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ANNUAL REPORT 2016_17

TRANSPOWER

A connected future.

CONTENTS

CHAIR AND CHIEF EXECUTIVE REVIEW

POWERING NEW ZEALAND TODAY + TOMORROW

ALISON ANDREW
CHIEF EXECUTIVE

HON. TONY RYALL
CHAIR

We keep New Zealand connected: our people plan, build and operate the high voltage electricity transmission system that powers our country and our lives. We are proud of our heritage – we have been powering Kiwi homes and businesses in one form or another for over 100 years.

Our two roles as grid owner and real-time system operator are interdependent – both are essential for the power system to operate successfully. While we are most widely known for transmitting electricity, our role is much broader than this. We have a responsibility to help New Zealand meet its changing energy needs in a safe, affordable and reliable way, while supporting an evolving consumer landscape.

> the power system of tomorrow will be very different to what it is today

> as technology options become more affordable, distributed solar and battery storage will be leveraged by homes, businesses, vehicles, communities and industrial users

This past year, a predominant theme across the company has been how we prepare for a future that is incredibly uncertain. Changing societal factors, variations in energy generation and relatively flat demand growth will have implications for our business – and therefore New Zealand – principally around future investment decisions and maintenance practices on the National Grid.

We know that the power system of tomorrow will be very different to what it is today. Like any business, we need to plan realistically for the future, but even more so given we operate a critical infrastructure business that supports the New Zealand economy. We are very aware that the regulated investment decisions we make are funded by the electricity consumers of New Zealand. The assets we own and operate are long term (lasting 60–70 years on average), and we need to ensure that our decisions are well informed so that the appropriate long-term investments are made for New Zealand.

To do this in the current environment, we need to be agile and responsive to an evolving industry and environment. Keeping abreast of international trends and emerging technology companies and investigating ourselves what effect batteries, electric vehicles, solar and consumer interaction will have on the energy landscape is an important part of this. As technology options become more affordable, distributed solar and battery storage will be leveraged by homes, businesses, vehicles, communities and industrial users – as well as electricity distribution and transmission systems. This will change the way we operate our business. In Transmission Tomorrow, we looked at scenarios that may eventuate, and this has helped to set out our strategic plan for the next 20+ years.

We are now taking those scenarios and developing our thinking further through a variety of reports and investigations into the technologies we believe will have the greatest impact on how we operate and those that could support us in providing further value to the electricity consumers of New Zealand. Shortly, a series of reports on battery storage, solar and electric vehicles will be released.

At the end of June 2017, we are in a good position to meet the challenges and opportunities of the changing landscape. We will continue working with our customers and stakeholders as we progress to ensure alignment across the entire electricity supply chain.

Delivering reliable and value-driven services

> we achieved our HVDC availability measure (matching our target of 98.5%) and exceeded our HVAC availability measure (98.73% against a target of 98.64%)

Grid reliability is highly valued by our customers and electricity consumers. Continuous improvements in our maintenance processes and how we deliver our grid services has resulted in us achieving all of our grid asset reliability targets. Our HVDC availability measure on 30 June 2017 was 98.5% (target 98.5%). Our HVAC availability measure on 30 June 2017 was 98.73% (target 98.64%).

We had some unique service challenges this year with the Hawke's Bay snowstorms (August 2016), Kaikoura earthquake (November 2016), Northland outage following gunshots at our transmission towers (January 2017) and the Canterbury fires (February 2017). These all required considerable response efforts from our team and service providers. Our investment in crisis emergency training proved invaluable at these times and enabled our service availability across the year. We commend our people, service providers and customers for their efforts during these unexpected events.

In early 2017, we conducted a review of our live line work, prompted by new guidelines published by the Electricity Engineers' Association and supported by WorkSafe. This review included robust discussions and workshops with our service providers as it became clear that the amount of work that could be performed 'live' in future was significantly reduced. Based on this volume, it would be difficult to maintain live-line competence across our workforce over the long term. We have agreed that only joint testing will be undertaken live going forward, and we will continue to explore opportunities for performing de-energised joint testing. This would be performed by dedicated, trained crews specialising in this process and maintaining a high level of competence. We are working through the full implications of this change on our forward work programme with our service providers, customers and the market.

Meeting our customers' expectations and improving our service performance is important to us. We measure our service each year through engagement and feedback from our customers. This year, we moved away from an annual survey to more specific, targeted surveys sent to our customers following a loss-of-supply event or completion of a project delivery milestone. This has provided greater insights into our performance and enabled us to quickly introduce improvements as they are needed. This year, our customers provided positive feedback about our services, especially regarding our project delivery.

Loss-of-supply events had a more mixed response, with several customers suggesting our communication effectiveness could improve, particularly in regards to unplanned events. We have introduced new, quarterly stakeholder forums to help address some of these concerns and encourage more frequent service conversations.

A large component of the National Grid network is unseen. Our network of physical towers and substations is operated by a complex computer software system that controls the grid in real time. As technology changes and cyber threats become more sophisticated, we continue to make cyber security improvements on our software network to protect the national infrastructure. This year, we implemented a 'threat-based view', in line with our company-wide critical risk programme, which enabled us to target investment in appropriate new resources, tools and capability. We are now working with our security partners to establish a connected framework to access the latest cyber intelligence with a view to proactively being able to react to threats across our systems.

“we continue to make cyber security improvements on our software network to protect the national infrastructure”

We operate TransGO, the fourth-largest telecommunications network in New Zealand. This high-capacity national fibre-optic network consists of over 7,000 kilometres of fibre and allows telecommunication between all our sites and locations, supporting grid operations, critical switching and the grid protection functions. We begin the expansion of TransGO into the West Coast and Northland this year and will complete both networks by 2019. Our TransGO network is increasingly enabling the use of new technologies to support our people in the field so they can send and receive key information quickly and efficiently.

Through the system operator service, we delivered the National Market for Instantaneous Reserves in late 2016, realising over $22 million in efficiency savings for the benefit of electricity consumers. Security of supply became a key focus area for the system operator in winter 2017, following several months of low inflows into the South Island hydro lakes.

“the National Market for Instantaneous Reserves is realising over $22 million in efficiency savings for the benefit of electricity consumers”

As we approached the 1% hydro risk curve, we established a dry winter working group to coordinate increased analysis and industry engagement to prepare for all possibilities. The national and South Island hydro risk meters were set at 'watch' for eight weeks from 1 June. During this time, we increased our monitoring and reporting and socialised plans with key industry stakeholders to ensure all parties were well prepared for this winter and future years. On 28 July, the national and South Island hydro risk meters returned to 'normal' following eight weeks set at 'watch'.

By adhering to best-practice asset management principles, we have successfully managed our $5 billion of transmission assets with high reliability and availability levels for consumers. We have maintained security of supply and delivered on our system operator obligations and will continue to build on this solid foundation to enable and plan for sustained, ongoing service delivery for our customers and stakeholders.

Transforming our business to improve performance

We performed well both financially and operationally this year, achieving most of our Business Plan and Statement of Corporate Intent (SCI) targets, despite a more challenging operating environment under our second five-year Regulatory Control Period (RCP2), which began on 1 July 2015 and continues until 30 June 2020.

We identified early in RCP2 the need to become more efficient to meet future financial and operational challenges. Our first business-wide transformation programme – Transformation 1 – was established in 2015 to achieve the expectations set by the Board and regulator. It was important we continued to provide a good transmission service while undertaking this transformation and achieving the savings targets required.

The programme was driven around a reconfiguration of how we operate the grid service and a series of operational improvement initiatives to enhance how we provide optimum grid reliability at the lowest possible cost, while also delivering an optimum system operator service. A behavioural transformation component, with comprehensive leadership training over a two-year period, was required to enable more effective collaborative work across the business and with our key stakeholders.

The first phase of this programme was completed on 30 June 2017 with real and sustainable benefits including:

- a significant reduction in our Total Recordable Injury Frequency Rate (TRIFR) from 7.8 (30 June 2016) to 5.0 (30 June 2017). This improvement arose from better process and a change in safety behaviour.
- an increase in HVAC availability to 98.73% – exceeding our target of 98.5%
- efficiencies in procedure and process through a new way of undertaking our grid business
- efficiencies and cost savings in our ongoing capital and operating expenditure.

From 1 July 2017, we have embarked on a second phase of transformation to build on the work carried out during our first transformation programme. Our people recognise the need to continuously adapt and evolve our business to meet the changing environment we operate in and provide value to those we provide services to. A key component of our work in this coming year will be delivering a substantial programme of work under Transformation 2 to further improve our operations and efficiency.

OPEX

15/16	$M	16/17
285.1		287.8

UP **1%**

TOTAL REVENUE

15/16	$M	16/17
1,034.5		1,061.1

TOTAL DIVIDEND

15/16	$M	16/17
163		165

Our operating revenue was $1,061.1 million, a 3% increase from $1,034.5 million in the previous period. The increase was a result of uplifts to the inputs used in the calculation of our allowable transmission revenue under the regulatory arrangements set by the Commerce Commission.

We maintained tight controls on our operating expenses with an increase of 1% to $287.8 million. This increase was mainly due to higher investigation costs from customer-funded projects such as investigation works for NZTA and for a large property development in Auckland.

Our earnings before interest, tax, depreciation, amortisation, asset write-offs and changes in the fair value of financial instruments (EBITDAIF) were $773.3 million, compared to $749.4 million in the previous financial year. This was a result of the revenue increase above.

Depreciation, amortisation and write-offs increased 3% to $277.4 million, reflecting ongoing asset commissioning and some reductions in asset profile lives. Our net interest expenses of $204.9 million were down 3% from last year. Our net profit after tax, before net changes in the fair value of financial instruments, was $208.4 million, an increase of 8% from 2015/16. Net profit after net changes in the fair value of financial instruments was $266.0 million.

The final dividend for the full year was $99 million. Together with the interim dividend of $66 million, a total dividend of $165 million will be paid to the Crown for the 2016/17 financial year. In addition to the dividends paid to the Crown, Transpower will pay $56 million in income tax relating to the 2016/17 financial year.

Capital expenditure (capex) for the year was $270 million, an increase of $40 million compared to the previous period. The previous year's capex figure reflected deferral of selected works until later in the RCP2 period. Most capital spend for this financial year related to a large number of relatively small Commerce Commission-regulated capital expenses. The portfolio areas of highest additional spend were tower painting and new transformers.

Connecting with our customers, communities and stakeholders

Nearly everyone in New Zealand is connected to the National Grid. The power system enables economic growth as well as a comfortable standard of living. Transmission is only one part of the wider electricity system value chain, and it is important we work closely with directly connected customers, generators and distributors to enable essential services to be provided to electricity consumers.

In October 2016, we launched a programme of work to help us understand better what services our customers and wider stakeholders value most and how those services might be defined and measured in a meaningful manner. In consultation with these groups, we have reviewed and updated our key service definitions, measures and targets for the proposed new measures for our next regulatory control period – RCP3. These measures were published in June 2017.

Transmission pricing has continued to be a topic of public interest this year. Although we do not determine how transmission pricing is allocated to customers (determined by the Electricity Authority), we do administer the process. We have been actively engaged in the wider Transmission

Pricing Methodology (TPM) consultation process being run by the Electricity Authority, with a view to help achieve the best outcomes for New Zealand.

Under the Electricity Industry Participation Code, we can undertake operational reviews of the TPM and propose changes to the Electricity Authority. Following the Electricity Authority's announcement that it needed to prepare a new cost-benefit analysis before any decisions could be made about its review of the Transmission Pricing Methodology Guidelines, we saw an opportunity to undertake an operational review (outside of the wider Electricity Authority process) to achieve real benefits for the industry and electricity consumers.

In June 2017, we released a consultation paper to the industry asking for feedback on whether we should undertake operational review of the TPM and, if so, what the scope of that review should look like. An operational review provides a way to bring forward implementation and benefits of some technical elements of the Electricity Authority's wider proposals and tidy up the current TPM to make it easier to understand. The Electricity Authority sees our review as complementary to its wider proposal and is supportive of us undertaking this process. Any proposals will be subject to its approval.

With around 300 kilometres of overhead lines in Auckland needing work in the near to medium future, as well as forecast population growth and development in the greater Auckland region, we need to plan carefully to meet growing transmission needs. Our transmission lines in Auckland are, in areas, tightly constrained by urban development. The work required will be challenging and costly, considering the proximity of our assets to people's homes and the need for scheduled outages to allow work to take place.

“with around 300km of overhead lines in Auckland needing work in the near to medium future, as well as forecast population growth and development… we need to plan carefully”

There are a number of other considerations that put pressure on our assets as Auckland continues to grow and develop its infrastructure. There are many other infrastructure providers growing their networks and requiring changes to the transmission network, for example, new roading initiatives requiring towers to be moved, new housing and development areas and the electrification of rail.

We are taking this opportunity to look strategically at Auckland's future electricity needs and how it will be served by our network. We are looking at this quite differently to how we usually undertake investment – looking 40 years out and working backwards as opposed to a 'fix it now' approach. We are currently working with a number of other major infrastructure providers for their views and collaboration. All our works are connected in one way or another, and we hope to be able to work together to drive mutual understanding and efficiencies for infrastructure development in Auckland.

This is one of our top priorities and have developed an Auckland Development team to focus solely on Auckland's changing electricity needs, working with our stakeholders to plan what is next for the Auckland transmission network. We expect to have a plan for our works by the end of 2017.

Being transparent in our reporting about our activities continues to help our stakeholders and customers engage effectively with us. We have taken steps to improve our reporting, making it more accessible to a wider range of customers and stakeholders. In 2017, we won the Award for (Integrated) Annual Report & CSR Report at the annual Asia-Pacific PR Excellence Awards. The International Association of Business Communicators has recognised the 2015/6 Annual Report and Review with a Gold Quill Award.

Our work and assets have an impact on the communities that we pass through. Through our CommunityCare Fund, we invest in projects that add value and benefit to communities along the National Grid route, as well as those affected by new projects. Over the last year, we have donated $960,000 to 38 community projects. These are some examples:

“our CommunityCare fund invests in projects that add value and benefit to communities along the National Grid route, as well as those affected by new projects”

- $48,000 to assist with building a new ablution block for the Poupatatē Marae in Manawatu. This marae represents hapū of Raukawa ki te Tonga – iwi involved with our Bunnythorpe-Haywards Conductor Replacement project.
- $43,700 for phase 2 renovations for the Dolphin Theatre, which represents an important part of the Onehunga community's social fabric.
- $20,000 for the purchase of rat traps by Predator Free Brooklyn. We were one of the early supporters of predator-free work in Wellington with a grant to Crofton Downs Predator Free in 2014. Some of our past power outages can be traced to rats or possums getting into our network. Being predator-free makes good business sense.

Keeping our people and the public safe

Our safety journey to improve our safety performance started nearly a decade ago. We recognised that it would take time to achieve sustained behaviour change and embed a culture where safety comes first. In the last year, we continued to build on the positive safety culture we have established across our business through a dedicated behavioural safety programme and a focus on our critical risks – the things that can seriously hurt or harm our staff, contractors and the public.

> we are proud of the improvement in our safety statistics, with our total recordable injury frequency rate (TRIFR) reducing to 5.0 against a target of <8

Our people and service providers have shown a real commitment to safety. We are proud of the improvement in our total recordable injury frequency rate (TRIFR), with a significant improvement in our safety statistics this year – our TRIFR reducing to 5.0 against a target of <8.

A key area that has enhanced our safety performance is a focus on critical risks and controls to help our people respond more constructively to incidents – that is, focusing investigations on which controls were/weren't in place or did/didn't work and why and what we need to do differently to prevent recurrence. We have also recently launched a Control Self Assessment programme of assurance to help us identify gaps in our controls and drive improvement.

We regularly work with stakeholders and lineside communities to ensure they understand how to stay safe around our transmission assets. We have designed all of our assets (towers, pylons, substations etc) to keep the public at a safe distance from high voltage electricity, with clearly marked signs and fences. In 2016 we prioritised our most critical risks and critical controls relating to public safety, and worked with our maintenance service providers to launch a staff-centric campaign focusing on public safety and the importance of reporting near misses.

