix) Other sources of income are recognised when earned and are reported in the financial periods to which they relate.
- (x) Government funding received as reimbursements of operating costs are recognised as income in the period in which the funding is receivable.
- (xi) Government funding received as reimbursements of the costs of capital projects is recognised as income in the period in which the funding is receivable.
- (xii) Grants received in respect of services provided are recognised when the requirements of the relevant grant agreement are met.

(c) Property, plant and equipment

- (i) Recognition and Measurement

Property, plant and equipment asset classes consist of land, buildings, railway infrastructure, rolling stock, ships and plant and equipment.

Property, plant and equipment are shown at cost or valuation, less any accumulated depreciation and impairment losses. Items of property, plant and equipment in the course of construction are classified as Capital Work in Progress. Cost includes expenditure that is directly attributable to the acquisition of the asset.

Where an asset is acquired for nil or nominal consideration, the asset is recognised initially at fair value, where fair value can be reliably determined; and the fair value of the asset received, less costs incurred to acquire the asset, is also recognised as income in the Statement of Financial Performance.

(ii) Revaluation

Land, buildings and railway infrastructure are revalued with sufficient regularity to ensure that the carrying amount does not differ materially from fair value. Fair value is determined from market-based evidence by an external, independent valuer.

Valuations are undertaken in accordance with the standards issued by the New Zealand Property Institute with the following bases of valuation adopted:

- * *Specialised buildings and railway infrastructure* – valued using optimised depreciated replacement cost.
- * *Rail corridor* – land associated with the rail corridor is valued based on adjacent use, as an approximation of fair value.
- * *Non-specialised land and buildings* - which could be sold with relative ease are valued at market value.

Any revaluation increase arising on the revaluation of land and buildings and railway infrastructure is credited to the asset revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense in the Statement of Financial Performance, in which case the increase is credited to the Statement of Financial Performance to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of land, buildings or track assets is charged as an expense to the Statement of Financial Performance to the extent that it exceeds the balance, if any, held in the asset revaluation reserve relating to a previous revaluation of that class of asset.

Other additions between revaluations are recorded at cost.

(iii) Disposals

Realised gains and losses arising from the disposal of property, plant and equipment are recognised in the Statement of Financial Performance in the period in which the transaction occurs. Any balance attributable to the disposed asset in the asset revaluation reserve is transferred to retained earnings.

(iv) Impairment

The carrying amounts of the Group's non-current assets are reviewed at each reporting date to determine if there is any indication of impairment. If any such indication exists, the asset will be tested for impairment by comparing its recoverable amount to its carrying amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

Value in use is the depreciated replacement cost for an asset where the future economic benefits or service potential of the asset are not primarily dependent on the asset's ability to generate net cash inflows and where the Group would, if deprived of the asset, replace its remaining future economic benefits or service potential.

The value in use for cash-generating assets and cash generating units is the present value of expected future cash flows.

If an asset's carrying amount exceeds its recoverable amount, the asset is impaired and the carrying amount is written down to the recoverable amount. For revalued assets, the impairment loss is recognised against the revaluation reserve. Where that results in a debit balance in the revaluation reserve, the balance is recognised in the Statement of Financial Performance.

For assets not carried at a revalued amount, the total impairment loss is recognised in the Statement of Financial Performance.

Plant and equipment, motor vehicles, leasehold improvements and equipment under finance leases are stated at cost less accumulated depreciation and impairment. In the event that settlement of all or part of the purchase consideration is deferred, cost is determined by discounting the amounts payable in the future to their present value as at the date of the acquisition.

(v) Renewals

Expenditures, including inventory, relating to track renewals, ballast, formation upgrading, and major overhauls of rolling stock are capitalised as fixed assets. Repairs and maintenance costs are expensed through the Statement of Financial Performance as incurred.

(vi) Depreciation

Depreciation is charged on a straight line basis at rates that will allocate the cost or valuation of the asset over its expected useful life to its estimated residual value. Leasehold improvements are depreciated over the period of the lease or estimated useful life, whichever is the shorter. In determining an asset's useful life, consideration is given to its expected usage, its expected wear and tear, technical or commercial obsolescence, and legal or similar limits on its use.

Depreciation is provided on freehold buildings, railway infrastructure, rolling stock, ships and containers, plant and equipment, but excludes land.

Depreciation on revalued buildings and track assets is charged to the Statement of Financial Performance. On the subsequent sale or retirement of a revalued property, the attributable revaluation surplus remaining in the asset revaluation reserve, net of any related deferred taxes, is transferred directly to retained earnings.

