

The Treasury

Letters of Expectations Information Release

September 2020

This document has been proactively released by the Treasury on the Treasury website at <https://treasury.govt.nz/publications/information-release/letters-of-expectations-september-2020>

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

- [23] 9(2)(a) - to protect the privacy of natural persons, including deceased people
- [25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information
- [31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility
- [33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;
- [37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [23] appearing where information has been withheld in a release document refers to section 9(2)(a).

Copyright and Licensing

Cabinet material and advice to Ministers from the Treasury and other public service departments are © **Crown copyright** but are licensed for re-use under **Creative Commons Attribution 4.0 International (CC BY 4.0)** [<https://creativecommons.org/licenses/by/4.0/>].

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

Deputy Prime Minister

Minister of Foreign Affairs

Minister for Disarmament and Arms Control

Minister for State Owned Enterprises

Minister for Racing



04 DEC 2019

Mr Brian Corban
Chair
KiwiRail Holdings Ltd
[23]

Dear Brian

2020/21 SHAREHOLDER EXPECTATIONS FOR KIWIRAIL HOLDINGS LTD

I am writing on behalf of shareholding Ministers to outline the matters that we expect the Board of KiwiRail Holdings Ltd (KiwiRail) to address in the business planning process for the 2020/21 financial year.

The Government remains committed to resolving key long term challenges facing the country including sustainable and inclusive economic development, supporting thriving and sustainable regions, preserving our natural capital, particularly in view of climate change, leveraging technology to boost productivity and a fair society for all New Zealanders.

Ministers expect that the Boards of entities that comprise the Crown's Commercial Portfolio will support the Government to resolve these challenges by continuing to maximise the value of the portfolio through improved financial performance and effective capital management.

This letter contains the following information:

- Ministers' specific expectations for KiwiRail;
- general expectations for the Crown's Commercial Portfolio; and
- schedule for the increases in capital in 2020/21 (Annex 2).

Entity specific expectations

Our expectations of KiwiRail in the upcoming year are framed by Cabinet's decisions on the Future of Rail review and by the significant investments that the Government is making to ensure a reliable and resilient rail system.

Our overall expectation is that KiwiRail's focus will be on delivering the new planning and funding framework, in particular:

- the importance of KiwiRail providing separate above and below rail financial reporting
- KiwiRail's focus should be on delivering its investments into the rail network and its commercial assets.

We expect KiwiRail to work cooperatively to be part of an integrated public sector transport system and to support the Crown's fiscal management and long term stewardship objectives. We expect it to work to build good working relationships with the Treasury, the Ministry of Transport and the New Zealand Transport Agency, providing timely and comprehensive information to enable them to carry out their various roles as Ministers' agents.

Realise the benefits from the public's investment in rail

In 2020/21, following two years of significantly increased investments and with future investments signalled, we expect KiwiRail to be demonstrating the benefits, and forecasting the future benefits of the public's investment in rail. We expect that through its capital expenditure programme, KiwiRail will maximise the broader fiscal stimulus that can be generated from infrastructure spending, particularly in the regions.

We regard it as important therefore, that KiwiRail demonstrates that it is delivering capital projects on time, on budget and with the best possible impact on:

- the state of and ability to maintain the service levels and resilience of the public rail network
- rail's modal share of freight to achieve increases in both the revenue and the positive externalities it generates.

In the past, KiwiRail's forecasts have been ^[34] with results falling short of these forecasts and being impacted by seismic and other one-off events.

With the Crown providing greater funding certainty, we expect KiwiRail's Statement of Corporate Intent (SCI) and business plan financial and performance forecasts to be based on reasonable best estimates and to provide greater confidence about the likelihood of forecasts being achieved.

To provide this confidence, KiwiRail's business plan for the period 2020/21 – 2022/23 should include the assumptions and significant risks underlying the financial and performance forecasts. These assumptions and risks should be accompanied by sensitivity analysis on their potential impact on the forecasts.

Demonstrate good practice governance and management

With several new members joining the Board during 2019/20, we expect the Board to focus on the development and communication of the strategic direction it intends for KiwiRail.

Given the extent of public investment publicly indicated through Budget 2019, Ministers have high expectations of the Board to ensure that KiwiRail demonstrates its use of good practice governance and has strong internal systems and controls, in particular over its procurement, project, asset, and risk management processes.

Transparency and Accountability for Spending

We expect KiwiRail to provide a high degree of transparency in reporting to:

- shareholding Ministers through its business plan, quarterly and other reporting; and
- the public and other stakeholders through the SCI and annual report.

KiwiRail's reporting should enable users to understand:

- the separate financial operation and results of KiwiRail's above and below rail activities
- the achievement of the public benefits and positive externalities sought from rail
- the state and level of service of the public rail network, including KiwiRail's delivery of its programme of capital expenditure projects by cost, timeframe and intended benefits.

General expectations

Although some of the general expectations are highlighted below, the full expectations for the Crown's Commercial Portfolio companies are contained in the Owner's Expectations Manual (OEM). The OEM, including updates, can be found on the Treasury's website: <https://treasury.govt.nz/publications/guide/owners-expectations-manual>.

Ministers expect that both directors and management of the Crown companies will be familiar with the OEM to ensure shareholder expectations are being met. Attached to this letter (Annex 1), is the timeline for the 2020/21 business planning process and key milestones.

Commercial valuations

Ministers place significant reliance on the Board's estimate of the entity's commercial value. We expect these valuations to be robust, and either prepared or reviewed independently, where appropriate. The review should include the reviewer's view of key assumptions included in the model. Guidance on the commercial preparation and disclosure is provided in Annex 2 of the OEM.