We had a serious safety incident in Hamilton in August 2016 where an Electrix worker was injured while completing some tower deviation work for us as part of the Waikato Expressway project. The accident occurred when a temporary tower fell while the Electrix worker was working on it. A full investigation is under way, and the WorkSafe investigation is ongoing.

The occurrence of this incident, at a time when we have an overall positive safety culture and improving safety statistics, reinforces the need to not be complacent. Our focus in 2017/18 is to increase our understanding of our critical risks and further reduce the likelihood of serious incidents and harm occurring.

Managing our assets effectively

> our asset management focus is about… effectively utilising our existing assets to help improve reliability, manage the grid footprint and reduce costs for electricity consumers

Our asset management is no longer about building new assets but about effectively utilising our existing assets to help improve reliability, manage the grid footprint and reduce costs for electricity consumers by not building expensive new transmission assets.

Our continued focus on improving our asset health modelling supports us in optimising our service levels, asset health and cost efficiencies. Understanding comprehensively how assets perform enables us to make better investment decisions, balancing reliability with cost and providing real value to our customers. These initiatives were delivered through the first phase of our transformation programme, which focused on improving our grid asset management capability.

As part of that transformation programme, last year, we introduced a new framework to enable more transparent, repeatable risk-based decisions relating to our asset management. This year, we have focused on embedding this framework. We have further progressed our analysis of risks relating to our grid business, using the bowtie method to consider and document consistently the causes, consequences and controls relating to a potential risk event.

We continue to hold our PAS 55 accreditation in asset management and are still the only New Zealand company to hold this international accreditation. We are working towards achieving the replacement certification ISO 55001. As part of this process, we have been working with AMCL, an independent certifier, to help us prepare a good-quality submission. AMCL completed an initial gap assessment last October to help us understand areas for improvement. In March 2017, AMCL completed a health check to see how we were progressing on the key non-conformance areas identified in the gap assessment. During the health check, AMCL confirmed that our grid asset class strategies are best in class and were satisfied that we are tracking well for a future ISO 55001 submission.

Our assets are exposed to the harsh New Zealand elements, so maintenance on our 25,000 steel lattice towers is a substantial programme of work. The best way for us to protect the towers that support much of the National Grid is with a good coat of paint. Through our Tower Painting Programme, we sought to extend tower lifespans and increase the number we could service in a year, while keeping workers safe undertaking this high-risk task. Our programme implementation enabled a step-change in the industry, reducing costs above and beyond what we anticipated, drawing out innovative new processes and equipment, and resulted in fewer injuries for workers.

We continue to look for new innovative ways to undertake our maintenance work. Densely populated urban zones pose unique challenges for this work. We have continued to explore the use of unmanned aerial vehicles (UAVs) for maintenance work, with advanced trials held in Auckland and the Rimutaka Ranges this year. By supplementing our helicopter inspections with UAV technology, where possible, we can achieve efficiencies in how we inspect and maintain the National Grid. UAVs are smaller, quieter, cheaper and faster than manned helicopter inspections and offer a less-intrusive experience for landowners while improving safety for our contractors.

> we have continued to explore the use of unmanned aerial vehicles (UAVs) for maintenance work, with advanced trials held in Auckland and the Rimutaka Ranges this year

We are working closely with the Civil Aviation Authority and Auckland Airport on UAV use, and in 2016, we published comprehensive guidelines to the Airshare website to boost public awareness and understanding of how this technology can be safely used near our assets.

Our largest long-term capital project is the Bunnythorpe-Haywards reconductoring scheme. Between now and 2020, we are replacing the conductors (wires) on two transmission lines connecting Haywards and Bunnythorpe substations as part of our maintenance programme. These lines were first commissioned in the mid-1950s and are essential for maintaining a consistent security of supply for the National Grid. Our transmission assets cross through remote and challenging terrain, sometimes on or near land that is of cultural significance. Our landowner liaison teams are working closely with local iwi and community liaison groups to ensure we protect and respect these sites and taonga as the works progress. The project reached a significant 50% completion milestone in March 2017 with the completion of line upgrades in the Akatarawa Forest area. We are on track for our 2020 completion date.

> the Bunnythorpe-Haywards reconductoring scheme… reached a 50% milestone in March 2017

Our people

Our people are at the heart of what we do, and are critical to our success. We work with Aon Hewitt to conduct an anonymous employee engagement survey each year, measuring how connected and committed our people feel towards Transpower. By regularly 'checking in' with our people, we can maintain what works well, and address any known issues. Our overall employee engagement score for this year was 75%, a 10% increase on the previous year's score.

We believe our workforce should reflect our unique and diverse country. This year, we published a Diversity and Inclusion Strategy outlining our plans to create and maintain a positive work environment where all our people feel included, welcome and valued.

Our Diversity and Inclusion Strategy is supported by an e-learning module designed to challenge our people's thinking and promote inclusive behaviours. It builds on last year's leadership training on unconscious bias. Te Reo courses have been delivered in all our offices as well as online. We will be publishing our Iwi Strategy this coming year.

> Our diversity and inclusion strategy outlines our plans to create and maintain a positive work environment where all our people feel included, welcome and valued

In late 2017, our Wellington staff will be moving from the two existing offices to newly redeveloped premises at 22 Boulcott Street, providing a more collaborative working environment for our people. The new Wellington office will house around 600 staff, along with one of the 24/7 coordination centres providing the system operator service. The new office offers efficiencies in terms of space utilisation and flexible working arrangements, while addressing the constraints of our existing premises.

Board changes

In September 2016, Mark Verbiest stood down as Chair after seven years of service. We would like to thank him for his stewardship during that time.

On 1 November 2016, we welcomed Hon. Tony Ryall as Chair.

We also welcomed new director Dean Carroll to the Board this year.

Our enduring role

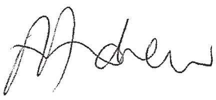
Our core business and planning activities are governed and led by our six strategic priorities that set out our near, medium and long-term business strategy. Further information about our six strategic priorities and how they inform our decision making can be found in our 2016/17 Annual Review (online only): this interactive document explores each strategic priority in detail, accompanied by real case studies of work delivered over the last financial year.

A key focus for 2017/18 will be developing a high-quality RCP3 proposal. The coming year is a crucial phase for establishing our view of suitable performance targets and funding baselines for the grid during the 2020 to 2025 period.

We will continue to evolve our business and service to ensure we meet or exceed the expectations of our customers and stakeholders (and therefore electricity consumers). We are committed to providing a level of service that enables continued economic growth and development, while keeping our costs as low as possible and safely managing the health of our assets and people.

We are all a part of a wider electricity supply chain – involving our customers, generators, distribution companies, landowners, retailers and technology providers – that keeps New Zealand connected now and for many generations to come. We maintain a strong focus on building strong connections and shared goals with those parties, as well as our service provider and partner organisations, for continued success.

We are proud to share our expertise with industry and to continue working together to deliver real value for New Zealanders both now and in the future.



ALISON ANDREW
CHIEF EXECUTIVE

HON. TONY RYALL
CHAIR

Governance and disclosures

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INFORMATION ON TRANSPOWER

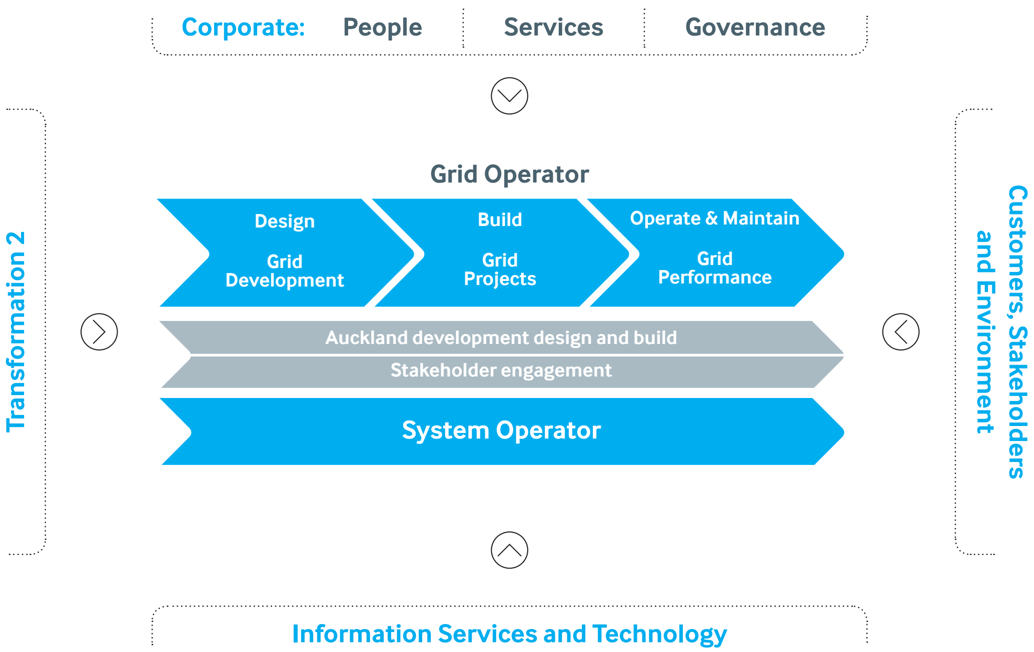
Transpower is a limited liability company and a State-Owned Enterprise (SOE) with its shares held on behalf of the Crown by the Minister of Finance and the Minister for State Owned Enterprises. Transpower has debt listed with the NZX and therefore is required to comply with debt listing obligations. Transpower has also elected to report against the NZX Corporate Governance Code.

The information contained in this governance and disclosure section of the annual report has been prepared in accordance with the NZX Corporate Governance Code as applicable for a SOE and other required disclosures.

Transpower owns and operates the National Grid – the high voltage transmission network connecting areas of generation with towns and cities across New Zealand. We outsource most of the maintenance work on the core grid among four service providers – Broadspectrum, Electrix, Electronet and Northpower. These organisations perform the 'on the ground' work on our assets, which are located all over New Zealand. The integrity and capability of these organisations assists us in keeping the lights on for New Zealand.

Organisation structure

Figure 1, below, shows how our dual roles as system operator and grid operator are supported by key business functions. The grid operator component of the business is responsible for designing, building and maintaining the National Grid. The system operator component of the business is responsible for managing the system in real-time. These core services are supported by corporate functions such as people services, corporate services and corporate governance. These core corporate functions are enabled by our IST, customers, stakeholders and environment and transformation functions.



Board of Directors

Our board is responsible for Transpower's long-term success and supervision of our management and business affairs. The board and management are committed to ensuring that we maintain a high standard of corporate governance and adhere to high ethical standards.

The shareholding Ministers, and ultimately the Cabinet, appoint our directors on advice from The Treasury. Directors are independent, non-executive and are generally appointed for terms of up to three years, although they may be reappointed. Our shareholding Ministers, in conjunction with the board, seek to ensure there is a balance and diversity of skills, knowledge, experience and perspectives among directors.

The role and responsibilities of the board are set out in our board charter.[1] The board has a minimum of eight scheduled meetings each year and also meets whenever necessary to discuss urgent business. The chair, chief executive and general counsel and company secretary establish meeting agendas to ensure key issues are covered throughout the year. The directors generally receive materials for board meetings seven days in advance. Executive team members and other senior employees regularly attend board meetings and are also available to directors between meetings.

The board appoints the chief executive and delegates responsibility for Transpower's day-to-day management to the chief executive, who in turn may delegate authority to executive managers. Our Delegated Authority Policy describes the limits of delegated authority and prescribes the matters in respect of which the board reserves its decision-making authority.

A director may obtain independent professional advice, at our cost, relating to Transpower's affairs or to their responsibilities as a director. Before obtaining any advice, directors must discuss the matter with the chair. Advice relating to our affairs is then made available to the board.

Our Directors' Interests Policy governs how we resolve and manage the way directors' individual interests are disclosed.

Director induction and professional development

The board introduces new directors to management and the business through customised induction programmes. These programmes usually include one-on-one meetings with management and site visits to key locations. New directors also receive a pack containing key information about our business, and meet with the chief executive and the executive team.

At least annually, the board holds strategic and professional development workshops. These provide opportunities for management to update the board on our key issues. Outside of these workshops, directors are regularly updated on relevant industry and company issues. There is an ongoing programme of presentations to the board by all parts of the business. Our directors ensure that they are independently familiar with the company's operations through continuous education to appropriately and effectively perform their duties. This includes participating in an ongoing site visits programme.

1. Available on this page https://www.transpower.co.nz/about-us/our-purpose-values-and-people/corporate-governance

Meetings of the board of directors

The members of the board of directors during the 2016/17 financial year are listed below, together with the number of board meetings held and attended during the period each director was eligible to attend such meetings.

DIRECTOR	DATE COMMENCED IN OFFICE	MEETINGS HELD	MEETINGS ATTENDED
Tony Ryall (chair)	1 May 2016	8	8
Don Huse (deputy chair)	1 May 2011	8	8
Jan Evans-Freeman	1 November 2012	8	7
Tim Lusk	1 May 2015	8	7
Pip Dunphy	1 May 2015	8	7
Bill Osborne	1 May 2016	8	8
Dean Carroll	1 November 2016	6	6
Mark Verbiest (resigned 31 October 2016)	1 August 2010	2	2

Directors skills matrix

The board has developed a skills matrix to identify the key skills necessary for governance at Transpower. The board then carried out a self-assessment, with assistance from an external governance expert, against these key skills. Based on this assessment, each area of the skills matrix was well represented on the Board, with two or more directors having each identified skill below.

SKILLS/EXPERTISE	
Executive leadership	Health and Safety
Governance	Energy / Infrastructure
Financial	Capital Markets
Risk	Customer / Service
Regulation / Legal	Technology / Innovation

Board committees

We have three regular board committees and one sub-committee:

1. the Risk Committee
2. the Audit and Finance Committee
3. the People and Performance Committee
4. the Transmission Pricing Methodology Sub-Committee.

Each board committee has **terms of reference** that outline the role, rights, responsibilities and membership requirements for that committee. Other committees may be established from time to time to consider matters of special importance or to exercise the board's delegated authority. The board is responsible for appointing committee members according to the skills, experience and other qualities they bring to the committee.

A minimum of two directors are required to sit on each committee, although typically three or more do so. Each committee is chaired by a director who is not our chair. This **annual report** document shows which directors belong to each committee. The agenda, papers and minutes of each committee are provided to all directors. The board is also given a verbal report by the committee chair on the outcomes of each meeting.

The committees attend meetings each year, scheduled to coincide with the timing of that committee's responsibilities. Each committee reviews its activities annually to ensure it is adequately covering its roles and responsibilities.

The Risk Committee

Our **Risk Committee** (a subset of the board) has responsibility for reviewing health and safety matters on the board's behalf and is responsible for ensuring that management has established a risk management framework that includes policy, procedures and assessment methodologies that enable us to effectively manage and monitor organisational risks.

It also recommends the appointment of internal auditors and manages the internal audit process, including reviewing, monitoring and approving internal audit reviews, annual audit plans and internal audit and management reports. The Risk Committee will direct internal audit functions or material to either the Audit and Finance Committee or the People and Performance Committee where the subject matter is within the expertise of the respective committee. The primary objective of these internal audits is to assist the board and the executive team in exercising good governance by providing independent assurance.

Meetings of the Risk Committee:

MEMBERS	MEETINGS HELD	MEETINGS ATTENDED
Pip Dunphy (chair)	4	4
Tim Lusk	4	4
Jan Evans-Freeman	4	4
Dean Carroll	1	1

The Audit and Finance Committee

Our Audit and Finance Committee is responsible for monitoring the financial performance and reporting of Transpower and its subsidiaries. It also reviews the appointment of external auditors (subject to the authority of the Auditor-General) and manages the external audit process, including reviewing and monitoring external audit and management reports.