For assets that are revalued, any difference between the depreciation on the revalued asset value and the depreciation based on the original cost is transferred from the asset revaluation reserve to retained earnings.

The average depreciable lives for major categories of property, plant and equipment are as follows:

Category	Useful life
Infrastructure	
- Tunnels and bridges	75 - 200 years
- Track and ballast	40 – 50 years
- Overhead traction	20 – 80 years
- Signals and communications	15 – 50 years
- Buildings	35 – 80 years

Category	Useful life
Rolling stock and ships	
- Wagons and carriages	5 - 30 years
- Locomotives	5 - 23 years
- Ships	20 years
- Containers	10 years
Other	
- Plant and equipment	5 – 35 years
- Motor vehicles	5 – 10 years
- Furniture and fittings	5 years
- Office equipment	3 - 5 years

(d) Valuation of intangible assets

Intangible assets comprise software applications which have a finite useful life and are recorded at cost less accumulated amortisation and impairment.

Intangible assets are recognised initially at cost. Intangible assets with a finite useful life are amortised on a straight-line basis over their estimated useful lives, which were 3 to 5 years for all reporting periods.

(e) Borrowing Costs

Interest expense is recognised in the Statement of Financial Performance using the effective interest rate method.

As a public benefit entity the Group has elected not to capitalise borrowing costs on capital projects.

(f) Inventories

Inventory comprises items that are used in the maintenance and operation of the rail network, fuel, passenger consumable items, and items used in the manufacture of assets for sale to external parties. Inventory is not held for trading purposes with the exception of consumable cafeteria supplies held on the rail and ferry passenger services.

Inventory is recorded at the lower of cost and current replacement cost. Cost comprises direct materials, and where applicable, direct labour costs and those overheads that have been incurred in bringing the inventory to its present condition and location. Cost is calculated on the weighted average method.

(g) Leases

(i) Operating Leases

Operating leases are defined as leases under which substantially all the risks and rewards of ownership of the applicable asset or assets remain with the lessor. Operating leased assets are not represented in the Consolidated Balance Sheet. Expenses relating to operating leases are charged to the Income Statement on a basis that is representative of the pattern of benefits expected to be derived from the leased asset.

(ii) Finance Leases

Leases in which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases.

Finance lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The interest expense component of finance lease payments is recognised in

the Statement of Financial Performance using the effective interest rate method. Assets acquired by way of a finance lease are included in property, plant and equipment, initially at an amount equal to the lower of its fair value and the present value of the future minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

(h) Income tax

The Parent is exempt from income tax as a public authority. All subsidiaries of the Parent are taxpayers. The accounting policies applied in respect of the subsidiaries are as follows:

Income tax expense comprises both current and deferred tax. Income tax expense is charged or credited to the Statement of Financial Performance, except when it relates to items charged or credited directly to equity, in which case the tax is charged to equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at reporting date and any adjustments to tax in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the carrying amounts used for taxation purposes.

The amount of deferred tax provided is based on the expected manner of realisation of the asset or settlement of the liability, using tax rates enacted or substantively enacted at each reporting date. Deferred tax assets and liabilities are not discounted.

A deferred tax asset is recognised in the financial statements for all deductible temporary differences and for the carry forward of unused tax losses and unused tax credits only to the extent that it is probable that future taxable surpluses will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Unrecognised deferred tax assets are reassessed at each balance sheet date.

(i) Goods and Services Tax (GST)

All items in the financial statements are presented exclusive of GST, except for receivables and payables, which are presented on a GST inclusive basis. Where GST is not recoverable as an input tax, it is recognised as part of the related asset or expense.

The net amount of GST recoverable from, or payable to, the Inland Revenue Department (IRD) is included as part of receivables or payables in the Balance Sheet.

Cash flows are included in the statement of cash flows on a net basis in respect of GST. The GST components of cash flows arising from investing and financing activities, which are recoverable from, or payable to, IRD, are classified as operating cash flows.

(j) Provisions

Provisions are recognised when the Group has a present or constructive obligation as a result of past events; and it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are measured at the present value of the expenditure expected to be required to settle the obligation.

If the effect of the time value of money is material, provisions are determined by discounting the future cash flows. Where discounting is used, the increase in the provision for the passage of time is recognised as a finance cost.

