

















Statement of Corporate Intent 2009-12

KiwiRail

CONTENTS

1 INTRODUCTION

The formation of KiwiRail as the trading entity of the New Zealand Railways Corporation over the last nine months sees the re-establishment of a fully integrated rail and inter-island ferry network for New Zealand. This is the first Statement of Corporate Intent for the new combined KiwiRail entity. This integration offers great opportunity to establish the most effective and efficient rail network appropriate for New Zealand's ongoing growth and prosperity.

As a new entity, KiwiRail is focussing on integrating its legacy businesses as well as setting the strategy going forward. As such, KiwiRail is working co-operatively with our Shareholder, the Crown, and their officials to agree this strategy and the associated funding requirements to deliver that strategy. Completion of that process will take some months, with a target date of November 2009. The review exercise will look at how KiwiRail can drive profitability through managing revenue, expenditure and investing capital appropriately to deliver a sustainable, efficient network.

Trading performance, before operating grant support and capital grants funding, is forecast to rise from an Earnings Before Interest, Tax and Depreciation (EBITDA) of $59 Million in 2010 to $126 Million in 2012. However this Statement of Corporate Intent reflects net cash deficits for each operating period due to unfunded capital expenditure going forward. In the event that sufficient long term funding is not available, the SCI will need to be modified, as permitted by the State-Owned Enterprises Act 1986.

2 THE KIWIRAIL BUSINESS

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
  - Auckland Metro Maintenance, which provides locomotive engineers and provides and maintains rolling stock for Veolia Auckland Transport Ltd
- KiwiRail Interislander – operates the ferry passenger and freight services. This includes:
  - New Zealand's only two inter-island ferries with rail capacity
  - Three "roll-on, roll-off" ferries carrying 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, TranzCoastal, Overlander and Capital Connection long distance passenger services
  - Tranz Metro, which provides urban passenger services under contract to the Greater Wellington Regional Council
- KiwiRail Network (ONTRACK) – maintains and improves the rail network and controls the operation of trains on the network.
- KiwiRail Mechanical Services. This includes:
  - Hillside Engineering, the rail and heavy engineering manufacturer
  - KiwiRail Mechanical Services, which provides all mechanical servicing
  - Professional Services Group, the rail engineering design house

3 STATEMENT OF CORPORATE INTENT 1 JULY 2009 – 30 JUNE 2012

This statement is prepared in terms of section 14 of the State-Owned Enterprises Act 1986.

3.1 Purpose and Vision

To be a world-class mover of people and freight by rail and ships and to be the natural choice for our customers in the markets in which we operate.

To be the backbone of the integrated New Zealand transport system

by:

- Being the cost effective supplier of choice for freight and passenger transport services in the markets that we operate
- Building and growing our business
- Being a critical link between our customers and their market/destination including bridging the North and South Islands with the Interislander
- Offering unique tourism experiences
- Being a dependable provider of public transport
- Taking pressure off the roads
- Being a significant player in the import and export supply chain
- Working together in the '*KiwiRail Way*'
- Delivering world class productivity for our activities as measured against similar operations
- Being innovative to achieve competitive advantage
- Operating in a fully commercial manner in line with Shareholder expectations
- Maximising our commercial return and our contribution to New Zealand's economic growth
- Delivering on time with improved speed of service
- Being a great New Zealand business and meeting our social obligation

3.1.1 OBJECTIVES

Under the Act, KiwiRail is required to operate as a successful business and specifically to achieve the following objectives:

- To operate an efficient, effective and profitable business and provide to the owners a commercial return on the capital employed
- To be a good employer
- To exhibit a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so

3.1.2 STRATEGIES

The following business strategies have been set for the period:

- To complete operational integration of the above and below rail businesses that were previously separated thereby developing an efficient and effective rail business as part of an integrated national transportation solution
- To create a culture and attitude for partnering to develop the best outcome for the end users
- To develop fair commercial pricing, strong systems and a pervasive customer-oriented culture thereby providing customer service outcomes that meet or exceed expectations
- Drive business behaviour that reflects the appropriate commercial outcomes opportunities and to grow wherever there is a commercial or economic return in line with our vision
- To extend the reach of the business through focus on deep integration with all customers to make use of KiwiRail a natural outcome.
- To operate the business as a safe and integrated network – optimising freight and passenger needs and treating branch lines as feeders for the wider network economics
- To continuously improve our service levels and productivity to ensure that we remain relevant in transit times and capability - both for today and the future, and that our need for subsidy decreases as profitability improves
- To manage our assets:
  - Efficiently maintaining, renewing and upgrading through the right mix of staff and contractors
  - Ensuring that our assets meet fit-for-purpose standards for the traffic carried now and in the future, without a backlog of outstanding work
- To plan our investments within the overall transport and infrastructure strategy set by the Government