Meetings of the Audit and Finance Committee:

MEMBERS	MEETINGS HELD	MEETINGS ATTENDED
Don Huse (chair)	4	4
Pip Dunphy	4	2
Bill Osborne	4	4
Tony Ryall (member from 1 November 2016)	2	2
Mark Verbiest (resigned 31 October 2016)	1	1

The **external auditor** is subject to the independence rules of the Auditor-General. These rules require the audit partner to be rotated after a maximum of six years. We disclose fees paid to external auditors in our annual report and differentiate between audit fees and fees for individually identified non-audit work.

Our board, particularly through our Audit and Finance and Risk Committee, has regular dialogue with both external and internal auditors and management.

Many of our directors who are members of the Audit and Finance and Risk Committees have previous financial experience. The Auditor-General has appointed **Grant Taylor of Ernst & Young** to carry out the audit on its behalf.

The People and Performance Committee

Our People and Performance Committee oversees our culture and performance and approves recruitment, remuneration, retention and termination decisions and policies and procedures regarding executive management. It reviews and recommends to the board the chief executive's remuneration, terms, annual key performance indicators and performance recommendations.

Many of our directors who are members of the audit and finance and risk committees have previous financial experience. The Auditor-General has appointed **Grant Taylor of Ernst & Young** to carry out the audit on their behalf.

Meetings of the People and Performance Committee:

MEMBERS	MEETINGS HELD	MEETINGS ATTENDED
Jan Evans-Freeman (chair)	4	3
Tim Lusk	4	4
Bill Osborne	4	4
Tony Ryall (from 1 November 2016)	2	2
Mark Verbiest (resigned 31 October 2016)	2	2

The Transmission Pricing Methodology Sub-Committee sub-committee

Our Transmission Pricing Methodology Sub-Committee sub-committee oversees management's involvement in proposed changes to the Transmission Pricing Methodology.

Meetings of the Transmission Pricing Methodology Sub-Committee sub-committee:

MEMBERS	MEETINGS HELD	MEETINGS ATTENDED
Don Huse (chair)	3	3
Tony Ryall	3	3
Tim Lusk	3	3

Board and committee performance

Our board acts in good faith and in the best interests of the company. The board is accountable to the shareholding Ministers for our performance, and our directors hold office sanctioned by our shareholding Ministers. The Treasury monitors and advises our shareholding Ministers on our board's performance. Each director's performance is evaluated by the chair, and the board also evaluates its overall performance annually through external evaluations.

Directors' interests

The following directors have made general disclosures of interest with certain external organisations based on their being a chair, director, board member, trustee, council member, member, employee or consultant of those organisations or holding bonds or shares of those organisations. The disclosures of interest cover the period up to the date the financial statements were signed.

DIRECTOR	POSITION	ORGANISATION
Tony Ryall	Chair	Nib NZ Limited
	Chair	Nib NZ Holdings Limited
	Director*	NMH Holdings Ltd
	Trustee	Massey University Foundation
	Consultant	Simpson Grierson
Don Huse	Chair	OTTP New Zealand Forest Investments Limited
	Director	Precinct Properties New Zealand Limited
Jan Evans-Freeman	Pro Vice-Chancellor	College of Engineering, University of Canterbury
	Director	Wireless Research Institute
	Director	Electric Power Engineering Centre (EPE Centre)
	Director	University of Canterbury Quake Centre
	Member	IPENZ Governing Board
Tim Lusk	Director	Environmental Protection Authority
	Director	Enable Networks Limited
	Director	Enable Services Limited
	Independent Director	Wairarapa Rural Fire Board
Pip Dunphy	Chair	First Gas Holdings TopCo Limited and subsidiary companies
	Chair	Gas Services NZ Limited and subsidiary companies
	Chair**	Advisory Board – Penny
	Deputy Chair	Abano Healthcare Limited
	Director	ACE Insurance Limited / Chubb Insurance New Zealand Limited
	Director	Fonterra Shareholders Fund
	Director	New Zealand Superannuation Fund
	Director	Tamaki Research Limited
	Member**	Advisory Board – NEXT Foundation
	Consultant*	Lattice Energy
Bill Osborne	Director	Rangitira Services Limited
	Vice President*	New Zealand Rugby Union Incorporated
	Director*	Ports of Auckland
	Director**	Chiefs Rugby Club GP Limited
Dean Carroll	Nil	
Mark Verbiest**	Chair	Spark New Zealand Limited
	Chair	Willis Bond Capital Partners Limited (and Director of related companies)
	Director	Freightways Limited
	Director	ANZ Bank New Zealand Limited
	Director	MyCare Limited
	Member	New Zealand Treasury Commercial Operations Advisory Board
	Consultant	Simpson Grierson
	Consultant	New Zealand Treasury

* *Appointed during the year*

** *Resigned during the year*

Directors' shares, loans and use of information

No directors hold shares in Transpower, have loans from Transpower or have made any request to use company information received in their capacity as directors that would not otherwise have been available to them.

Directors insurance

The Transpower Group has arranged policies of directors' and officers' liability insurance, which, together with the indemnity provided by Transpower's constitution and separate deeds of indemnity between Transpower and individual directors, ensure that, generally, directors will incur no monetary loss as a result of actions undertaken by them as directors. Certain actions are specifically excluded, for example, the incurring of penalties and fines that may be imposed in respect of breaches of the law.

Directors remuneration

Remuneration and benefits payable to directors for services as a director are determined in conjunction with the shareholding Ministers as follows:

PAYMENTS TO DIRECTORS OF TRANSPOWER	DATE COMMENCED IN OFFICE	DATE CEASED IN OFFICE	2017 $000	2016 $000
Tony Ryall (chair from 1 November 2016)	1 May 2016		104	9
Don Huse (deputy chair)	1 May 2011		75	73
Jan Evans-Freeman	1 November 2012		62	55
Tim Lusk	1 May 2015		59	58
Pip Dunphy	1 May 2015		62	58
Bill Osborne	1 May 2016		59	9
Dean Carroll	1 November 2016		40	–
Mark Verbiest (chair until 31 October 2016)	1 August 2010		50	114

During the year, no director of Transpower or the Transpower Group has received or became entitled to receive any benefit other than that disclosed above.

Information on directors of subsidiary companies as at 30 June 2017

TB&T Limited
Christopher Sutherland
David Knight

Halfway Bush Finance Limited
Christopher Sutherland
David Knight

Risk Re-insurance Limited
David Knight
John Clarke
Alex Ball

emsTradepoint Limited
John Clarke
Alex Ball
David Knight

The directors of the subsidiary companies are all Transpower employees. They do not receive any additional remuneration for their role as a director.

We're for New Zealand

SHAREHOLDER RELATIONS

Through regular communications with our shareholding Ministers, we present a balanced assessment of our position to enable the Ministers to assess the company's performance, business model, strategy and prospects.

We meet with our shareholding Ministers annually to examine our performance and review our strategic direction. Our shareholding Ministers can place items on the agenda for the annual meeting (including any governance or strategy items) and request other meetings throughout the year if required. Our board and senior executives attend the annual shareholders' meeting and are available to answer any questions the shareholding Ministers have. We also attend the Finance and Expenditure Select Committee annually to discuss our performance during the year. The Finance and Expenditure Select Committee also meets separately with our external auditors.

The board submits our Statement of Corporate Intent, business plan, interim report and annual report to our shareholding Ministers. We also consult with our shareholding Ministers on substantial business and operational matters and those outside the scope of our core business. We announce various matters that have a material effect on our commercial value to the NZX and both The Treasury's website and ours, pursuant to the SOE and NZX continuous disclosure requirements.

We report on the environmental, social and governance considerations specific to our company on our website to demonstrate to our shareholding Ministers and other stakeholders how we manage those issues. Our Statement of Corporate Intent contains both financial and non-financial measures.

STATEMENT OF CORPORATE INTENT (SCI) MEASURES

Our principal objective, as set out in section 4 of the State Owned Enterprises Act 1986, is to operate as a successful business.

SECTION 4 OBJECTIVE	OUR OPERATIONS
To be as profitable and efficient as comparable businesses that are not owned by the Crown	■ Within regulatory and commercial parameters: – Deliver and operate a safe, reliable, cost efficient transmission grid that meets New Zealand's needs now and into the future. – Deliver an efficient system operator service that supports competition and provides a reliable and efficient supply of electricity. ■ Pursue business opportunities based on the capabilities and expertise developed through our core business activities.
To be a good employer	■ Promote a high level of safety, taking all practicable steps to provide safe working conditions. ■ Maintain a well-qualified and motivated workforce that we treat fairly and properly in all aspects of recruitment, retention and employment.
To be an organisation that exhibits 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.	■ Build and maintain effective relationships with landowners, occupiers and other community representatives and interest groups affected by our activities. ■ Build and maintain effective relationships with Māori, including acknowledging their interests in land. ■ Work in partnership with communities to plan, deliver, and operate efficient and effective infrastructure while managing adverse social and environmental impacts of our activities.

We measure our performance against a range of safety, operational, financial and non-financial performance targets. The 2016/17 targets are as per our 2016/17 Statement of Corporate Intent.

Our 2017/18, 2018/19 and 2019/20 targets are as per our 2017/18 Statement of Corporate Intent.Our 2017/18, 2018/19 and 2019/20 targets are as per our 2017/18 Statement of Corporate Intent.

Safety performance targets

We strive to provide a working environment in which there are no fatalities or injuries causing permanent disability. We also seek to reduce the rate at which our activities cause injury through continuously focusing on safety and making improvements to our processes. Each year, we commit to measures to reduce injuries for the coming year, with zero fatalities.

The staff who work for our service provider organisations – Broadspectrum, Electrix, Electronet and Northpower – are the most exposed to health and safety risks inherent in carrying out high voltage work, often at height in remote parts of New Zealand. We work with these organisations on health and safety issues, and a health and safety leadership team comprising the Transpower chief executive and chief executive officers of our four service providers meets bi-annually to ensure a national focus for an ongoing safe, healthy working environment. The objective of these meetings is to implement major change programmes to improve safety performance, with a strong focus on behavioural safety management.

In the last 12 months, we experienced an injury causing permanent disablement, when a truck lost control and rolled into one of our service provider's vehicles. This resulted in a permanent eye injury to one of our service provider employees. While this injury was not preventable or controllable by Transpower, it is a permanent disability suffered at work by someone contracted by Transpower with significant consequences for that individual. We also had an incident where an Electrix worker was injured while completing some tower deviation work for us as part of the Waikato Expressway project. A full investigation is under way, and the WorkSafe investigation is ongoing.

The safety statistics reported on below include service providers, Transpower staff and other contractors who work at Transpower sites.

	2016/17 ACTUAL	2016/17 TARGET	2017/18 TARGET	2018/19 TARGET	2019/20 TARGET
Number of fatalities or injuries causing permanent disability	1	0	0	0	0
Total recordable injury frequency rate (TRIFR)	5.0	≤ 8.0	≤ 6.0	–	–

By working with our service providers to increase our focus on safety we have seen a substantial improvement in our safety performance. This can be seen through our TRIFR results over the last three years, which steadily reduced from 13.3 in 2014/15, to 7.8 in 2015/16 and to 5.0 in 2016/17.

Service performance targets

We have a set of network service targets that we describe in full in our Services Report[2]. These encompass the following targets:

- **Grid interruptions** – targets for frequency (occurrence) and duration of interruptions. Different targets for high-priority, important, standard, N-security and generator connection locations. -15 targets in total.
- **Grid availability** – targets for the inter-island high-voltage direct current (HVDC) link and for key (i.e. market sensitive) circuits within our high-voltage alternating current (HVAC) networks. Two targets in total.

We have a financial incentive, set by the Commerce Commission, to meet or outperform these targets. This incentive can generate a post-tax credit or debit of up to $10 million each year. For HVAC availability, we set a target for the coming year based on the planned outages needed to deliver our work programme. Our SCI target across all other measures is to achieve a revenue-neutral outcome.

2. See ranspower.co.nz/sites/default/files/plain-page/attachments/TP%20Services%20Report.pdf

We achieved the grid interruptions target for occurrence, with a small net positive incentive of $0.03 million. Within this measure we met the performance standards for important, standard, and N-security sites. We did not achieve the performance standards for high priority sites (three interruptions against a target of two) or generator sites (20 interruptions against a target of 11 and an incentive collar of 16). The generator result included four interruptions due to snow storms in Hawke's Bay and six interruptions due to birds nesting in equipment serving the Maraetai hydro station.

We did not achieve our duration target for important, standard and N-security sites. This was due to a combination of events. We deliberately underwent a longer interruption at Blackpoint as this was preferable than a costlier, temporary solution and acceptable to the customer. Other contributing events to missing this target included challenging fault finding and restoration issues (insulator gunfire damage and bush fires in Northland), and customer livening challenges at Tangiwai. The overall outcome across our restoration targets was a small negative incentive of $0.15 million.

Each year we agree a set of system operation service targets with the Electricity Authority. We also have a financial incentive to meet or outperform these targets. Our SCI target is to achieve a revenue-neutral outcome.

	2016/17 ACTUAL	2016/17 TARGET	2017/18 TARGET	2018/19 TARGET	2019/20 TARGET
Grid interruptions:					
■ Achieve targets for occurrence	✓	✓	✓	✓	✓
■ Achieve targets for duration	missed	✓	✓	✓	✓
Grid availability:					
■ HVDC energy availability	98.6%	98.5%	98.5%	98.5%	98.5%
■ Key HVAC circuits availability	99.0%	98.7%	98.7%	–	–
Achieve system operation targets	✓	✓	✓	✓	✓

✓ *represents target met or intended to be met*

Financial performance targets

Our five key financial metrics are focused on the following:

- **Sustaining our credit rating** – we track free funds from operations (FFO) to interest cover and FFO to debt. Sustaining our credit rating is important for maintaining good access to capital markets and for achieving favourable credit pricing.
- **Balance sheet strength** – we hold leverage at a level that provides an efficient return on equity while maintaining resilience to withstand financial shocks.
- **Returns** – we measure our return on equity, and overall return on capital employed. Return on capital employed tracks relatively close to the allowable return on our regulated transmission assets (of 6.44% from 1 April 2015).

	2016/17 ACTUAL	2016/17 PLAN	2017/18 PLAN	2018/19 PLAN	2019/20 PLAN
Free Funds from Operations (FFO) Interest coverage	3.4	3.2	3.4	3.4	3.5
FFO / Debt	16.7%	15.8%	16.4%	15.8%	16.2%
Debt / (net debt + equity)	68%	70%	68%	67%	67%
Return on equity	12.8%	12.8%	12.4%	11.9%	10.7%
Return on capital employed	7.0%	6.9%	6.8%	6.5%	6.1%

Social responsibility performance targets and actions

As outlined in our SCI, we have set a mix of targets and actions relating to our social responsibility performance for the 2016/17 year.

CATEGORY	TARGET OR ACTION	2016/17 ACTUAL	2017/18 TARGET
Environmental	Hold sulphur hexafluoride (SF_6) emissions at or below 0.8% of installed nameplate capacity	0.4%	≤ 0.8%
Environmental	Publish carbon emissions report	Carbon Footprint Report scheduled for end September publication	✓
Community	Deliver two CommunityCare funding rounds that give back to those communities impacted by our assets or work	✓	✓
Cultural	Number of iwi relationship agreements tabled with iwi	4	2
Cultural	Number of iwi relationship-building initiatives completed	2	2

✓ *represents target met or intended to be met*

STAKEHOLDER RELATIONS

Each year, we hold an annual public meeting, providing our stakeholders with an opportunity to learn more about our business performance, our future growth, and our corporate social responsibility focus and responsibilities.

In addition to our shareholding Ministers, our stakeholders include other Ministers of the Crown and their ministries, The Treasury, customers, regulators, iwi, industry and business groups, contractors and suppliers, and the wider public. We invest considerable effort in maintaining productive relationships with our stakeholders. This includes providing timely and appropriate information and opportunities for feedback.