(k) ACC Partnership Programme

The subsidiary company KiwiRail Holdings Limited and its subsidiaries belong to the ACC Partnership Programme whereby it accepts the management and financial responsibility for employee work related accidents. Under the programme, KiwiRail Holdings Limited is liable for all its claims costs for a period of four years up to a specified maximum. At the end of the four year period, a premium is paid to ACC for the value of residual claims, and from that point the liability for ongoing claims passes to ACC.

The liability for the ACC Partnership Programme is measured annually by independent actuaries using actuarial techniques at the present value of expected future payments to be made in respect of the employee injuries and claims up to the reporting date. Consideration is given to anticipated future wages and salary levels and experience of employee claims and injuries. Expected future payments are discounted using market yields on Government bonds at balance date with terms to maturity that match, as closely as possible, the estimated future cash outflows.

The Parent and its subsidiary ONTRACK Infrastructure Limited do not belong to the ACC partnership programme and insure directly through the payment of levies to the ACC.

(l) Employee entitlements

Provision is made for benefits accruing to employees in respect of annual leave, retiring and long service leave, and sick leave when it is probable that settlement will be required and they are capable of being measured reliably.

The provision for retiring leave, long service leave and sick leave is calculated on an annual basis by independent actuaries.

Provisions made in respect of employee benefits expected to be settled within twelve months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits which are not expected to be settled within twelve months are measured on an actuarial basis at the present value of the estimated future cash outflows to be made by the consolidated entity in respect of services provided by employees up to the reporting date.

Employee entitlements to salaries and wages, annual leave, long service leave and other similar benefits are actuarially valued on an annual basis and are recognised in the Income Statement when they accrue.

(m) Contributions to superannuation plans

Certain employees are members of defined contribution schemes and the Group contributes to those schemes. A defined contribution scheme is a plan under which the employee and the Group pay fixed contributions into a separate entity. The Group has no legal or constructive obligation to pay further contributions in relation to employee service in the current and prior periods. The contributions are recognised as labour and related costs in the Income Statement when they are due.

(n) Financial assets

Financial assets comprise cash and cash equivalents and loans and receivables. Derivatives are measured at fair value through profit and loss unless they are hedge accounted.

Financial assets are recognised and derecognised on the trade date where the purchase or sale of a financial asset is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs except for those financial assets classified as at fair value through profit or loss which are initially measured at fair value.

(i) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, call deposits and other investments with an initial term of less than 3 months.

(ii) Impairment of financial assets

Financial assets, other than those at fair value through profit or loss are assessed for indicators of impairment at each balance date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that have occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment has been impacted. For financial assets carried at cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of a doubtful debt provision. When a trade receivable is uncollectible, it is written off against the doubtful debt provision. Subsequent recoveries of amounts previously written off are credited to the Statement of Financial Performance. Changes in the carrying amount of the doubtful debt provision are recognised in the Statement of Financial Performance.

(o) Financial liabilities

Financial liabilities are classified as either financial liabilities at 'fair value through profit or loss' or 'at amortised cost'.

Payables

Payables are recognised when the Group becomes obliged to make future payments resulting from the purchase of goods and services. Payables are initially measured at fair value and subsequently measured at amortised costs using the effective interest rate method.

Borrowings

Borrowings are initially measured at fair value, net of transaction costs. Borrowings are subsequently measured at amortised cost using the effective interest method, with the interest expense recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for more than 12 months after the balance sheet date.

(p) Derivative financial instruments and hedging activities

The Group uses derivative financial instruments within predetermined policies and limits in order to manage its exposure to fluctuations in foreign exchange, commodity and interest rate risks. The Group does not engage in speculative transactions or hold derivative financial instruments for trading purposes.

To manage this exposure the Group uses the following derivative financial instruments:

- Foreign exchange forward contracts and options
- Interest rate swaps
- Fuel commodity hedges
- Copper commodity hedges

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into (the trade date). Any transaction costs are expensed immediately. The derivative financial instruments are subsequently re-measured to fair value. The method of recognising the resulting gain or loss depends on whether the derivative financial instrument is designated as a hedging instrument, and, the nature of the item being hedged.