3.2 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 Interisland 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 metro areas, near regions and long distance for both domestic and tourist markets
- To develop, where appropriate, rail and ferry services and rail and ferry intellectual property in expanded markets
- To undertake or participate in business activities which add value for customers and leverage the capabilities of KiwiRail

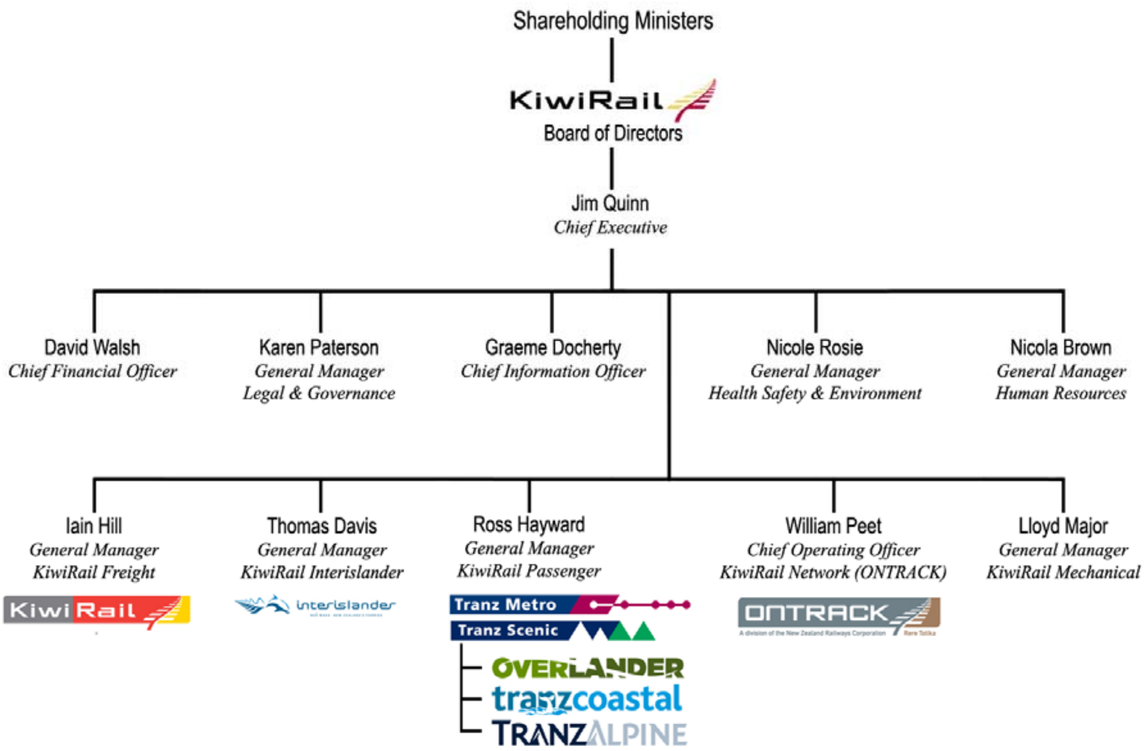
Within all these areas KiwiRail undertakes activities that permit profitable utilisation of its existing assets, including intellectual property and the expertise of its people. These activities will be developed as part of the operation of KiwiRail, through subsidiary and associated companies and through alliances with business partners.

3.3 Corporate Responsibility Commitment

KiwiRail’s commitment to Corporate Responsibility has been defined across five impact areas:

- 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 deliver to our **customers** what we have promised; we will listen to them and involve them in our solutions and innovations
- To work with our **suppliers** to develop long term partnerships based on best practice procurement methods which reflect mutually agreeable codes of conduct and respect basic human rights
- To recognise the environment, 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 to protect the **environment** by better understanding, managing and measuring our environmental impacts and minimise the carbon footprint of the assets in our care by reduction in GHG emissions metrics per NTK by 10 percent between 2010 and 2012 while continuing the sustainable growth of our operations. We will review our environmental practices to ensure their continued relevance

3.4 KiwiRail's Structure



3.5 Government Operating and Capital Support for Rail Business

The combined financial statements for this entity have $90 million of operating support for the 2009/10 financial year which has been approved by the Shareholder. Trading performance, before operating grant support and capital grants funding is forecast to improve from a budgeted EBITDA of $59 Million in 2010 to $126 Million in 2012. However, in the 2009/10 year it is forecast that KiwiRail will report a deficit that is primarily connected with a shortfall in funding of our capital investment program. Beyond the 2009/10 financial year no operating support grant has been assumed nor has additional capital support (beyond specifically approved projects) been assumed which results in larger deficits for those future years.