Our board has a clear policy for engagement and regular communication with significant stakeholders, in particular, our customers and regulators. The board regularly assesses its stakeholder engagement and ensures that conduct towards stakeholders complies with our ethical obligations and the law, and is within broadly accepted social, environmental and ethical norms.

During the year, the Transpower Group made donations and study grants of $947,000 (2016: $1,052,000). Donations principally comprise sponsorship of university research projects, tertiary scholarships and the CommunityCare Fund. These donations are to improve knowledge, grow the capability and diversity of potential employees and give back to those communities that are impacted by Transpower's assets.

The CommunityCare Fund makes one-off grants for projects that add real value and benefit to communities affected by Transpower assets or projects.

DISCLOSURE OBLIGATIONS

The board has appointed a Disclosure Officer and, with the Officer, examines continuous disclosure at the end of every meeting, including whether anything discussed at the meeting warrants disclosure, and reviews any disclosures made the previous month. The executive team also evaluates disclosure at its two-weekly meetings.

Debt listings

We have debt listed on the NZX Debt Market quoted under the ticker codes TRP010, TRP020, TRP030 and TRP040 (together, bonds). As a listed issuer, we are subject to certain requirements and obligations under the NZSX/NZDX Listing Rules, including a continuous disclosure obligation.

Within the last 12 months, we have obtained a waiver from rule 5.2.3 (as modified by NZX's ruling on Rule 5.2.3 issued on 29 September 2015), which requires at least 25% of the tranche of bonds quoted on the NZX Debt Market to be held by at least 100 bondholders who are members of the public. Accordingly, the bonds may not be widely held and there may be reduced liquidity in the bonds. The waiver in respect of the TRP040 bonds is for a period of six months from 16 March 2017. In addition to disclosing the waiver, its conditions and their implications in our interim and annual reports, we are required to notify NZX Regulation if there is any material reduction in the total number of members of the public holding bonds and/or the percentage of total bonds held by members of the public holding at least a minimum holding. Transpower is required to disclose the waiver and its conditions in any other offer document relating to an offer of the TRP040 bonds made during the period of the waiver. Transpower was also required to disclose the waiver and its conditions and the liquidity as a risk in the pricing supplement for the TRP040 bonds.

Based on the register of bondholders, Transpower has at least the following number of bond-holders as at 31 August 2017:

BONDHOLDER #'S	TRP010		TRP020		TRP030		TRP040	
	# OF BOND-HOLDERS	# OF BONDS ($000'S)	# OF BOND-HOLDERS	# OF BONDS ($000'S)	# OF BOND-HOLDERS	# OF BONDS ($000'S)	# OF BOND-HOLDERS	# OF BONDS ($000'S)
1,001-5,000	22	110	3	15	7	35	5	25
5,001-10,000	74	691	28	275	30	294	20	182
10,001-100,000	285	10,178	101	4,026	111	3,785	35	1,206
>100,001	83	314,021	60	195, 684	42	145,886	29	98,587
TOTAL	**464**	**325,000**	**192**	**200,000**	**190**	**150,000**	**89**	**100,000**

Our Insider Trading Policy and Guidelines have clear rules for when directors, officers and staff are dealing in listed Transpower debt securities.

REMUNERATION AND PERFORMANCE

Our remuneration model is designed to provide line of sight between the company objectives and individual objectives. It aims to attract, maintain and motivate our employees.

All employees have fixed remuneration, adjusted each year at a level set by the People and Performance board committee. Any increase is informed by data from independent remuneration specialists. Employee fixed remuneration is based on a matrix of their performance and how their salary compares to the market of a comparable position.

The chief executive and members of the general management team can earn incentive payments, subject to company and individual targets being met, and at the discretion of the board. Any changes to chief executive or executive management salaries are subject to approval by the board following review by the People and Performance board committee.

The chief executive objectives for 2016/17 related to:

AREA	MEASURES
Company objectives	Total recordable injury frequency rate (TRIFR) <= 8
	Zero fatalities or permanent injuries
	Staff engagement >= 70%
	Achieve below grid interruption targets
	Achieve 98.5% availability targets for HVDC and 98.7% availability for key HVAC circuits
	Achieve positive system operator service provider agreement (SOSPA) outcomes
	Achieve restoration targets for customers
	Achieve EBITDA plan
	Achieve capex deliverability target
	Produce deliverable efficient plan for Regulatory Control Periods 2 and 3.
Individual objectives	Business transformation
	Transpower's reputation enhanced with key stakeholders and our licence to operate is enhanced with specific criteria
	Build leadership team and succession capability
	Position Transpower for the future via key strategic pieces of work
	Advance our risk and safety programmes and frameworks

Executive remuneration

The details of the chief executive (CE) remuneration are set out below. Figures include KiwiSaver. Incentives are based on company and individual objectives. The incentive and amount of the incentive relate to that salaried year.

YEAR	FIXED REMUNERATION PAID AND PAYABLE $000	% OF INCENTIVE MET RELATING TO THAT YEAR	AMOUNT OF INCENTIVE $000	CARPARK $000	TOTAL REMUNERATION RELATING TO THAT YEAR $000
2017/18	998				
2016/17	969	94	271[3]	5	1,245
2015/16	940	97	271[4]	5	1,216

General managers have performance objectives with line of sight to the Company and CE objectives. Their salaries are informed by performance ratings and incentives can be 20-25% of their salary. In relation to their 2016/17 objectives, executive management received an average of 94% of their available incentive. For 2015/16 objectives, executive management received an average of 90% of their available incentive.

3. This payment was made in September 2017 but related to the performance in the 2016/17 financial year.
4. This payment was made in September 2016 but related to the performance in the 2015/16 financial year.

Remuneration greater than $100,000.

Aside from the chief executive, Transpower employees who received total remuneration of greater than $100,000 were in the following bands.

2016/17		2015/16	
	COUNT		COUNT
590-599	1	500-509	1
530-539	1	480-489	1
510-519	1	470-479	1
500-509	1	450-459	1
450-459	1	420-429	1
440-449	1	400-409	1
430-439	1	390-399	1*
400-409	2*	380-389	1
380-389	1	360-369	1
370-379	1	340-349	1
350-359	1*	310-319	3
320-329	2	300-309	1
300-309	2	290-299	5*
290-299	1	270-279	3*
280-289	1	260-269	1
270-279	4	250-259	3
260-269	7	240-249	9
250-259	3	230-239	5
240-249	5	220-229	14*
230-239	12	210-219	10
220-229	7	200-209	7*
210-219	9	190-199	6
200-209	8	180-189	13*
190-199	13	170-179	11
180-189	19	160-169	18*
170-179	10*	150-159	36*
160-169	30*	140-149	45
150-159	35	130-139	69*
140-149	68*	120-129	73
130-139	70*	110-119	79*
120-129	63	100-109	71
110-119	74*		
100-109	62*		
	517		**492**

The bands above include all remuneration paid to or on behalf of employees, including base salary, performance payment, KiwiSaver, medical insurance, death and disability insurance, income protection insurance and severance or redundancy payments.

*The asterisk indicates those remuneration bands that include one or more former employees who received a severance or redundancy payment, without which they would not have been in that band.

CODE OF ETHICS AND CONDUCT POLICY

We have a Code of Ethics and Conduct Policy that our directors, employees, contractors and consultants are expected to comply with. The code is designed to promote and maintain high standards of ethical behaviour and provides advice on how to deal with ethical problems that may be encountered in our operations.

Our Code of Ethics and Conduct Policy sets out explicit expectations for decision making and personal behaviour in respect of the following:

- Acting honestly and with high standards of personal and professional integrity.
- Conflicts of interest for employees, contractors and consultants. Our directors declare any interests they have after they are appointed to the board, and the interests are updated at every meeting. The chair and general counsel together decide whether the interests present any conflicts and manage those accordingly, including not allowing directors to vote or be present during discussions where there may be a conflict.
- Proper use of our property or information.
- Not participating in any illegal or unethical activity, including safeguards against insider trading in the entity's securities (refer also to the Insider Trading Policy).
- Fair dealing with shareholders, customers, employees, suppliers and other stakeholders.
- Giving and receiving gifts, koha, facilitation payments and bribes (refer also to the Discretionary Expenditure, Gifts and Travel Policy).
- Compliance with relevant laws and regulations.
- Reporting of unethical decision making and/or behaviour (refer also to the Compliance Policy).
- Conduct expected of management and the board in responding to and supporting instances of whistleblowing (refer to the Compliance Policy).

Our Code of Ethics and Conduct Policy includes processes for recording and evaluating compliance with the code and measures for dealing with breaches of the code, depending on the person who has breached it.

New employees are required to acknowledge that they have read and understood and will comply with the requirements of our Code of Ethics and Conduct Policy. Our induction process includes the completion of the 'Doing the right thing at Transpower' online e-learning module, which ensures people who join us are familiar with our organisation and what we expect of them while they are part of our team. This includes familiarisation with our Code of Ethics and Conduct Policy.

The board reviews the Code of Ethics and Conduct Policy every five years and is regularly updated by the general manager – people on any non-compliance with the policy.

Risk management

We recognise that risk management is an integral element of good management practice and governance. Our board requires us to have rigorous processes for risk management, supported by internal controls, to ensure that we meet our strategic objectives and protect the organisation from adverse events.

The Risk Committee (a subset of the board) is responsible for ensuring that management has established a risk management framework that includes policy, procedures and assessment methodologies that enable us to effectively manage and monitor organisational risks.

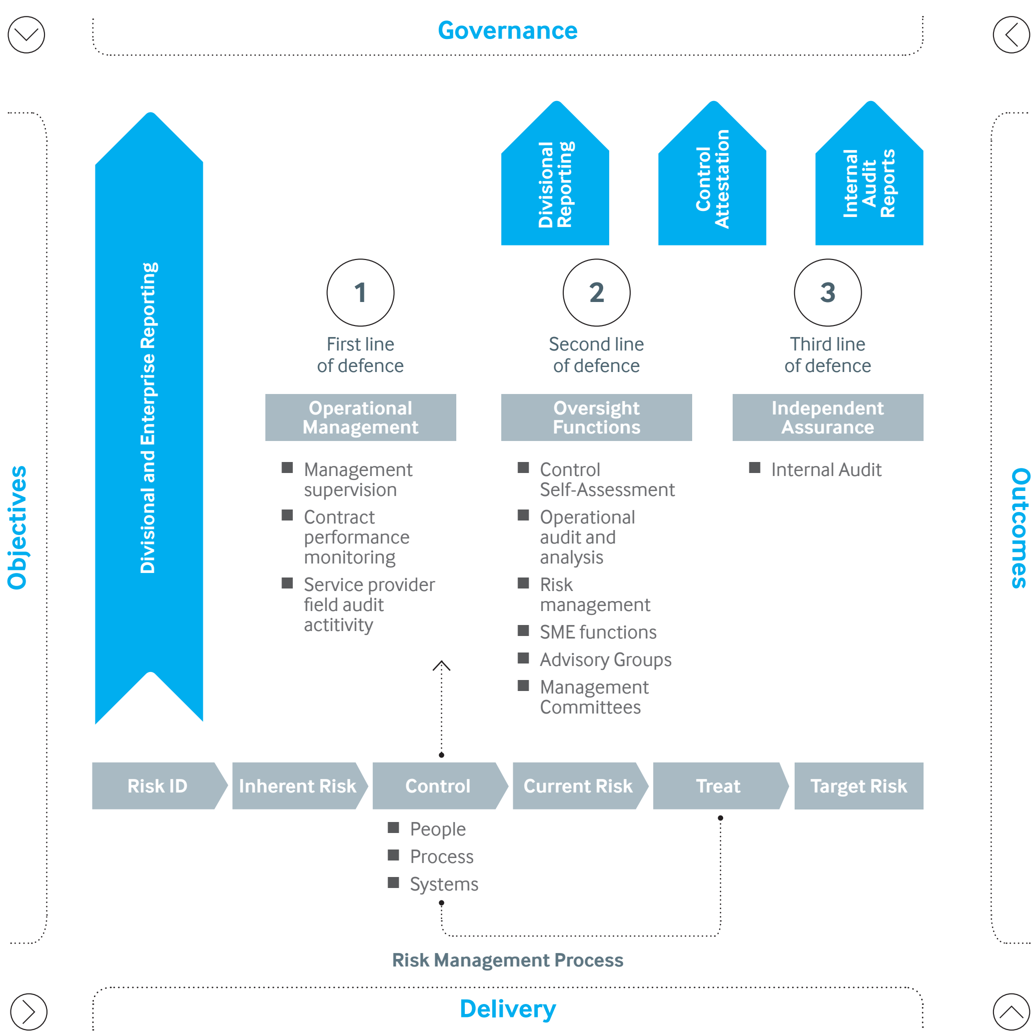
Our risk management policy is consistent with the internationally recognised standard AS/NZS ISO 31000:2009 and reflects the same risk management principles. Our risk management methodologies include bowtie risk analysis and semi-quantitative risk assessment. These methodologies enable us to have a more comprehensive understanding of the risks that we face and the control environment that we use to manage those risks.

Management report on status of the risk and control environment to the Risk Committee on a quarterly basis. The content of the reports relates to strategic and external risks, organisational risks and internal audit reviews.

Transpower delivers its internal audit function utilising external resources (Deloitte) to carry out a range of compliance and improvement audits. The internal audit reports are provided to the Risk Committee, and, where applicable, also to the Audit and Finance Committee. All board members have access to these reports. The internal audit partner attends the Risk Committee on request.

Transpower uses a risk and assurance framework to assess, manage and treat risks. A diagram of the framework is set out below.

Tranpower Risk & Assurance Framework



DIVERSITY AND INCLUSION AT TRANSPOWER

As part of our behavioral transformation, we're focusing on creating and maintaining a vibrant, diverse, positive work environment where all our people feel included, welcomed and valued. We want to better reflect the communities we serve and believe companies that are both diverse and inclusive perform better.

We do not have a formal diversity policy. However, in 2016, we agreed a diversity strategy and supplementary workplan, focusing on three key areas:

1. Growing our diversity (and awareness of diversity) to grow our performance
2. Attracting and retaining more women
3. Attracting and retaining more Māori

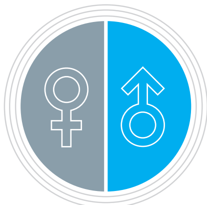
In 2017 we introduced a diversity online e-learning module to develop staff awareness and capability in this area and encourage a more inclusive workplace.

We also held unconscious bias training for managers in 2016 and continue to offer training and support for staff. Unconscious bias is where an individual is unaware that they have certain in-built preferences and are unaware how these preferences influence decision making.

Diversity metrics as at February 2017

Our most recent engagement survey took place in February 2017, with results reported in March. The survey asked our employees their ethnicity. We have based our ethnicity figures on this survey, which had a response rate of 95%. We have accordingly based our responses below on a March date.