Gains and losses, and movements in fair values of derivative financial instruments not in hedging relationships are recognised in the Statement of Financial Performance as follows:

- Foreign exchange forward contracts and options excluding contracts relating to fuel purchases – as part of “Foreign exchange net gains and losses”
- Interest rate swaps – as part of ‘Net finance costs’
- Fuel related foreign exchange forward contracts, fuel commodity hedges and copper commodity hedges – as part of ‘Operating expenses’

The risk management objectives and strategy for undertaking various hedge transactions is covered by the Group Treasury Policy. The Group documents, at the inception of the transaction, the hedging relationship between hedging financial instruments and the hedged items. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives used in the hedging transaction are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair value of derivative financial instruments is classified as a non-current asset or liability when maturity of the hedged item exceeds 12 months. It is classified as a current asset or liability when the maturity of the hedged item is less than 12 months.

Cash flow hedges

Changes in the fair value of derivative financial instruments designated as cash flow hedges are recognised directly in the cash flow hedge reserve within equity to the extent that the hedges are deemed effective. To the extent that the hedges are ineffective for accounting, changes in fair value are recognised in the Statement of Financial Performance.

If a derivative financial instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, or the designation of the hedge relationship is revoked or changed, then hedge accounting is discontinued. The cumulative gain or loss previously recorded in the cash flow hedge reserve remains there until the forecast transaction occurs. If the underlying hedged transaction is no longer expected to occur, the cumulative, unrealised gain or loss recognised in the cash flow hedge reserve with respect to the derivative instrument is recognised immediately in the Statement of Financial Performance.

Where the hedge relationship continues throughout its designated term, the amount in the cash flow hedge reserve is transferred to the carrying value of the asset when it is recognised.

(q) Foreign currency transactions

Foreign currency transactions are translated to New Zealand currency at the exchange rates ruling at the transaction date.

Monetary assets and liabilities in foreign currencies at balance date are translated at exchange rates ruling at balance date. All exchange differences arising on the translation of monetary assets and liabilities in foreign currencies, whether realised or unrealised, are recognised in the Statement of Financial Performance, except when deferred in equity as qualifying cash flow hedges.

15 APPENDIX 2: SUBSIDIARIES AND ASSOCIATED COMPANIES

The terms share and subsidiary have the same meanings as in section 2 of the State-Owned Enterprises Act 1986.

1. The Corporation shall ensure at all times that:
 - Control of the affairs of every subsidiary of the Corporation is exercised by a majority of the Directors of that subsidiary; and
 - A majority of the Directors of every subsidiary of the Corporation are persons who are also Directors of the Corporation, Executives of the Corporation, Executives of a subsidiary of the Corporation, or who have been approved by the shareholding Ministers for appointment as Directors of the subsidiary.
2. Without consulting shareholding Ministers, neither the Corporation nor its subsidiaries shall sell or otherwise dispose of, whether by single transaction or any series of transactions, and whether by a sale of assets or shares, the whole or any part of the business, if:
 - That which is to be sold, or disposed of, is valued at more than 5 percent of the Shareholder's equity in the Corporation; or
 - The sale or disposal will materially reduce the nature and scope of the business as recorded in Section 3 of the Statement of Corporate Intent.

16 APPENDIX 3: CONSULTATION

KiwiRail will consult with its Shareholding Ministers on matters that would have a material effect on the scale, scope, financial return or risk of the activities of the Corporation or its subsidiaries, including:

- (a) Any substantial capital (or equity) investment
- (b) The sale or disposal of the whole or any substantial part of the corporation or its subsidiaries
- (c) Any substantial expansion of activities outside the scope of its business as defined in Section 2 of the Statement of Corporate Intent
- (d) Any other significant transactions.

DIRECTORY

DIRECTORS

Chair

Deputy Chair

Directors

John Spencer

Paula Rebstock, CNZM

Bob Field, ONZM

John Leuchars

Rebecca Thomas

Kevin Thompson

Mark Tume

EXECUTIVE TEAM

Chief Executive

General Manager Human Resources

General Manager Interislander

Chief Information Officer

General Manager KiwiRail Freight

General Manager KiwiRail Passenger

General Manager KiwiRail Mechanical

General Manager Legal and Governance

General Manager KiwiRail Network

Chief Financial Officer

Jim Quinn

Nicola Brown

Thomas Davis

Graeme Docherty

Iain Hill

Dr Deborah Hume

Lloyd Major

Karen Paterson

Rick van Barneveld

David Walsh

Bankers

Bank of New Zealand

North End Branch, 100 Lambton Quay Wellington

P.O. Box 1596, Wellington 6140

Auditors

Stephen Lucy, Audit New Zealand

On behalf of the Auditor-General

L8, St Paul's Square, Wellington

Private Bag 99, Wellington 6140

Registered office

L4, Wellington Railway Station, Bunny Street,

Wellington 6011