It is the expectation of the Board of KiwiRail that it shall approach the Crown in coming months with further detailed business cases to support further funding being provided to the business. These cases will either support specific Government objectives on Public Transport or enable the business to deliver future benefits to the Crown via specific investment strategies and initiatives to bridge the expected deficit gap.

Some key strategic reviews will be undertaken during the next financial year. Fundamental to this is whether the business continues to operate a national network or whether it operates using smaller lines that are not totally integrated. Such a decision informs many of the core strategies the business will then follow, including, but not limited to, the reinvestment strategy programme, for example on specific lines, or for specific assets, i.e. ferries.

The Crown has yet to confirm the exact framework under which KiwiRail will operate. Currently KiwiRail is governed by the New Zealand Railways Corporation Act 1981 and the State-Owned

Enterprises Act 1986. Clarification of the operating environment and the Government's objectives for the business is assumed to occur within the next year.

Funding

- For the 2009/10 financial year a Government Subsidy of $90 million will be provided
- Continued funding for public good outputs from Vote: Transport
- Current funding shortfalls for the 2009/10 year are approximately $48 million and this rises significantly in 2011 and 2012 due to there being no operating subsidy agreed beyond 2010 as well as no funding to enable the planned capital upgrades and deferrals carried over from 2010 as detailed in this SCI. Discussions are ongoing with officials and shareholding ministers to bridge the funding gap for 2009/10 and beyond
- Key strategic reviews will be undertaken during the 2009/10 year to determine future shape of the business and results of this review will help determine future funding requirements of the business in terms of capital and operating support
- Continuation of the existing freight and metro upgrade capital grants as already approved
- Continuation of current drawn and approved additional lines of debt funding including the working capital and new locomotives debt facility
- Ultimately no significant capital investment will occur in the business in the absence of agreed funding despite that currently being the case in this SCI
- In the event that sufficient long term funding is not available, the SCI will need to be modified, as permitted by the State-Owned Enterprises Act 1986.

A core assumption for the plan is that the current infrastructure used to operate the rail network is brought up to market readiness over the next five years. This investment is required as a result of years of under-investment, which has had the impact of the business operating in a suboptimal way. The plan assumes that future revenue streams can both be protected and unlocked if the network that the business operates with is of sufficient standard. Without the level of reinvestment as outlined, the business believes it will not be able to achieve the targets set out in this plan.