Our people



All staff

30% female at March 2017
28% female at March 2016

All staff

70% male at March 2017
72% male at March 2016

People leaders

26% female at March 2017
23% female at March 2016

People leaders

74% male at March 2017
77% male at March 2016

Executive management

27% female at March 2017
27% female at March 2016

Executive management

73% male at March 2017
73% male at March 2016

Board

29% female at March 2017
29% female at March 2016

Board

71% male at March 2017
71% male at March 2016

New appointments

46% female at March 2017
32% female at March 2016

New appointments

54% male at March 2017
68% male at March 2016

MEASURE	DESCRIPTION	AS AT MARCH 2017		AS AT MARCH 2016	
Age profile	Median age	45.3 years		45.1 years	
Gender by role	ROLE GROUPINGS BY GENDER	FEMALE %	MALE %	FEMALE %	MALE %
	All	30	70	28	72
	People leaders	26	74	23	77
	Executive Management	27	73	27	73
	Board	29	71	29	71
Ethnicity by role	ROLE GROUPINGS BY ETHNICITY	%		UNKNOWN	
	Māori	4			
	NZ European	61			
	African	4			
	British and Irish	6			
	Chinese	4			
	Indian	3			
	North American	2			
	Other	9			
	Other Asian	4			
	Other European	2			
	Not disclosed	16			
Part-time working arrangements	Percentage of staff working part time hours	6		5	
New employees	The previous year's intake by age and gender	Median age 36.6 years Gender: Female 45.7%; Male 54.3%		Median age 37.3 years Gender: Female 32.4%; Male 67.6%	
	Ethnicity				
	– Māori	2%		–	
	– NZ European	41%		59%	
	– Australian	6%		1%	
	– British and Irish	17%		7%	
	– Chinese	6%		6%	
	– Fijian	1%		–	
	– Indian	6%		6%	
	– Other	6%		8%	
	– Other Asian	11%		1%	
	– Other European	6%		9%	
	– Not disclosed	1%		3%	

MEASURE	DESCRIPTION	AS AT MARCH 2017	AS AT MARCH 2016
Internal hire rate	The previous year's appointments identifying internal versus external hires	29% of all appointments have been internal. 66% of all roles in level 1-3 roles were internal candidates (level 1-3 means the chief executive, executive management and those non-administrative roles reporting to the executive management).	43% of all appointments were internal. 71 % of roles in level 1-3 roles were internal candidates.
Employee satisfaction	Response to the diversity statement "I feel Transpower values diversity (e.g., age, gender, ethnicity, language, education qualifications, ideas and perspectives)"	82%	74%

The chief executive of Transpower, Alison Andrew is part of the Champions for Change initiative in New Zealand.

THE NZX CORPORATE GOVERNANCE CODE

Transpower has compared its disclosures to those required under the NZX Corporate Governance Code (the code). There are certain parts of the code that do not apply to Transpower, such as those clauses related to Director appointments, takeovers, director remuneration and shareholder rights. As a SOE, these governance arrangements are the responsibility of the Crown.

Certain documents such as the code of ethics, and Board and committee charters were placed on Transpower's website in August 2017[5].

5. https://www.transpower.co.nz/about-us/our-purpose-values-and-people/corporate-governance

Financial statements

CONTENTS

Statement of comprehensive income

for the year ended 30 June 2017

		GROUP	
		2017	**2016**
	NOTES	$M	$M
Operating revenue	2	1,061.1	1,034.5
Operating expenses	3	287.8	285.1
Earnings before interest, tax, depreciation, amortisation, asset write-offs and changes in the fair value of financial instruments	1	773.3	749.4
Depreciation, amortisation and write-offs	5	277.4	269.3
Net interest expenses	4	204.9	212.3
Earnings before changes in the fair value of financial instruments and tax		291.0	267.8
(Gain)/loss in the fair value of financial instruments	15	(80.0)	16.7
Earnings before tax		371.0	251.1
Income tax expense	16	105.0	70.1
Net profit and total comprehensive income		266.0	181.0
Total net profit and total comprehensive income for the period is attributable to:			
Non-controlling interest	8	4.6	(0.9)
Owners of the parent		261.4	181.9
		266.0	181.0

These statements are to be read in conjunction with the accompanying notes.

Reconciliation of net profit specifying the net impact of fair value movements

Earnings before changes in the fair value of financial instruments and tax		291.0	267.8
Income tax expense excluding changes in the fair value of financial instruments		82.6	74.9
Earnings before net changes in the fair value of financial instruments	1	208.4	192.9
(Gain)/loss in the fair value of financial instruments		(80.0)	16.7
Income tax expense (credit) on changes in the fair value of financial instruments		22.4	(4.8)
Net profit		266.0	181.0

Statement of financial position

as at 30 June 2017

		GROUP	
		2017	**2016**
	NOTES	$M	$M
ASSETS EMPLOYED			
Cash and cash equivalents		28.3	79.9
Investments	9	97.2	128.8
Trade receivables and other assets	10	142.1	135.7
Derivatives and hedge commitment in gain	7	197.6	346.3
NZPCL investment	8	77.6	76.3
Property, plant and equipment	5	4,589.4	4,599.7
Intangibles	5	389.4	392.9
Capital work in progress	5	75.9	68.0
TOTAL ASSETS EMPLOYED		5,597.5	5,827.6
FUNDS EMPLOYED			
Liabilities			
Trade and other payables	11	107.9	96.2
Current tax liability		19.2	14.6
Deferred income	2	84.0	72.9
Derivatives and hedge commitment in loss	7	339.7	491.2
Provisions	12	30.4	31.0
Debt	6	3,082.8	3,334.0
NZPCL debt	8	74.4	79.4
Deferred tax	16	377.8	328.8
Total liabilities		4,116.2	4,448.1
EQUITY			
Capital	13	1,200.0	1,200.0
Accumulated surplus		279.0	181.8
Non-controlling interest	8	2.3	(2.3)
Total equity		1,481.3	1,379.5
TOTAL FUNDS EMPLOYED		5,597.5	5,827.6

The board of directors of Transpower New Zealand Limited authorised these financial statements for issue on 17 August 2017.

For, and on behalf of, the board

HON. TONY RYALL
CHAIR

DON HUSE
DEPUTY CHAIR

These statements are to be read in conjunction with the accompanying notes.

Statement of changes in equity

for the year ended 30 June 2017

		GROUP				
	NOTES	ORDINARY SHARES $M	RETAINED EARNINGS $M	OWNERS OF THE PARENT $M	NON CONTROLLING INTEREST $M	TOTAL $M
2015/16						
Equity at 1 July 2015		1,200.0	177.5	1,377.5	(1.4)	1,376.1
Profit for the period		–	181.9	181.9	(0.9)	181.0
Total comprehensive income		–	181.9	181.9	(0.9)	181.0
Transactions with owners						
Dividends paid	13	–	(177.6)	(177.6)	–	(177.6)
Total equity at 30 June 2016		1,200.0	181.8	1,381.8	(2.3)	1,379.5
2016/17						
Equity at 1 July 2016		1,200.0	181.8	1,381.8	(2.3)	1,379.5
Profit for the period		–	261.4	261.4	4.6	266.0
Total comprehensive income		–	261.4	261.4	4.6	266.0
Transactions with owners						
Dividends paid	13	–	(164.2)	(164.2)	–	(164.2)
Total equity at 30 June 2017		1,200.0	279.0	1,479.0	2.3	1,481.3

These statements are to be read in conjunction with the accompanying notes.

Cash flow statement

for the year ended 30 June 2017

	GROUP	
	2017	**2016**
	$M	$M
CASH FLOW FROM OPERATIONS		
Receipts from customers	1,059.8	1,021.4
Interest received	5.5	8.6
Payments to suppliers and employees	(281.4)	(286.4)
Tax payments	(51.3)	(29.4)
Interest paid	(210.4)	(221.5)
Net cash inflows from operations	522.2	492.7
CASH FLOW FROM INVESTMENTS		
Sale of property, plant and equipment	4.7	8.1
Sale of short-term investments	104.9	47.6
Purchase of property, plant and equipment and intangibles	(265.6)	(240.1)
Purchase of short-term investments	(74.0)	(99.4)
Net cash (outflows) from investments	(230.0)	(283.8)
CASH FLOW FROM FINANCING		
Increase in loans	792.7	915.8
Dividends paid	(164.2)	(177.6)
Interest rate swap terminations	–	(10.1)
Repayment of loans	(972.3)	(891.0)
Net cash (outflows) from financing	(343.8)	(162.9)
Net increase/(decrease) in cash held	(51.6)	46.0
Opening balance brought forward	79.9	33.9
Closing net cash carried forward	28.3	79.9
Closing net cash carried forward comprises:		
Cash and on-call deposits	0.9	34.8
Short-term deposits with original maturity less than three months	27.4	45.1

These statements are to be read in conjunction with the accompanying notes.

Cash flow statement reconciliation

RECONCILIATION OF "NET PROFIT (LOSS)" WITH "NET CASH FLOW FROM OPERATIONS"

	GROUP	
	2017	**2016**
	$M	$M
Net profit	266.0	181.0
Add (deduct) non-cash items:		
Change in the fair value of financial instruments	(80.3)	16.7
Depreciation, amortisation and write-offs	277.4	269.3
Deferred tax	(49.0)	30.5
Capitalised interest	(6.0)	(7.3)
Movements in working capital items:		
(Increase)/decrease in trade and other receivables	(7.2)	(6.4)
(Increase)/decrease in prepayments	1.2	0.9
(Decrease)/increase in trade and other payables, interest payable and deferred income	16.4	(7.4)
(Decrease)/increase in taxation payable	4.6	10.2
(Decrease)/increase in provisions	1.1	5.2
Net cash flow from operations	522.2	492.7

Notes to the financial statements

for the year ended 30 June 2017

1. TRANSPOWER GROUP INFORMATION

Reporting entity and statutory base

Transpower New Zealand Limited (Transpower) is a state-owned enterprise registered in New Zealand under the Companies Act 1993. The financial statements are in New Zealand dollars and are of Transpower and its subsidiaries (together, the Group).

The Group is the owner and operator of New Zealand's national electricity grid. The Group is a for-profit entity in accordance with XRB A1 Accounting Standards Framework.

Basis of preparation

The financial statements have been presented in accordance with the State-Owned Enterprise Act 1986 and are prepared in accordance with the Financial Markets Conduct Act 2013. The financial statements have been prepared and comply with generally accepted accounting practice (GAAP) in New Zealand and the Financial Reporting Act 2013.

The financial statements comply with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards. The financial statements comply with International Financial Reporting Standards (IFRS).

The statement of comprehensive income and the cash flow statement are prepared so that all components are stated exclusive of GST. All items in the statement of financial position are stated exclusive of GST with the exception of receivables and payables, which include GST.

The financial statements of the Group's subsidiaries are prepared in the functional currency of that entity, being New Zealand dollars. The exception to this is New Zealand Power Cayman 2003-1 Limited, which has a functional currency of US dollars. Its presentational currency is New Zealand dollars.

Measurement basis

The measurement basis adopted in the preparation of these financial statements is historical cost except as modified for certain investments, held for sale assets, financial assets and financial liabilities.

Transpower discloses an alternative measure of profit, which is earnings before net changes in fair values of financial instruments. Transpower discloses this information as it provides a different measure of underlying performance to the IFRS-mandated profit measures, which are also disclosed. The directors consider that this additional profit measure is useful additional information for users of the financial statements. Transpower has consistently reported an alternative profit on this basis since the adoption of IFRS.

1. TRANSPOWER GROUP INFORMATION continued

Significant accounting policies

a) Basis of consolidation

The Group financial statements consolidate the financial statements of subsidiaries as at and for the year ended 30 June 2017.

Subsidiaries are those entities controlled, directly or indirectly, by Transpower.

All significant intercompany balances and transactions are eliminated on consolidation.

The Group discloses a non-controlling interest (NCI) relating to New Zealand Power Cayman 2003-1 Limited (NZPCL). NCI is measured at the NCI's share of net assets.

b) Accounting policies and information about judgements that have had a significant effect on the amounts recognised in the financial statements are disclosed in the relevant notes as follows:

i.	Operating revenue and deferred income	Note 2
ii.	Capital assets and commitments	Note 5
iii.	Debt, financial instruments and risk management	Note 6

New standards not yet adopted

Transpower has elected not to early adopt the following standards (or revisions to standards) considered to be relevant to the financial statements but not yet effective.

NZ IFRS 9 Financial instruments, effective from 1 July 2018

On adoption of NZ IFRS 9, the presentation of fair value movement attributing to own credit risk will move from profit or loss to other comprehensive income. In the event that Transpower qualifies and elects to adopt hedge accounting on cross-currency and interest rate swaps, this may have a material impact upon the Group financial statements.

NZ IFRS 15 Revenue from contracts with customers, effective from 1 July 2018

Management has performed an initial assessment on this standard and does not believe it will have a material impact upon the financial statements.

NZ IFRS 16 Leases, effective from 1 July 2019

Management has not yet fully assessed this standard. However, when adopted, it is expected that the present value of lease commitments disclosed in note 3 would be capitalised as an asset and an offsetting liability created. There would be related reductions in leasehold expenditure and an increase in depreciation expense.

New standards adopted during the period

There were no new or revised standards adopted during the period that had a material impact on the financial statements.

2. OPERATING REVENUE AND DEFERRED INCOME

	GROUP 2017 $M	GROUP 2016 $M
Transmission revenue		
HVAC interconnection	689.3	667.8
HVAC connection	124.4	127.3
EV (rebate) charge – HVAC	(14.5)	(28.2)
HVDC	126.2	128.0
EV (rebate) charge – HVDC	25.3	22.5
Other regulated transmission	4.6	7.6
Customer investment contracts	38.9	43.5
Other transmission	7.5	5.6
	1,001.7	974.1
Other revenue		
System operator	45.3	44.0
Other	14.1	16.4
	59.4	60.4
Total operating revenue	1,061.1	1,034.5

Description

Transmission revenue

Transmission revenue consists of charges for the transmission of electricity from the point of generation to the point of supply, being high voltage alternating current (HVAC) interconnection, connection and high voltage direct current (HVDC).

Customer investment contracts are contracts entered into with customers to build grid connection assets.

System operator income relates to payments received for the provision of real time services to ensure the short term security of the New Zealand electricity system.

Included in the above numbers is revenue subject to the telecommunications development levy of $2.4 million in the year to 30 June 2017 (June 2016: $1.9 million).

Accounting policies

Transmission revenue is recorded as it is invoiced, apart from customer investment contracts. Revenue from customer investment contracts is grossed up for imputed interest expense and recognised over the estimated life of the related assets.

Certain transactions relating to the operation of the electricity market, specifically wholesale market related ancillary services and losses and constraint payments, are "passed-through" and are therefore not recorded in profit or loss. This pass-through occurs because Transpower is deemed to act only as an agent. Similarly, Transpower acts as an agent relating to its natural gas market operation.

Agreements between Transpower and third parties to underground and/or realign certain transmission line assets are recognised based on the revenue source. If the revenue is received from central or local government, or their agencies, then the revenue is recognised according to the Government Grants standard (NZ IAS 20) with revenue grossed up for an imputed interest expense and recognised over the life of the related transmission assets. If revenue is received from non government parties then it is recognised once the related assets are commissioned. The related assets are also written off.

Related disclosures

	GROUP 2017 $M	GROUP 2016 $M
Deferred income		
Customer investment contracts	19.6	15.0
Transmission realignment	60.0	55.6
Other	4.4	2.3
Total deferred income	84.0	72.9

3. OPERATING EXPENSES AND LEASE COMMITMENTS

	GROUP	
	2017	**2016**
	$M	$M
Grid maintenance		
HVAC substations maintenance	41.7	45.3
HVDC substations and cables maintenance	9.2	9.1
HVAC lines maintenance	35.4	38.3
HVDC lines maintenance	1.9	0.9
Transmission related rates	6.8	6.6
Other	8.0	7.5
	103.0	107.7
IST maintenance and operations		
Support and maintenance	10.3	10.3
Outsourced services	14.8	15.2
Licences	8.0	8.6
IST leases	9.1	9.5
	42.2	43.6
Other operating expenses		
Investigations	15.9	12.4
Ancillary service costs	4.2	3.0
Employee benefits	100.3	99.2
Capitalised salary costs	(19.2)	(20.0)
Salary transferred to investigations	(4.9)	(5.4)
Operating lease and rental costs	3.7	4.1
Industry levies	10.8	9.5
Insurance	4.3	5.3
Other business support costs	27.5	25.7
	142.6	133.8
Total operating expenses	287.8	285.1

Description

Maintenance includes inspection, servicing and repair costs.

Other grid maintenance expenses include maintenance support, communication system and training for service providers and third parties.

Investigations includes work that the Group conducts prior to the commencement of a capital project, updates to maintenance standards and demand response costs.

Other business support costs include such items as legal fees, office equipment, communications, vehicles, travel, consultants, contractors, donations and study grants.

Accounting policies

If there are costs associated with entering into an operating lease then these costs are treated as Prepayments and then amortised to Operating lease and rental costs over the life of the related operating lease.