Wellbeing focus

Ministers expect entities to be cognisant of the government's focus on wellbeing. We are supportive of the reporting frameworks being adopted, to varying degrees, across the Crown's commercial entities (such as Integrated Reporting), which are increasingly being used by companies internationally.

Executive pay

Ministers acknowledge that it is the Board's role to set the executive team's remuneration. We expect that the remuneration will be appropriately linked to performance, and set at a level sufficient to attract and retain the necessary skills to enable Crown owned companies to operate as successful businesses and to be as profitable and efficient as comparable businesses that are not owned by the Crown.

Ministers are, however, also mindful of the government's focus on raising pay levels for those on low and middle incomes. To this end, we expect Boards to take a conservative approach with respect to executive remuneration and to have robust processes in place to support, and publicly justify, the decisions made.

Shareholding Ministers are focused on the transparency of executive remuneration, and we expect to see this reflected in your entity's upcoming half-year report (if applicable), and then in your annual report thereafter. Further disclosure in subsequent half-year reports is not required. If you have not already, you will shortly receive a letter outlining these expectations.

Support diversity

Consistent with government support for increased diversity and gender balance on Boards, entities are encouraged to support diversity and inclusion in the workplace and in leadership.

Governance – Board evaluations

Board evaluations help Boards improve performance and contribute to advice to shareholding Ministers on board composition. A full, independent Board evaluation is expected to be undertaken at least every three years, with a more limited interim evaluation between those times. Information should also be provided on investment in director development.

No surprises

Ministers expect to be informed well in advance of any material or significant events relating to the entity, whether positive or negative. Examples of matters that could fall within the 'no surprises' policy could include, but are not limited to: any risk to financial forecasts, imminent media coverage of any activities that could attract critical media comment or on which shareholding Ministers could be asked to express a view.

In particular, companies should inform Ministers' offices before the announcement of all financial results, and before companies appear in front of select committees.

Engagement

Your Treasury relationship managers will be in contact shortly after you receive this letter to discuss Ministers' expectations in more detail. If you have any questions please contact Ann Webster (on ^[39]). Alternatively you can contact Maureena van der Lem, Manager Commercial Performance, (on ^[39]).

On behalf of shareholding Ministers, I would like to thank you, the Board, and the management and staff of KiwiRail for your work in rebuilding rail as the backbone of a sustainable 21st century transport network.

We look forward to KiwiRail's continued contribution in 2020/21.

Yours sincerely



Rt Hon Winston Peters
Minister for State Owned Enterprises
on behalf of shareholding Ministers

cc: Greg Miller, CEO, KiwiRail Limited, ^[39]

Annex 1

Timetable for the Business Planning Process for 2020/21

Table 1: Summary timetable for the Business Planning Process

<i>Due by</i>	<i>Key Action</i>
January / February	The Treasury to discuss the Letter of Expectations with the Chair
Friday, 28 February	Board sends Strategic Issues letter to Ministers
Friday, 28 February	Board provides Post Investment Reviews to the Treasury
Thursday, 30 April	Board submits draft SCI and business plan
Friday, 29 May	Board provides advice on: <ul style="list-style-type: none">• whether special fees are sought for 2020/21;• the professional development spend in 2019/20 and the proposed professional development budget for 2020/21; and• whether an evaluation of its performance in the past 12 months has taken place, what process was used and the outcomes of the evaluation.
Tuesday, 30 June	Board delivers final SCI to shareholding Ministers
As soon as practicable after delivery of the final SCI to Ministers	Company to publish SCI on its website

All entities are expected to provide shareholding Ministers with a **Strategic Issues letter**, by **Friday, 28 February 2020** in response to the Letter of Expectations. Should your company wish to engage with shareholding Ministers to seek clarification around their expectations, we would ask that you advise the Treasury as early as possible of such intentions.

Entities are expected to provide shareholding Ministers with a draft SCI and Business Plan, consistent with the expectations as detailed in this letter, by no later than **Thursday, 30 April 2020**.

The final SCI should be delivered to shareholding Ministers on or before **Tuesday, 30 June 2020**.

Shareholding Ministers should be alerted as soon as possible if any of these deadlines cannot be met.

Further guidance on the timetable is contained in section 5.6.4 of the OEM. The OEM is available from the Treasury's website.

Annex 2

Schedule for Increases in Capital for Kiwirail Holdings Limited for 2020/21

Section 10 of the State-Owned Enterprises Act 1986 provides that the Minister of Finance and the responsible Minister may, on behalf of the Crown, subscribe for shares in KiwiRail out of money appropriated by Parliament for the purpose.

The Estimates of Appropriation provide funding to KiwiRail and KiwiRail also receive funding from other appropriations, such as the Provincial Growth Fund, as equity investments through the subscription of shares by the Crown.

To provide for the effective financial management of Vote Transport and to support shareholding Ministers to effectively carrying out their ownership responsibilities, share subscription and entitled persons' agreements will be prepared in accordance with the timetable set out in the table below.

As part of the preparation of its 2020/21 – 2022/23 SCI and business plan, KiwiRail should prepare a monthly forecast of its capital expenditure requiring Crown funding to be paid through share subscriptions.

The amount for each payment period will be based on KiwiRail's final SCI and business plan as provided to the Commercial Performance team of the Treasury in July 2020 and may be adjusted for variations in actual compared with forecast commitments and needs.

Share subscription and entitled persons' agreements will be accompanied, for each appropriation or funding agreement for which equity funding is sought, by a description of the capital expenditure intended in the period, and the capital expenditure in the prior period.

Table 2: Schedule for Increases in Capital

Milestone for issue of share subscription and entitled persons' agreements	Indicative Payment Date for Subscribed Shares
Final 2020/21 – 2022/23 SCI provided to Ministers	By end July 2020
2019/20 annual report	By end October 2019
Half yearly report	By end February 2020