3.6 Performance Targets and Measures

KEY PERFORMANCE MEASURES	2009 Actual*	2010 Budget	2011 Forecast	2012 Forecast
Full twelve months of operations. Reported NZRC consolidated accounts are only consolidated with KiwiRail Ltd accounts for 9 months from 1 October 2008. These tables have added KiwiRail Ltd accounts for the 3 months ended 30 September 2008 giving a true twelve month comparative for the Group against future years. Preliminary Financial results for 2009 before audit completed)				
Financial Measures (# excl capital grants and operating support subsidy)				
Group Net Profit After Tax Including Government Capital Grants	$231.4m	$348.3m	$64.0m	($90.0m)
Group Net Profit After Tax Excluding Government Capital Grants	($111.3m)	($151.7m)	($237.1m)	($250.5m)
Group EBITDA From Trading #	$89.1m	$59.0m	$97.3m	$126.3m
Group Net Cash Surplus / (Deficit)	$44.5m	($48.1m)	($290.4)	($306.2)
Group Operating EBITDA to Operating Turnover #	13.0%	9.0%	14.1%	17.0%
Group Operating Return (EBITDA) on Average Shareholders' Equity #	0.7%	0.5%	0.8%	1.0%
KiwiRail Freight Group Operating EBITDA to Operating Turnover (Includes KiwiRail Mechanical Services Business Unit) #	10.5%	8.7%	13.6%	17.3%
Interislander Operating EBITDA to Operating Turnover #	11.2%	10.7%	11.6%	13.1%
Tranz Scenic Operating EBITDA to Operating Turnover #	16.3%	14.9%	17.4%	21.9%
Tranz Metro Operating EBITDA to Operating Turnover #	17.7%	16.7%	14.9%	13.1%
KiwiRail Network Operating EBITDA to Operating Turnover #	9.0%	(1.9%)	(3.2%)	(4.3%)
Group Operating EBITDA to Tangible #	0.67%	0.43%	0.69%	0.88%
Annual Capital Expenditure				
KiwiRail Freight	$71m	$138m	$133m	$89m
Tranz Scenic	$1m	$5m	$22m	$19m
Interislander	$10m	$7m	$27m	$7m
Developing Auckland Rail Transport (DART)	$180m	$175m	$45m	-
Auckland Electrification	$34m	$105m	$108m	$144m
Wellington Regional Rail Plan (WRRP)	$67m	$146m	$93m	-
Network	$148m	$171m	$268m	$294m
Other	$9m	$19m	$5m	$4m
Total Capital Expenditure	**$520m**	**$767m**	**$700m**	**$556m**
Current Assets to Current Liabilities	0.64	0.44	0.80	0.82
Productivity KPIs				
Freight Operating Cost (Excl Depreciation)/NTK	$0.082	$0.084	$0.081	$0.076
Freight Labour Cost/NTK	$0.0203	$0.0213	$0.0209	$0.0197
Interislander Labour Cost / Revenue	25.8%	27.2%	26.8%	26.6%
Tranz Scenic Operating Cost (Excl Depn)/Pax	$48.41	$51.79	$50.72	$49.46
Freight Tonne Density Per KM of Track	1,037,432	1,016,345	1,092,771	1,189,764
Commercial Volume Targets				
Freight Tonnes Carried (000)	14,412	14,133	15,090	16,498
Freight NTKs (million)	3,962	3,881	4,173	4,544
Interisland Passenger Journeys (000s)	857	863	889	916
Interisland Commercial Vehicle Lane Mtrs (000)	1,058	1,052	1,073	1,095
Tranz Metro Wellington Passenger Journeys (000)	11,876	11,981	12,280	12,587
Tranz Scenic Passenger Journeys (000)	483	447	468	493
Customer Focus KPIs				
Customer Satisfaction Interisland	78%	80%	84%	86%
On Time Performance Key Freight Trains (<30 minutes)	76%	80%	85%	90%
On Time Performance Tranz Metro	88%	92%	95%	95%
On Time Performance Interisland (<15 minutes)	82%	86%	90%	93%
Infrastructure and Engineering Targets				
New rail laid (km)	33	23	40	70
New sleepers laid ('000)	103	61	120	200
Line de-stressed (km)	156	210	200	280
Bridge timber spans replaced (m)	373	204	210	210
Bridge timber piers replaced (No.)	132	114	110	110
New locomotives purchased	-	10	10	-
New passenger carriages purchased	-	2	10	5
People Engagement and Safety in the workplace and community				
LTIFR (Per Million Hours) Reduction Target	4	5	5	5
Level Crossings upgraded	7	8	8	8
Corporate Responsibility				
GHG Emissions (tonnes)	335,293	331,477	338,583	350,204
GHG Emissions % reduction for year (index per million NTK)	-	(0.9%)	5.0%	5.0%

3.7 Ratio of Shareholders' Funds to Total Assets

KiwiRail's targets for the ratio of Total Shareholders' Funds (TSF) to Total Assets is as follows:

	2009 Actual*	2010 Budget	2011 Forecast	2012 Forecast
Ratio of Shareholders' Funds to Total Assets	94.1%	93.8%	91.5%	89.3%

** Preliminary Financial results for 2009 and before audit completed*

(TSF includes share capital, retained earnings and capital grants.)

3.8 The Crown's Investment in KiwiRail

The Crown's investment in KiwiRail, as at 30 June as measured by Shareholders' Funds, is estimated to be:

Crown's Investment in KiwiRail	2009 Actual*	2010 Budget	2011 Forecast	2012 Forecast
Total Shareholders' Funds (TSF)	$12,554m	$12,903m	$12,967m	$12,877m
Average Shareholders' Funds (ASF)	$12,091m	$12,728m	$12,935m	$12,922m

** Preliminary Financial results for 2009 and before audit completed*

A breakdown of the Crown's investment by major assets types and liabilities are as follows:

Breakdown Of Depreciated Replacement Costs Valuation	2009*
Land	$6,018m
Rail Network Infrastructure	$5,834m
Operating Railway Assets	$462m
Operating Ships	$57m
Other Assets (Buildings and Plant)	$329m
Work In Process	$374m
Working Capital Assets	$261m
Working Capital Liabilities	($339m)
Debt	($442m)
Total Depreciated Replacement Costs Valuation	**$12,554m**