3. OPERATING EXPENSES AND LEASE COMMITMENTS continued

Related disclosures

Fees paid to external auditor	GROUP	
	2017	**2016**
	$000	$000
Audit of financial statements		
Audit and reviews of financial statements (1)	441	433
Other services		
Other assurance (2)	8	40
Training courses	55	54
Trust deed requirements (3)	11	14
Remuneration benchmarking report	6	2
	80	110
Total fees paid to external auditor	521	543

(1) This includes an annual audit and a six monthly review.
(2) Includes a report on the wash up of the system operator service provider agreement and in 2016 included a review of the company valuation methodology.
(3) Trust deed requirements includes fees payable to review directors certificates in relation to debt held against two trust deeds.

Operating lease commitments	GROUP	
	2017	**2016**
	$M	$M
Commitments in respect of non-cancellable operating leases payable		
Within one year	14.5	13.5
One to two years	14.6	13.5
Two to five years	42.2	40.4
Later than five years	92.3	104.6
Total operating lease commitments	163.6	172.0

The lease commitments primarily relate to the leasing of fibre optic cables for Transpower's communications network (included in IST leases) and a lease for the Wellington office building (included in operating lease and rental costs under other operating expenses).

4. NET INTEREST EXPENSES

	GROUP	
	2017	**2016**
	$M	$M
Interest revenue		
Interest received	5.5	7.7
	5.5	7.7
Interest expenses		
Interest expenses and associated fees	209.9	221.5
Capitalised interest	(6.0)	(7.3)
Imputed interest	6.5	5.8
	210.4	220.0
Total net interest expenses	204.9	212.3

Description

Capitalised interest is based on Transpower's forecast weighted average cost of borrowing. For 2017, capitalised interest was 6.92% (2016: 7.1%).

Imputed interest arises on deferred income and the unwind of the discount of future cash flows related to provisions.

5. CAPITAL ASSETS AND COMMITMENTS

This note includes property, plant and equipment, intangible assets, non-current assets held for sale, capital work in progress and capital commitments

GROUP	HVAC TRANSMISSION LINES	HVDC TRANSMISSION LINES	HVAC SUBSTATIONS	HVDC SUBSTATIONS AND SUBMARINE CABLES
	$M	$M	$M	$M
At 30 June 2017				
Cost	2,511.2	147.4	2,403.0	865.0
Accumulated depreciation/amortisation	(573.9)	(49.3)	(664.5)	(289.4)
Net book value/carrying value	1,937.3	98.1	1,738.5	575.6
30 June 2017 reconciliation				
Opening net book value/carrying value (1 July 2016)	1,914.5	101.0	1,731.3	611.1
Additions/transfers	95.2	1.1	87.8	1.3
Disposals/transfers	(10.1)	–	(7.6)	(0.5)
Depreciation/amortisation	(62.3)	(4.0)	(73.0)	(36.3)
Closing net book value/carrying value	1,937.3	98.1	1,738.5	575.6
At 30 June 2016				
Cost	2,429.8	146.3	2,331.8	864.3
Accumulated depreciation/amortisation	(515.3)	(45.3)	(600.5)	(253.2)
Net book value/carrying value	1,914.5	101.0	1,731.3	611.1
30 June 2016 reconciliation				
Opening net book value/carrying value (1 July 2015)	1,897.4	103.0	1,729.2	641.5
Additions/transfers	82.9	2.0	82.7	6.3
Disposals/transfers	(5.0)	(0.1)	(6.8)	(0.2)
Depreciation/amortisation	(60.8)	(3.9)	(73.8)	(36.5)
Closing net book value/carrying value	1,914.5	101.0	1,731.3	611.1

COMMUNICATIONS $M	ADMINISTRATION ASSETS $M	TOTAL PROPERTY, PLANT AND EQUIPMENT $M	EASEMENTS AND RIGHT TO ACCESS $M	SOFTWARE $M	TOTAL INTANGIBLE ASSETS $M	CAPITAL WORK IN PROGRESS $M
349.0	184.4	6,460.0	303.5	309.5	613.0	75.9
(169.8)	(123.7)	(1,870.6)	(3.6)	(220.0)	(223.6)	–
179.2	60.7	4,589.4	299.9	89.5	389.4	75.9
174.2	67.6	4,599.7	290.6	102.3	392.9	68.0
32.1	12.9	230.4	9.9	30.4	40.3	269.7
(2.0)	(4.1)	(24.3)	–	–	–	(261.8)
(25.1)	(15.7)	(216.4)	(0.6)	(43.2)	(43.8)	–
179.2	60.7	4,589.4	299.9	89.5	389.4	75.9
324.8	176.9	6,273.9	293.6	279.8	573.4	68.0
(150.6)	(109.3)	(1,674.2)	(3.0)	(177.5)	(180.5)	–
174.2	67.6	4,599.7	290.6	102.3	392.9	68.0
192.2	68.6	4,631.9	288.2	103.1	391.3	77.7
9.9	15.6	199.4	3.0	35.1	38.1	229.5
(1.8)	(2.2)	(16.1)	–	(0.2)	(0.2)	(239.2)
(26.1)	(14.4)	(215.5)	(0.6)	(35.7)	(36.3)	–
174.2	67.6	4,599.7	290.6	102.3	392.9	68.0

5. CAPITAL ASSETS AND COMMITMENTS continued

	2017 $M	2016 $M
Depreciation, amortisation and write-offs		
Total depreciation	216.4	215.5
Total amortisation	43.8	36.3
Write-offs	17.2	17.5
	277.4	269.3

Capital work in progress can be split into the following classes	GROUP	
	2017 $M	2016 $M
HVAC transmission lines	23.5	23.2
HVAC substations	35.0	30.6
Communications	1.8	2.2
Other	15.6	12.0
	75.9	68.0

Description

Administration assets include computer hardware, plant, equipment, furniture and motor vehicles.

The most significant right to access asset relates to the 2011 purchase of access rights to the Vector Tunnel in Auckland for $50 million. The Vector Tunnel right to access asset is being amortised over the contract life, which is 90 years.

Accounting policies

Transpower uses the cost model for all capital assets. Capital work in progress is recorded at cost. Cost is determined by including all costs directly associated with bringing the assets to their location and condition for use. Finance costs incurred during the period of time that is required to complete and prepare the asset for its intended use are capitalised as part of the total cost for capital work in progress.

Assets are transferred from capital work in progress at cost to property, plant and equipment or intangible assets as they become operational and available for use.

At each reporting date, Transpower reviews the carrying amounts of its tangible and intangible assets and exercises judgement to determine whether there is any indication that those assets have suffered an impairment loss.

If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). The recoverable amount for regulated assets is generally equal to the regulatory book value for revenue recovery purposes. There is no regulatory impairment in 2017 (2016: nil).

Depreciation

Depreciation of property, plant and equipment is calculated using the straight line method to write down the cost of property, plant and equipment to its estimated residual value over its estimated useful life.

Transpower has a variety of different assets with different lives. The estimated weighted average useful lives by asset category are as follows:

HVAC transmission lines	58 years
HVAC transmission high voltage cables	45 years
HVAC transmission lines (tower painting)	15 years
HVAC substations	43 years
HVDC substations (including submarine cables)	28 years
HVDC transmission lines	55 years
Communication assets	15 years
Administration assets	16 years

5. CAPITAL ASSETS AND COMMITMENTS continued

Non-current assets held for sale

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Intangibles

The cost of acquiring a finite-life intangible asset is amortised from the date the underlying asset is held ready for use on a straight-line basis over the period of its expected benefit, which is as follows:

Software	5–8 years
Right to access asset	90 years

Easements are deemed to have an indefinite useful life and are tested for impairment annually.

Certain easements have been donated by the Crown. These are recognised at cost (nil) plus any direct cost associated with putting the easement in place.

Key judgements

Transpower has exercised judgement, with assistance from independent engineers, in determining the useful life of property, plant and equipment and finite life intangible assets. For transmission line assets, a determining factor in the life assumption is proximity to the coast.

Transpower has also used judgement to determine the appropriate component level of asset at which to depreciate and whether or not an item is capital in nature.

Related disclosures

Land and buildings are contained within the above classes and have a net book value of $250.8 million (2016: $247.5 million). Held for sale non-current assets are contained within the above classes and have a net book value of $1.5 million (2016: $0.4 million).

	GROUP	
	2017	2016
	$M	$M
Capital commitments in respect of contracts for property, plant and equipment		
Property, plant and equipment	106.1	105.6
	106.1	105.6
Capital commitments in respect of contracts for intangible asset		
Easements and right to access assets	0.1	0.1
Software	–	0.3
	0.1	0.4
Total capital commitments	106.2	106.0

6. DEBT, FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

(a) Summary

Debt is issued by the Group in both New Zealand dollars (NZD) and foreign currencies. Derivatives are used to manage currency risk and interest rate risk by converting foreign borrowings to NZD and by converting floating interest rates to fixed interest rates. The use of derivatives means that Transpower effectively has borrowings denominated in NZD, predominantly at fixed interest rates.

Debt and associated derivatives are designated as fair value through profit or loss on the basis of preventing an accounting mismatch. The Group's debt and derivatives are managed as one integrated portfolio.

The Group also uses derivatives in its purchase of goods and services.

The Group is subject to a number of financial risks that arise as a result of its business activities, including having a debt portfolio that is denominated in both NZD and foreign currencies, holding an investment portfolio and from purchases in certain foreign currencies.

Financial risk management is carried out by a central treasury function, which operates under policies approved by the board of directors.

Key judgements

Fair values of debt and derivatives are determined by discounting cash flows based on the relevant yield curve. The yield curve is adjusted to reflect the credit risk of the counterparty to the transaction or the credit risk of Transpower. These valuations are considered level two in the IFRS three-level valuation hierarchy.

(b) Financial risks

i. Liquidity risk

Liquidity risk is the risk of the Group being unable to access sufficient funds to meet its financial obligations in an orderly manner. This might result from the Group not maintaining adequate funding facilities or being unable to replace existing debt maturities.

To smooth the Group's refinancing requirements in future periods, the Group's policy is that committed funding facilities maturing in any 12-month period are not to exceed NZD750 million. No more than 50% of debt can mature within the next three years and at least 30% of debt must mature after five years.

Term debt

The Group has four debt facilities. The aggregate principal amount of the debt outstanding may not exceed the following:

	CURRENCY	FOREIGN CURRENCY EQUIVALENT	NZD
		$M	$M
Domestic medium term note programme	NZD	–	No set limit
Australian medium term note programme	AUD	750	787
European commercial paper programme (ECP)	USD	500	682
Domestic commercial paper programme (CP)	NZD	–	500

In addition to the above, the Group's liquidity policy requires the Group to have access to committed funding facilities to cover the sum of all debt that matures over the next six months plus peak cumulative anticipated operating cash flow requirements over the next six months. To meet this policy requirement, Transpower has:

- a two-year standby facility for NZD250 million, maturing 6 December 2017, undrawn since inception
- a two-year standby facility for NZD250 million, maturing 7 December 2018, undrawn since inception.

6. DEBT, FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

ii. Interest rate risk

Interest rate risk is the risk of an adverse impact on the present and future finance costs of the Group arising from an increase in interest rates. Transpower uses various financial instruments to fix interest rates to mitigate interest rate risk.

The Group's policy sets minimum and maximum hedging parameters expressed as a percentage of forecast debt.

Interest rate swaps and options are used to change the interest rate profile on existing and forecast debt and cross-currency interest rate swaps entered into.

iii. Currency risk

Currency risk on debt is the risk of adverse impact of exchange rate movements, which determine the NZD cost of debt (principal and interest) issued in foreign currencies.

Foreign currency borrowings are converted into an NZD-denominated exposure at the time of commitment to drawdown. Currency risk on foreign currency-denominated borrowings is managed using cross-currency interest rate swaps and basis swaps.

Cross-currency interest rate swaps eliminate foreign currency risk on the underlying debt by determining the NZD equivalent of the interest payments and final principal exchange at the time of entering into the swap.

Basis swaps are used to eliminate currency risk when the Group issues bonds in a foreign currency. In a basis swap, the Group receives the offshore currency floating interest rate and pays the NZD floating interest rate.

Currency risk on foreign currency-denominated purchases is the risk of adverse impact of exchange rate movements, which determine the NZD cost of foreign currency-denominated purchases. It is the Group's policy to hedge committed foreign currency-denominated payments greater than NZD1 million (NZD equivalent) by using forward foreign exchange contracts to fix or offset the NZD cost. For committed payments between NZD100,000 and NZD1 million, the Group has discretion on whether or not to hedge.

6. DEBT, FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

Debt and related derivatives – interest rate, currency and liquidity risk

The following table details Transpower's debt and associated derivatives. The result after derivatives is that Transpower effectively has a debt portfolio in New Zealand dollars at predominantly fixed interest rates across multiple repayment dates. The derivatives in the table below are interest rate swaps and cross-currency interest rate swaps that relate directly to the particular debt issue. The effective interest rate on debt including the effect of derivative financial instruments was 6.8% (2016: 6.9%).

GROUP 2017

	DEBT CURRENCY	DEBT AND DERIVATIVE MATURITY DATE	DEBT FACE VALUE	DEBT FAIR VALUE	DERIVATIVE FAIR VALUE	TOTAL DEBT + DERIVATIVES FAIR VALUE
			$M	NZ$M	NZ$M	NZ$M
ECP & CP						
NZD Issue Aug	NZD	24-Aug-17	34.8	34.9	–	34.9
NZD Issue Sep	NZD	4-Sep-17	29.8	29.9	–	29.9
NZD Issue Sep	NZD	18-Sep-17	29.8	29.9	–	29.9
NZD Issue Sep	NZD	28-Sep-17	24.8	24.8	–	24.8
Bonds						
Bonds 2018	NZD	30-Nov-18	325.0	336.9	(8.7)	328.2
Bonds 2019	NZD	6-Sep-19	200.0	209.9	(6.7)	203.2
Bonds 2019	NZD	12-Nov-19	50.0	55.2	(4.8)	50.4
FRN CPI linked	NZD	15-May-20	100.0	98.9	2.4	101.3
Bonds 2020	NZD	10-Jun-20	150.0	166.0	(18.1)	147.9
Bonds 2022	NZD	30-Jun-22	150.0	153.2	(4.8)	148.4
Bonds 2022	NZD	16-Sep-22	100.0	102.0	(2.2)	99.8
Bonds 2023	NZD	15-Mar-23	50.0	54.5	(3.7)	50.8
Bonds 2028	NZD	15-Mar-28	100.0	109.9	(9.7)	100.2
European Medium Term Note (EMTN)						
HKD EMTN	HKD	24-Mar-20	400.0	75.1	(1.7)	73.4
AUD EMTN	AUD	6-Aug-21	150.0	166.8	(2.3)	164.5
AUD EMTN	AUD	28-Aug-23	300.0	360.4	(14.5)	345.9
US Private Placement (USPP)						
USPP 2019	USD	27-Sep-19	75.0	112.4	9.9	122.3
USPP 2021	USD	13-Oct-21	232.0	332.8	(36.1)	296.7
USPP 2022	USD	15-Dec-22	150.0	215.7	(13.7)	202.0
USPP 2023	USD	13-Oct-23	78.0	112.6	(13.1)	99.5
USPP 2026	USD	28-Jun-26	75.0	100.4	11.3	111.7
USPP 2026	USD	13-Oct-26	70.0	101.7	(14.3)	87.4
USPP 2028	USD	28-Jun-28	75.0	98.9	11.8	110.7
				3,082.8	(119.0)	2,963.8
Debt short term				119.5		
Current portion of long-term debt				–		
Debt short term				119.5		
Debt long term				2,963.3		
Total debt as per statement of financial position				3,082.8	(119.0)	2,963.8
Debt face value (as per above)						
New Zealand dollar debt			1,344.2			
Foreign debt after adjusting for related cross-currency interest rate swaps			1,593.2			
			2,937.4			

The notional amount of the cross-currency interest rate swaps is NZD1,593.2 million.

6. DEBT, FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

Interest rate swaps (IRS) are used to fix interest payments as per the Group's treasury policy.