The $12,554 million Shareholder value reported above values the assets using the Depreciated Replacement Cost (DRC) methodology for the businesses fixed assets. This methodology reports the investment required to rebuild the network to a similar standard based on the latest costs for materials, equipment and labour. These values are then reduced to reflect the estimated useful life for the assets, that is, they are depreciated to reflect the age of that particular asset. KiwiRail regularly has these values reassessed by independent valuers. This valuation was conducted on KiwiRail's rolling stock and other assets on acquisition by New Zealand Railways Corporation on 1 October 2008. KiwiRail Network's (ONTRACK) assets are also based on a DRC valuation for fixed assets as at 30 June 2009. Land values are based on market value.

KiwiRail has evaluated alternative valuation methodologies, particularly Discounted Cashflow (DCF). Work is underway to review and split the business into logical trading groups. Once that is complete we will value the trading businesses using DCF and the Network using DRC valuation methodology.

Other material factors that are relevant to the determination of a valuation of KiwiRail are:

- KiwiRail now funds its full infrastructure cost under the current pricing model. This model contributes significantly to the deficit the business faces as a result of the costs associated with maintaining the below rail assets. The Ministry of Transport in collaboration with other agencies is developing advice on rail and road costs, benefits and charges
- The wider contribution rail makes to the New Zealand economy needs to be considered when making an assessment of the true value of KiwiRail to New Zealand

The valuation will be updated annually.

3.9 Forecast Commentary on Performance Targets and Measures

The Corporation's forecast performance is driven by the following key elements:

- Net Profit After Tax (NPAT) Before and After Capital Grants
  - Impacted significantly by Capital Grants for Metro and other rail projects and Operating Support Grant for 2009 and 2010. There is no Operating Support Grant beyond 2010 and Capital Grants fall off due to the winding down of the Metro projects from 2011 (other than Auckland Electrification)
  - Excluding the Capital Grants, NPAT is negative due to the large non cash depreciation charge which rises from $229 Million in 2009 to $309 Million by 2012
- EBITDA from Trading and EBITDA to Operating Turnover
  - EBITDA from Trading (before Government Operating Grant support and Capital Grants Funding) is forecast to rise to $126 Million by 2012 from a budget of $59 Million in 2010. This is driven predominantly by new commercial deals with major customers, a recovery in general economic conditions, significant fuel savings and maintenance savings with the introduction of new locomotives, improved integration benefits and cost efficiency from strategic initiatives
  - Initial 4 percentage point decline in EBITDA to Operating Turnover for the 2010 budget is a direct correlation of the worsening economic conditions. Also KiwiRail Network operating performance falls due to lower third party revenue for projects
  - Significant improvement (5.1 percentage points) in the 2011 financial year in line with improvement in EBITDA trading performance
- Cash Surplus / (Deficit)
  - Cash deficit $48.1 Million in 2010 is due to shortfall in capital renewals funding in 2010. The 2010 year had extra working capital funding of $20 Million and capital funding of some network and rolling stock upgrades. In 2011 the deficit rises significantly due to no operating support grants being assumed, no additional working capital facility and no additional capital funding for any projects other than the Metro projects. This trend continues into 2012 in line with the capital expenditure increases in Network, the lack of operating support grants and no further capital funding other than for Metro projects
- Capital Expenditure
  - DART - $220m of the total $600m project to be completed & finalised in 2010 & 2011 (completion date)
  - WRRP - $240m of the total $316m project over years 2010 & 2011 (completion date)
  - Auckland Electrification - $356m of the total $500m project over the SCI period, completion date 2013
  - KiwiRail Freight driven by the purchase of the new 20 new Locomotives with $55m in 2010 & $20m in 2011
  - Tranz Scenic driven by phasing of new carriages – 2 in 2010, 10 in 2011 & 5 in 2012
  - Interislander in 2011 driven by the Aratere refurbishment
  - Network increase of $97m in 2011 is driven by the upgrade of the national rail network in line with the original Rail Development Group plan (RDG plan), however accepting that economic constraints may affect the original timelines of that investment as originally envisioned. There has also been fiscally-driven deferral of some key track renewal projects from 2010 into 2011 – 2012 and beyond
- Working Capital
  - Decline in Current Ratio driven mainly by repayment of long term debt using closing cash, decline in accounts receivable relative to accounts payable
- GHG Emissions
  - Indexed to NTK's – target is set as a change in the index
  - Decrease in 2010 driven by key infrastructure projects (cement production is a significant contributor to GHG's)
  - Improvement in 2011 & 2012 is driven by the introduction of the fuel efficient locomotives & the winding up of the key infrastructure projects (DART, WRRP)

3.10 Accounting Policies

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

3.11 Dividend Policy

It is noted that due to KiwiRail's current financial position, and in particular its heavy capital investment programme, that dividend payments for the term of this Statement of Corporate Intent are likely to be zero.

Ultimately it is intended that funds surplus to the Corporation's investment and operating requirements will be distributed to the Corporation's Shareholders'. The general policy is that the dividends are to be calculated as 65% of surplus operating cashflows.

The level of surplus operating cashflows available for dividend will be determined by reference to:

- the Corporation's medium-term fixed asset expenditure programme
- the Corporation's investment in new business opportunities
- the sustainable financial structure for the business
- the Corporation's working capital requirement; and will exclude
- capital profits earned on disposal of assets where such profits are to be used to meet investing and operating requirements

In recommending dividends payable to the Shareholders', KiwiRail will follow procedures generally adopted by directors of publicly listed companies, and in accordance with sections 13 and 15 of the State-Owned Enterprises Act 1986. The dates for payment of dividends will be the business day nearest to 15 March for the interim dividend and the business day nearest to 30 September for the final dividend.

3.12 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
- Other information requested by Ministers in accordance with section 18 of the State-Owned Enterprises Act 1986

3.13 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.

3.14 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.

APPENDIX ONE: STATEMENT OF ACCOUNTING POLICIES

A REPORTING ENTITY

New Zealand Railways Corporation ("the Parent") is a statutory corporation established pursuant to the New Zealand Railways Corporation 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 and associate company. The Group is domiciled in New Zealand.

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.

Financial accounting policies and resulting financial statements of the Group are authorised for issue by the Board of directors .

B BASIS OF PREPARATION

Statement of compliance

Externally reported financial statements comply with the New Zealand Railways Corporation Act 1981, the State-Owned Enterprises Act of 1986 and New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") and other applicable financial reporting standards as appropriate for public benefit entities.

Measurement base

Financial statements are 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 are applied consistently to all periods presented in published financial statements.

Functional and presentation currency

The functional currency of the Parent and the Group is New Zealand dollars. Financial statements are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars ($'000). Unless otherwise specified, all dollar amounts in financial statements and accompanying notes are stated in New Zealand dollars.

C 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 Interisland ferries
- Operate Wellington Metro and Tranz Scenic rail passenger services
- Operate rail freight transport services in New Zealand
- Carry out engineering and mechanical services to the locomotives and other rolling stock

D CRITICAL JUDGEMENTS

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 judgements 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 ongoing basis. Revisions of accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Classification of property

The Group owns a number of properties which are maintained primarily to provide for future rail activities. The receipt of market-based rental from these properties is incidental to the holding of these properties. These properties are held for strategic objectives.

The Group currently owns unoccupied land. This land is currently classified as property, plant & equipment. The future use of this land is being assessed in accordance with the strategic objectives of the Group.

Asset revaluations

The Parent’s land is held at fair value and other assets are carried at depreciable replacement cost. When assets are revalued this is done by independent valuers.

The property, plant and equipment of the newly-acquired KiwiRail Holdings Limited and its subsidiaries were valued at acquisition in accordance with the requirements of NZIFRS.

Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation of uncertainty at the balance sheet date, that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial period are discussed below.

Removal of contaminated material

The Group may need to make provision for the removal of contaminated material from land previously used for rail operations. The cost of this remedial work is uncertain. An estimation of the likely cost is to be made at the time that an investigation is undertaken.

Depreciation and useful lives

The useful lives of the Group’s assets are estimated by management based on historical analysis and other available information such as the physical condition of the asset and the expected period of use of the asset.

E SIGNIFICANT ACCOUNTING POLICIES

The following accounting policies are consistently applied to all reporting periods presented in published financial statements.

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 income statement.

The consolidated financial statements of the Group include the Groups' share of the net profit or loss of associate companies on an equity accounted basis. Associate companies are entities in which The Group has significant influence, but not control, over the operating and financial policies. Investments in associate companies are stated at the Parent's share of the fair value of the net assets at acquisition plus the share of post acquisition movements in reserves.

Revenue

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.

Freight revenue is recognised based on the relative transit time.

Passenger revenue is recognised at the date of travel.

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.

Government funding received as reimbursements of the costs of capital projects is recognised as revenue in the period in which the funding is receivable.

Grants received in respect of services provided are recognised when the requirements of the relevant grant agreement are met.