The table below shows the notional IRS that are not directly related to underlying debt. The table includes forward starting and offsetting IRS. The IRS are net settled. The table below reflects the net cash outflows comprising both IRS assets and liabilities. IRS with unrealised gains are assets and IRS with unrealised losses are liabilities.

	DERIVATIVE NOTIONAL VALUE	DERIVATIVE FAIR VALUE
	$M	$M
Value of interest rate swaps (net settled) – liabilities	4,205.0	303.0
Value of interest rate swaps (net settled) – assets	1,280.0	(41.9)
Total fair value of interest rate swaps		261.1
Total fair value of debt-related derivatives as shown above		(119.0)
Total debt derivatives fair value (refer to note 7 for further derivatives breakdown)		142.1

Effective net contractual cash flow maturity profile

The effective net cash flows on floating rate payments are determined by applying the applicable swap curve to determine the expected future cash flows.

	WITHIN ONE YEAR	ONE TO TWO YEARS	TWO TO THREE YEARS	THREE TO FOUR YEARS	FOUR TO FIVE YEARS	GREATER THAN FIVE YEARS	TOTAL
	$M	$M	$M	$M	$M	$M	$M
Debt and corresponding derivatives	212.1	426.0	791.5	85.0	677.9	1,351.2	3,543.7
Interest rate swap (portfolio) – liabilities	116.4	88.3	65.7	10.6	10.7	29.8	321.5
Interest rate swap (portfolio) – assets	(18.1)	(10.2)	(5.5)	(3.3)	(2.9)	(4.8)	(44.8)
Trade and other payables	106.8	0.2	0.3	0.2	–	0.4	107.9
Total contractual cash flows	417.2	504.3	852.0	92.5	685.7	1,376.6	3,928.3

6. DEBT, FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

Debt and related derivatives – interest rate, currency and liquidity risk

The following table details Transpower's debt and associated derivatives. The result after derivatives is that Transpower effectively has a debt portfolio in New Zealand dollars at predominantly fixed interest rates across multiple repayment dates. The derivatives in the table below are interest rate swaps and cross-currency interest rate swaps that relate directly to the particular debt issue. The effective interest rate on debt including the effect of derivative financial instruments was 6.9% (2015: 7.2%).

GROUP 2016

	DEBT CURRENCY	DEBT AND DERIVATIVE MATURITY DATE	DEBT FACE VALUE	DEBT FAIR VALUE	DERIVATIVE FAIR VALUE	TOTAL DEBT + DERIVATIVES FAIR VALUE
			$M	NZ$M	NZ$M	NZ$M
Bonds						
Bonds 2017	NZD	15-Feb-17	50.0	52.4	(2.0)	50.4
Bonds 2018	NZD	30-Nov-18	325.0	342.6	(9.8)	332.8
Bonds 2019	NZD	6-Sep-19	200.0	212.2	(9.3)	202.9
Bonds 2019	NZD	12-Nov-19	50.0	56.9	(6.9)	50.0
FRN CPI linked	NZD	15-May-20	100.0	97.3	3.5	100.8
Bonds 2020	NZD	10-Jun-20	150.0	171.0	(25.0)	146.0
Bonds 2022	NZD	30-Jun-22	150.0	156.0	(9.6)	146.4
Bonds 2023	NZD	15-Mar-23	50.0	56.0	(5.8)	50.2
Bonds 2028	NZD	15-Mar-28	100.0	115.9	(16.2)	99.7
EMTN						
CAD EMTN	CAD	20-Mar-17	250.0	276.1	34.4	310.5
HKD EMTN	HKD	24-Mar-20	400.0	79.1	(6.3)	72.8
AUD EMTN	AUD	6-Aug-21	150.0	167.0	(6.9)	160.1
AUD EMTN	AUD	28-Aug-23	300.0	366.5	(31.7)	334.8
USPP						
USPP 2016	USD	27-Sep-16	25.0	36.0	5.1	41.1
USPP 2019	USD	27-Sep-19	75.0	121.1	(0.3)	120.8
USPP 2021	USD	13-Oct-21	232.0	353.8	(62.2)	291.6
USPP 2022	USD	15-Dec-22	150.0	230.5	(24.1)	206.4
USPP 2023	USD	13-Oct-23	78.0	120.5	(24.4)	96.1
USPP 2026	USD	28-Jun-26	75.0	107.6	3.5	111.1
USPP 2026	USD	13-Oct-26	70.0	109.7	(27.2)	82.5
USPP 2028	USD	28-Jun-28	75.0	105.8	4.0	109.8
				3,334.0	(217.1)	3,116.9
Debt short term				–		
Current portion of long-term debt				364.5		
Debt short term				364.5		
Debt long term				2,969.5		
Total debt as per statement of financial position				3,334.0	(217.2)	3,116.9
Debt face value (as per above)						
New Zealand dollar debt			1,175.0			
Foreign debt after adjusting for related cross-currency interest rate swaps			1,941.9			
			3,116.9			

The notional amount of the cross-currency interest rate swaps is NZD1,941.9 million.

6. DEBT, FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

Interest rate swaps (IRS) are used to fix interest payments as per the Group's treasury policy.

The table below shows the notional IRS that are not directly related to underlying debt. The table includes forward starting and offsetting IRS. The IRS are net settled. The table below reflects the net cash outflows comprising both IRS assets and liabilities. IRS with unrealised gains are assets and IRS with unrealised losses are liabilities.

	DERIVATIVE NOTIONAL VALUE	DERIVATIVE FAIR VALUE
	$M	$M
Value of interest rate swaps (net settled) – liabilities	4,507.5	439.0
Value of interest rate swaps (net settled) – assets	1,707.5	(76.9)
Total fair value of interest rate swaps		362.1
Total fair value of debt-related derivatives as shown above		(217.2)
Total debt derivatives fair value (refer to note 7 for further derivatives breakdown)		144.9

Effective net contractual cash flow maturity profile

The effective net cash flows on floating rate payments are determined by applying the applicable swap curve to determine the expected future cash flows.

	WITHIN ONE YEAR	ONE TO TWO YEARS	TWO TO THREE YEARS	THREE TO FOUR YEARS	FOUR TO FIVE YEARS	GREATER THAN FIVE YEARS	TOTAL
	$M	$M	$M	$M	$M	$M	$M
Debt and corresponding derivatives	507.0	95.1	416.2	775.6	69.4	1,889.7	3,753.0
Interest rate swap (portfolio) – liabilities	111.9	112.1	95.0	85.8	13.3	54.8	472.9
Interest rate swap (portfolio) – assets	(18.6)	(18.7)	(12.5)	(8.6)	(6.0)	(22.0)	(86.4)
Trade and other payables	95.1	0.2	0.2	0.1	0.3	0.5	96.4
Total contractual cash flows	695.4	188.7	498.9	852.9	77.0	1,923.0	4,235.9

iv. Credit risk

Credit risk is the risk of adverse impact on the Group through the failure of a counterparty bank, financial institution or customer to meet its financial obligations. Transpower's credit risk arises from financial assets excluding equity investments.

Treasury credit risk

The Group's policy is to establish credit limits with counterparties that are either a bank, a financial institution, a special-purpose derivative products company or a New Zealand corporate. These net credit limits are not to exceed the lesser of 20% of Group shareholders' funds or 15% of the shareholders' funds of the counterparty as shown in the most current audited annual report. In addition, if the counterparty is a New Zealand corporate, the credit limit for investments is not to exceed $40 million.

Counterparties must have a minimum long-term Standard & Poor's credit rating of A or above (or Fitch or Moody's equivalent). The exception to these minimum credit ratings is for Risk Reinsurance Limited (RRL) investments. Credit exposures against these limits are monitored on a daily basis.

For those counterparties with which the Group has a collateral support agreement (CSA), the counterparty credit limit for derivatives is defined as the maximum exposure threshold dictated by the CSA.

The maximum credit exposure in respect of non-derivative assets is best represented by their carrying value.

6. DEBT, FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

The credit risk arising from the use of derivative products is minimised by the netting and set-off provisions contained in the Group's International Swaps and Derivatives Association (ISDA) agreement. Under these agreements, transactions are net settled. Therefore, the maximum credit exposure is best represented by the net mark to market valuation by counterparty where the net valuation is positive as follows:

	GROUP	
	2017	**2016**
	$M	$M
Cross-currency interest rate swaps (CCIRS)	66.3	153.3
Foreign exchange forward contracts	–	–
Total	66.3	153.3

The breakdown of the CCIRS by counterparty is as follows:

	GROUP	
	2017	**2016**
	$M	$M
ANZ Bank New Zealand Limited	29.2	59.8
Bank of New Zealand	14.5	31.8
Citibank N.A.	3.8	19.1
Commonwealth Bank of Australia	18.8	32.7
Westpac Banking Corporation	–	9.9
	66.3	153.3

Customer credit risk

Transpower recovers the value of its transmission assets over their useful lives in accordance with Commerce Commission input methodology regulations. The effect of these regulations is that, for the majority of assets, a customer default would result in Transpower recovering any revenue shortfall from all other transmission customers.

Transpower's customers comprise predominantly electricity generators, distribution companies and some large industrial users. There is a high concentration of credit risk with respect to trade receivables due to the small number of significant customers from which the majority of revenue is received. It is the Group's policy to perform credit evaluations on customers requiring credit, and the Group may in some circumstances require collateral. Collateral held at 30 June 2017 $0.2m (June 2016: nil). The Group holds bank guarantees to protect itself in the event private developers are unable to pay any outstanding balances owing on transmission realignment projects performed on their behalf. The bank guarantee reduces as payments are made by the developers.

The entities below have receivables balances greater than 10% of the total trade receivables of $106.5 million at 30 June 2017 (June 2016: $99.3 million).

	GROUP	
	2017	**2016**
	$M	$M
Vector Limited	21.4	19.4
Meridian Energy Limited	11.8	11.9
Powerco Limited	10.9	11.3

There is a specific credit risk in relation to customer default on customer investment contracts where revenue is recovered from individual customers over time for specific assets already in use. Transpower believes the majority of this risk relates to certain large industrial users. Transpower monitors the creditworthiness of these organisations. The largest credit risk in this category relates to an organisation with future revenue payments out to 2046 of $8.4 million on a net present value basis.

There have been no customer defaults in 2017 (2016: nil).

6. DEBT, FINANCIAL INSTRUMENTS AND RISK MANAGEMENT continued

v. Sensitivity analysis

Currency risk – debt

All foreign currency debt is converted back to NZD, eliminating foreign currency exposure. Therefore, no sensitivity analysis has been performed for foreign currency debt.

Interest rate risk

The Group has minimal interest rate exposure, given that the majority of the net debt and derivative portfolio is fixed. Therefore, no sensitivity analysis has been performed on interest rate risk.

Fair value risk

The Group's net debt is designated as fair value through profit or loss. As such, the Group is subject to fair value gains or losses. The extent of the gains or losses is based on the Group's cash flow profile compared to the corresponding movement in the yield curve and market perceptions on credit risk.

A parallel shift in the yield curve by 1% (100 basis points) or the same movement due to a change in credit spreads would create the following fair value movements based on debt, investments and derivatives held at balance date:

GROUP	2017	2017	2016	2016
Yield curve interest rate change	+100bp	-100bp	+100bp	-100bp
	$M	$M	$M	$M
Yield curve impact on pre-tax profit/(loss)/equity	82.7	(85.6)	112.0	(116.6)

vi. Commodity risk

Commodity risk is the risk of an adverse impact in commodity prices such as prices for aluminium and copper. These are some of the raw materials used in the construction of the electricity transmission network. Generally, Transpower has contracts in which commodity risk is borne by the supplier.

vii. Insurance risk

Transpower operates a captive insurance company through its subsidiary Risk Reinsurance Limited (RRL) and also has external insurance. RRL maintains an investment portfolio to meet insurance claims.

The insurance is outlined in the table below.

Insurance policy	AMOUNT INSURED	DEDUCTIBLE	RRL RETAINED RISK	EXTERNALLY INSURED RISK	TOTAL INSURED
	$M	$M	$M	$M	$M
HVDC submarine cables	0–15	–	15.0	–	
	15–40	–	8.8	16.3	90.0
	40–90	–	–	50.0	
Other grid assets (excluding transmission lines)	0–10	0.1	9.9	–	750.0
	10–750	–	–	740.0	
Transmission lines	0–10	1.0	9.0	–	10.0

For the HVDC cables above, an insurance claim between $15 – $40 million would have the first $15 million paid by RRL with any residual amount paid 35% RRL and 65% external insurance providers on a pro-rata basis. The remaining layer between $40 – $90 million is all external insurance providers liability.

viii. Regulatory risk

Transpower is a natural monopoly and is regulated by the Commerce Commission. The Commerce Commission determines what rate of return applies to Transpower's assets. It also determines the incentives that apply to Transpower, which covers operating expenditure, capital expenditure and meeting certain deliverables and outage targets.

There is a risk that Transpower's rate of return may be set at too low a level to compensate Transpower for undertaking investments in grid assets. There is also a risk Transpower does not perform against the targets set by the Commerce Commission. The Commerce Commission can penalise Transpower for failing to reach targets or reward Transpower for exceeding targets. The network performance incentive is +/- $10 million per annum. The operating expenditure and base capex incentive is one-third of the overspend or underspend.

7. DERIVATIVES AND HEDGE COMMITMENT

This note shows the short-term (ST) and long-term (LT) breakdown of the derivatives and hedge commitments.

	GROUP						
	ST ASSET $M	LT ASSET $M	TOTAL ASSET $M	ST (LIABILITY) $M	LT (LIABILITY) $M	TOTAL (LIABILITY) $M	NET ASSET (LIABILITY) $M
2017							
Debt-related derivatives							
Cross-currency interest rate swaps	–	95.8	95.8	–	(33.1)	(33.1)	62.7
Interest rate swaps	44.9	55.7	100.6	(120.0)	(185.4)	(305.4)	(204.8)
Purchasing related derivatives and hedge commitment							
Foreign exchange forward contracts	–	–	–	(0.6)	(0.6)	(1.2)	(1.2)
Commitment on fair value hedges	0.6	0.6	1.2	–	–	–	1.2
Total derivatives and hedge commitment	45.5	152.1	197.6	(120.6)	(219.1)	(339.7)	(142.1)
2016							
Debt-related derivatives							
Cross-currency interest rate swaps	–	183.1	183.1	(39.6)	(7.5)	(47.1)	136.0
Interest rate swaps	38.0	123.5	161.5	(108.8)	(333.6)	(442.4)	(280.9)
Purchasing related derivatives and hedge commitment							
Foreign exchange forward contracts	–	–	–	(1.0)	(0.7)	(1.7)	(1.7)
Commitment on fair value hedges	1.0	0.7	1.7	–	–	–	1.7
Total derivatives and hedge commitment	39.0	307.3	346.3	(149.4)	(341.8)	(491.2)	(144.9)

Description

Derivatives are used to manage financial risk. The gain or loss on derivatives represents the unrealised gain or loss at balance date. The Group anticipates that the derivatives will be held until maturity, and it is unlikely that settlement at the reported fair values will occur.

Accounting policies

Derivative financial instruments

The Group uses derivative financial instruments to reduce its exposures to fluctuations in foreign currency exchange rates and interest rates. All derivatives are classified as fair value through profit and loss except for those derivatives that are used to reduce foreign currency exposure on purchases. These hedges are designated as fair value hedges. For fair value hedging relationships, gains or losses on hedging instruments are included in profit or loss together with any change in the fair value of the hedged purchase commitment attributable to the foreign currency risk.

The valuation technique and key inputs used to value the derivatives are disclosed in note 6 Debt, financial instruments and risk management.