Interest revenue is recognised as it accrues, using the effective interest method.

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.

Dividend income is recognised when the right to receive payment has been established.

Other sources of revenue are recognised when earned and are reported in the financial periods to which they relate.

Expenditure

Expenditure comprises amounts paid and payable by the Parent and the Group for goods and services provided from suppliers, and is recorded in the period in which it is incurred.

General expenditure is recognised within the financial statements in the period in which it is incurred.

Interest expense is recognised using the effective interest rate method.

Property, plant and equipment

Items of property, plant and equipment are initially recorded at cost and, except for land, depreciated. Initial cost includes the purchase consideration, or fair value in the case of subsidised assets, and those costs directly attributable to bringing the asset to the location and condition necessary for its intended use.

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 revenue in the Income Statement.

Land, buildings and track assets held for use in the production or supply of goods and services, or for administrative purposes are stated in the Balance Sheet at their revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are carried out for a number of classes of property, plant and equipment to reflect the service potential and economic benefit obtained through control of the asset. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance date.

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

Buildings and railway infrastructure – specialised assets valued using 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 track assets 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 Income Statement, in which case the increase is credited to the Income Statement 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 Income Statement 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.

Realised gains and losses arising from the disposal of property, plant and equipment are recognised in the Income Statement 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.

The carrying amount of the Group's non current assets is 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. If there is any indication that an asset is impaired, the recoverable amount will be estimated for the individual asset. If it is not possible to estimate the recoverable amount for the individual asset, the recoverable amount of the cash generating unit to which the asset belongs will be determined. A cash generating unit is the smallest identifiable group of assets that generate cash inflows largely independent of the cash inflows of other assets or group of assets. Losses resulting from impairment are reported in the Income

Statement unless the asset is carried at a revalued amount in which case any impairment loss is treated as a revaluation decrease.

Depreciation on revalued buildings and track assets is charged to the Income Statement. 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.

Plant and equipment, motor vehicles, leasehold improvements and equipment under finance leases are stated at cost less accumulated depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition of the item. 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.

Track 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 as incurred.

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.

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

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	DEPRECIABLE LIFE
Tunnels & bridges	60 – 100 years
Buildings	40 years
Wagons & carriages	30 years
Track & ballast	25 – 40 years
Locomotives	23 years
Ships	20 years
Overhead traction	10 – 40 years
Signals & communications	10 – 40 years
Containers	10 years
Plant & equipment	5 – 35 years
Motor vehicles	5 – 10 years
Furniture & fittings	5 years
Office equipment	3 years

Non current assets held for sale

Non current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the net asset (or disposal group) is available for immediate sale in its present condition. The sale of the asset (or disposal group) is expected to be completed within one year from the date of classification.

Non current assets held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Intangible assets

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

Borrowing Costs

Borrowing Costs are recognised in the Income Statement in the period in which they are incurred.

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 net 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.

Leases

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.

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 Income Statement 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.

Income tax

The Parent is defined as a Public Authority under the Income Tax Act 2004 and is therefore not a taxpayer. All subsidiaries of the Parent are taxpayers. The accounting policies applied in respect of the subsidiaries are as follows:

Income tax expense, comprising current and deferred taxes, is recognised in the Income statement.

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

Income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

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 substantially 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.

Goods and services tax (GST)

All items in 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.

Commitments and contingencies are disclosed exclusive of GST.

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.

Provisions

Provisions are recognised when the Group has a present and 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.

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.

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 illnesses and 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 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.

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.

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 recognised in the Income Statement when they accrue.

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.

Financial assets

Investments are recognised and derecognised on the trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment 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.

Financial assets are classified into the following specified categories: financial assets ‘at fair value through profit or loss’, ‘held-to-maturity investments’, ‘available-for-sale’ financial assets, and ‘loans and other receivables’. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of change in value.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are recognised initially at fair value plus transaction costs and subsequently measured at cost using the effective interest rate method, less any provision for impairment. The effective interest method is a method of calculating the cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

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 Income Statement. Changes in the carrying amount of the doubtful debt provision are recognised in the Income Statement. With the exception of available-for-sale equity instruments, if, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the Income Statement to the extent that the carrying amount of the investment at the date the impairment is reversed, does not exceed what the amortised cost would have been, had the impairment not been recognised.

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.

Derivative financial instruments and hedging activities

The Group uses derivative financial instruments within predetermined policies and limits, in order to hedge its exposure to fluctuations in foreign exchange rates, interest rates and commodity prices. Derivative financial instruments are initially recorded at fair value and subsequently measured at fair value at each reporting date. Changes in the fair value of derivative financial instruments are charged against income. The Group does not apply hedge accounting.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not measured at fair value with changes in fair value recognised in the Income Statement.

The Group does not engage in speculative transactions or hold derivative financial instruments for trading purposes.

Foreign currency

Foreign currency transactions are translated to New Zealand currency at the exchange rates ruling at the dates of the transactions.

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 Income Statement.

Statement of cash flows

The following are the definitions of the terms used in the Statement of Cash Flows:

- cash is cash on hand and current accounts in banks, short term deposit accounts with a maturity date of less than three months net of any bank overdraft;
- investing activities are those activities relating to the acquisition, holding and disposal of property, plant and equipment and of investments, and include the purchase and sale of interests in other entities;
- financing activities are those activities which result in changes in the size and composition of the capital structure. This includes both equity and debt not falling within the definition of cash; and
- operating activities include all transactions and other events that are not investing or financing activities.

Cash flows from certain items are disclosed net due to the nature and amount of the transactions involved.

Comparatives

Certain comparatives are reclassified to correspond with the most current year presentation. The Group acquired a significant subsidiary during the year.

F NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

The following standards and amendments were available for early adoption but have not been applied by the Group in the preparation of the financial statements:

- NZIFRS 4 *Insurance contracts* removes the partial exemption for qualifying entities. NZIFRS 4 is applicable for annual reporting periods beginning on or after 1 January 2009. It is not expected to have an impact on the consolidated financial results of the Group as this standard is concerned only with disclosure.
- NZIFRS 8 *Operating Segments,* which will become effective for accounting periods commencing on or after 1 January 2009. New Zealand Railways Corporation, as a public benefit entity, is not required to comply with this accounting standard.
- NZIAS 1 *Presentation of Financial Statements (revised 2007)* replaces NZIAS 1 *Presentation of Financial Statements (issued 2004)* and is effective for reporting periods beginning on or after 1 January 2009. The revised standard requires information in financial statements to be aggregated on the basis of shared characteristics and introduces a Statement of Comprehensive Income. It is not expected to have any impact on the consolidated financial results of the Group as this standard is concerned only with disclosure.
- NZIAS 23 *Borrowing Costs (revised 2007)* replaces NZIAS 23 *Borrowing Costs (issued 2004)* and is effective for reporting periods beginning on or after 1 January 2009. The revised standard requires that an entity capitalize borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of that asset. The revised standard will also require borrowing costs to be considered when revaluing property, plant and equipment to fair value based on depreciated replacement cost. Any necessary adjustments to depreciated replacement cost carrying values will have flow on effect to depreciation expense. The potential impact on the Group's financial results has not yet been quantified. As a Public Benefit Entity, the Group has exercised its option not to apply NZIAS23. Accordingly, the Group has expensed all borrowing costs to the Income Statement as they were incurred.
- NZIAS 32 *Financial Instruments*: Presentation relates to amendments to puttable financial instruments and obligations arising on liquidation. NZIAS 32 is applicable for annual reporting periods beginning on or after 1 July 2009. It is not expected to have any impact on the consolidated financial results of the Group as this standard is concerned only with disclosure.

APPENDIX TWO: 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% of the Shareholders' equity in the Corporation; or
- the sale or disposal will materially reduce the nature and scope of the business as recorded in section 3.2 of the Statement of Corporate Intent.




APPENDIX THREE: 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 2.0 of the Statement of Corporate Intent

(d) Any other significant transactions



DIRECTORY

Directors

Chairman	**Rt Hon James Bolger, ONZ**
Deputy Chairman	Paula Rebstock, CNZM
Members	Linda Constable, MNZM
	Bob Field ONZM
	Mark Franklin
	Bryan Jackson
	Mark Tume

Executive Team

Chief Executive	**Jim Quinn**
General Manager Human Resources	Nicola Brown
General Manager Interislander	Thomas Davis
Chief Information Officer	Graeme Docherty
General Manager Passenger	Ross Hayward
General Manager Freight	Iain Hill
General Manager Mechanical	Lloyd Major
General Manager Legal and Governance	Karen Paterson
Chief Operating Officer Network	William Peet
General Manager Health, Safety and Environment	Nicole Rosie
Chief Financial Officer	David Walsh

Bankers	Bank of New Zealand North End Branch, 100 Lambton Quay Wellington P O Box 1596, Wellington 6140
Auditors	John O'Connell, Audit NZ 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 P O Box 593, Wellington 6140