8. NZPCL DEBT AND INVESTMENT

	GROUP 2017 $M	GROUP 2016 $M
Investment		
Current	–	2.1
Non-current	77.6	74.2
	77.6	76.3
Debt		
Current	–	2.1
Non-current	74.4	77.3
	74.4	79.4
Net investment (debt)	3.2	(3.1)
Non-controlling interest net of tax	2.3	(2.3)

Description

In November 2009, the Group partially terminated the 2003 cross-border lease in respect of the majority of the HVAC transmission assets in the South Island. As a result of the partial termination, Transpower has consolidated a special-purpose vehicle, New Zealand Power Cayman 2003-1 Limited (NZPCL). NZPCL has a USD deposit with a financial institution and a USD loan from another financial institution. The cash flows from the deposit and loan offset. No consideration was transferred. The loan to NZPCL is guaranteed by Transpower.

As Transpower has no legal ownership interest in NZPCL, the net liabilities and any movements in net liabilities are recognised as a non-controlling interest. The substance of the transaction is such that Transpower rather than the non-controlling interest would be responsible for any shortfall between the value of the asset and the liability.

Accounting policies

The loan and the deposit are recognised at fair value in the Group financial statements based on discounted cash flows. These financial instruments are designated as fair value through profit or loss.

The difference between the asset and liability is due to the yield curves that have been applied to the cash flows. These valuations are considered level two in the IFRS three-level valuation hierarchy.

9. INVESTMENTS

	GROUP 2017 $M	2016 $M
Risk Reinsurance Limited investments		
– Deposits	28.4	25.1
– Floating rate notes	1.0	2.0
– Corporate bonds	67.8	52.7
– Equities	–	8.9
	97.2	88.7
Transpower investments		
– Deposits	–	40.1
Total investments	97.2	128.8

Description

Transpower has a captive insurance company called Risk Reinsurance Limited (RRL). RRL invests premiums received from Transpower. RRL reinsures externally and maintains sufficient investments to meet expected claims. RRL does not offer insurance to any external parties.

For RRL cash and bond holdings, the counterparties have maximum limits depending on their ratings. Investments in deposits, floating rate notes and corporate bonds were made in financial instruments issued by organisations with credit ratings of BBB or above.

During the year RRL sold its equities and now holds only fixed interest investment assets that better reflect policy liabilites.

Accounting policies

Fair values of quoted investments are based on prices current at balance date. If the market for a financial asset is not active, fair value is established by using valuation techniques, reference to similar instruments and discounted cash flow analysis.

RRL investments are classified as fair value through profit or loss. This classification is on the basis that RRL has an active investment programme (held for trading). Deposits, floating rate notes and corporate bonds are valued using discounted cash flow analysis and are considered level two in the NZ IFRS 13 three-level valuation hierarchy.

The investments are current assets.

10. TRADE RECEIVABLES AND OTHER ASSETS

	GROUP 2017 $M	GROUP 2016 $M
Current		
Trade and other receivables	106.5	99.3
Prepayments	7.7	7.8
Inventory	3.4	3.0
	117.6	110.1
Non-current		
Prepayments	24.5	25.6
Total trade and other receivables	142.1	135.7
Ageing of trade receivables		
Current	106.5	99.3
Past 31 days	–	–
	106.5	99.3

Description

The prepayments predominantly relate to telecommunication lease connection fees.

There was no impairment of receivables during the year (2016: nil).

Accounting policies

For trade receivables, fair values are materially similar to their face value. Therefore, receivables are recorded at face value. Due to the short-term nature of the receivables, no discounting is applied.

11. TRADE AND OTHER PAYABLES

	GROUP 2017 $M	GROUP 2016 $M
Current		
Trade creditors and accruals	96.7	84.3
Employee entitlements	10.1	10.7
	106.8	95.0
Non-current		
Other non-current payables	1.1	1.2
	1.1	1.2
Total trade and other payables	107.9	96.2

Accounting policies

For trade and other payables, fair values are materially similar to their face value. Therefore, payables are recorded at face value. Due to the short-term nature of the trade creditors, no discounting is applied.

12. PROVISIONS

	GROUP			
	CONTRACTOR PROVISION	DISMANTLING & ENVIRONMENTAL HAZARDS	OTHER	TOTAL
	$M	$M	$M	$M
Balance at 1 July 2016	14.2	11.0	5.8	31.0
Provisions made during the period	1.3	3.9	3.3	8.5
Provisions used during the period	(0.5)	(4.8)	(3.0)	(8.3)
Provisions reversed during the period	–	(0.8)	–	(0.8)
Balance at 30 June 2017	15.0	9.3	6.1	30.4
Current portion of provisions	0.7	4.0	1.7	6.4
Non-current portion of provisions	14.3	5.3	4.4	24.0
Balance at 30 June 2017	15.0	9.3	6.1	30.4

Description

Contractor provision

Transpower has determined that a future payment to a contractor should be recognised as a provision. Accordingly, the future cash flow has been present valued and recognised as a provision and also capitalised as property, plant and equipment. The present value is being amortised as the interest incurred and the provision used each year. The future payment will occur if certain assets are free from defects and have met prescribed service levels.

Dismantling and environmental hazards

Transpower recognises environmental hazard and dismantling costs where it believes a reliably measurable obligation exists. Transpower has estimated these costs based on engineering advice. Actual costs may vary from the figures indicated.

Accounting policies

Provisions are liabilities of uncertain timing or amount. They are measured at the amounts expected to be paid when the liabilities are settled.

13. EQUITY

Capital

Transpower has 1,200,000,000 issued and fully paid $1 ordinary shares. Transpower's authorised capital is $1,200,000,000 (2016: $1,200,000,000). The shares confer on the holders the right to vote at any annual general meeting of Transpower. All shares rank equally.

The group manages capital to maintain its strong credit rating and to have sufficient capital available to meet its financing and operating requirements. Surplus equity is returned by way of dividends to shareholders.

Credit rating

Transpower's strong investment grade credit rating remains unchanged from the prior year (Standard & Poor's AA- and Moody's A1).

13. EQUITY continued

Net tangible assets per share

	GROUP	
	2017	**2016**
	$M	$M
Net assets (equity)	1,481.3	1,379.5
Less intangibles (note 5)	(389.4)	(392.9)
Total net tangible assets	1,091.9	986.6
Net tangible assets per share ($)	0.91	0.82

Dividends

Dividends declared and provided by Transpower are as follows:

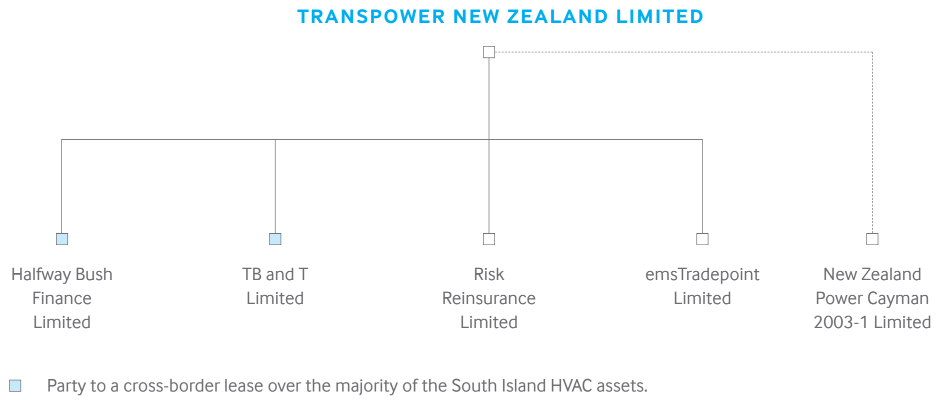
	2017	**2017**	**2016**	**2016**
	$M	CENTS PER SHARE	$M	CENTS PER SHARE
Previous year final dividend paid	98.2	8	112.8	9
Interim dividend paid	66.0	6	64.8	5
	164.2	14	177.6	14
Final dividend declared subsequent to balance date (refer note 19)	99.0	8	98.2	8

Group entities

All subsidiaries are wholly owned, are incorporated in New Zealand (except where specified otherwise) and have a balance date of 30 June 2017.

Transpower has no ownership interest in NZPCL. NZPCL is a special-purpose vehicle registered in the Cayman Islands and is consolidated for financial reporting, indicated by the dotted line in the diagram below. Refer to note 8 NZPCL debt and investment for more detail. Risk Reinsurance Limited is registered and incorporated in the Cayman Islands and was established to provide insurance for the Transpower Group.

As at balance date, the group entities are as follows:



14. SEGMENT REPORTING

In 2017, the Group has one reportable segment – transmission. The transmission segment activities include the transmission of electricity from the point of generation to the point of connection.

This segment has external revenue derived from New Zealand customers, and its assets are based in New Zealand.

The Group has no other reportable segments. The balance of the financial information (that is not the transmission segment) is reported as other in the table below.

The material portions of the other balance is made up of the following discrete activities:

- **System operator** – the provision of real time services to ensure the short term security of the New Zealand electricity system.
- **RRL** – established in 2001 to provide insurance services to the Group.

Segment results are determined based on information provided to the Chief Operating Decision Maker. They are calculated using the avoidable cost allocation methodology (ACAM).

The disclosures below have changed from the 2016 financial year. The monthly internal management report, upon which the segment information is based, no longer discloses expenses. Therefore, the disclosures below no longer disclose expenses or earnings totals.

Major customers

External customers that contribute 10% or more of total Group revenue are:

CUSTOMER	% OF GROUP REVENUE	SEGMENT
Vector Limited	19.5 (2016: 18.5)	Transmission
Meridian Energy Limited	11.6 (2016: 11.0)	Transmission
Powerco Limited	10.2 (2016: 9.4)	Transmission

	TRANSMISSION		OTHER		ADJUSTMENTS		TOTAL	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
	$M	$M	$M	$M	$M	$M	$M	$M
External revenue	995.3	968.6	59.3	60.1	6.5	5.8	1,061.1	1,034.5
Capex	261.3	220.5	8.6	9.2	–	–	269.9	229.7

The adjustment is:

	2017	**2016**	**EXPLANATION**
	$M	$M	
External revenue	6.5	5.8	Financial statements include imputed interest in non-operating expenses, net interest expenses (note 4) rather than revenue

15. CHANGE IN FAIR VALUE OF FINANCIAL INSTRUMENTS

	GROUP	
	2017	2016
	$M	$M
Accounting hedges		
Foreign exchange forward contracts – hedge accounted	(0.5)	2.9
Hedge commitment	0.5	(2.9)
	–	–
Other		
Foreign debt	(55.5)	(67.4)
Cross-currency interest rate swaps	75.6	36.5
NZD interest rate swaps	(76.9)	26.0
Investments	0.3	(1.9)
NZD debt	(23.5)	23.5
	(80.0)	16.7
Total fair value (gain) loss	(80.0)	16.7

Description

The Group experiences fair value movements through movements in underlying interest rates and exchange rates on debt and derivatives and movements in credit spread.

The Group generally seeks to fix interest rates to provide certainty of interest rate costs. This means that, prima facie, a decrease in market interest rates will result in the Group sustaining fair value losses, and conversely, an increase in market interest rates will result in fair value gains.

Credit spreads are an estimate of the additional premium over the relevant yield curve that would be required by market participants to compensate them for the perceived credit risk inherent in the counterparty and transaction. For derivative transactions, the impact of credit spreads is substantially lower than for debt and investment transactions due to the offsetting nature of the cash flows.

Related disclosures

The following table shows the impact of credit spread movements on fair value:

	GROUP	
	2017	2016
	$M	$M
Current year fair value profit/(loss) movement included above		
Fair value movement in debt due to credit spread movement	(67.6)	34.3
Fair value movement in asset due to credit spread movement	–	(1.4)
Fair value movement in derivatives due to credit spread movement	5.5	22.7
Statement of financial position balance – decrease in debt due to credit spread	104.5	172.1
Statement of financial position balance – (decrease) in investment due to credit spread	(2.3)	(2.3)
Statement of financial position balance – decrease in derivatives due to credit spread	32.8	27.3

16. TAXATION

	GROUP 2017 $M	GROUP 2016 $M
Income tax expenses		
Current tax expense		
Current period	55.1	39.6
Adjustment for prior periods	0.9	–
	56.0	39.6
Deferred tax expense		
Origination and reversal of temporary differences	49.6	30.5
Adjustment for prior periods	(0.6)	–
	49.0	30.5
Total income tax expense (credit)	105.0	70.1
Reconciliation of effective tax		
Operating surplus before tax	371.0	251.1
Income tax at 28c	103.9	70.3
Tax effect of:		
Net non-deductible expenses and non-assessable items	0.8	(0.2)
Under/(over) provided in prior periods	0.3	–
Total income tax expense (credit)	105.0	70.1

Description

There are no unrecognised deferred tax balances (2016: nil).

For property, plant and equipment, differences that give rise to deferred tax typically arise from the accounting book including capitalised interest, differences in depreciation rates between tax and accounting and the capital contribution rules.

Accounting policies

Deferred tax arises from differences between the accounting and tax values of assets and liabilities, except where the initial recognition exemption applies (e.g. buildings).

Deferred tax is shown as a net liability for the Group. This disclosure reflects that the deferred tax balances relate to companies in the Transpower Consolidated Tax Group and are in the same jurisdiction, being New Zealand.

Imputation credits

The imputation credit balance at 30 June 2017 is $81.8 million (2016: $89.3 million). This balance includes the tax payable outstanding at 30 June 2017.

Deferred tax	GROUP				
	BALANCE 1 JULY 2015 $M	RECOGNISED IN PROFIT OR LOSS $M	BALANCE 30 JUNE 2016 $M	RECOGNISED IN PROFIT OR LOSS $M	BALANCE 30 JUNE 2017 $M
Property, plant and equipment temporary differences	399.1	34.6	433.7	28.6	462.3
Fair value of net debt and derivatives	(90.0)	(4.1)	(94.1)	21.8	(72.3)
Revenue deferral	(5.1)	–	(5.1)	(1.9)	(7.0)
Dismantling provision	(1.7)	–	(1.7)	1.6	(0.1)
Other	(4.0)	–	(4.0)	(1.1)	(5.1)
Total deferred tax	298.3	30.5	328.8	49.0	377.8

17. RELATED PARTIES

Transactions with key management personnel

The Group did not conduct any business with key management personnel aside from the compensation payments below.

Key management personnel compensation

Key management personnel received the following compensation for their services to the Group:

	GROUP	
	2017	**2016**
	$M	$M
Directors' fees	0.5	0.5
Other key management personnel	5.7	5.1
Short-term employee remuneration	6.2	5.6
Defined contribution schemes	0.2	0.2

There were no termination payments to key management personnel in 2017 (2016: none).

There was no long-term compensation paid to key management personnel.

Government-related transactions

Transpower, being a State-owned enterprise, transacts with other government-related entities. The most significant transactions and balances (greater than $15 million) are as follows:

	GROUP	
	2017	**2016**
	$M	$M
Meridian Energy Limited – revenue	123.6	113.8
Electricity Authority – revenue	46.0	43.2

Meridian Energy Limited (Meridian) is a majority state owned company and is an electricity generator and retailer. Meridian pays Transpower primarily for the transportation of electricity across the national electricity grid.

The Electricity Authority (EA) is an independent Crown entity responsible for regulating the New Zealand electricity market. The EA pays Transpower a contracted fee for its role as system operator.

Transpower also settles its income and indirect tax obligations with Inland Revenue.

Some directors of the company may be directors or officers of other companies or organisations with which Transpower may transact.

All related-party transactions are carried out on an arm's length and independent commercial basis.

18. CONTINGENCIES

(i) Guarantees

NZPCL

In November 2009, the Group partially terminated the 2003 cross-border lease in respect of the majority of the HVAC transmission assets in the South Island. As a result of the partial termination, Transpower has consolidated a special-purpose vehicle, NZPCL. NZPCL has a USD deposit with a financial institution and a USD loan from another financial institution. The cash flows from the deposit and loan offset. No consideration was transferred. The loan to NZPCL is guaranteed by Transpower.

The substance of the transaction is such that Transpower rather than the non-controlling interest would be responsible for any shortfall between the value of the asset and the liability. The likelihood of losses in respect of these matters is considered to be remote.

18. CONTINGENCIES continued

Debt

Transpower has given a negative pledge covenant to certain debt holders that, while any debt issued remains outstanding, we will not, subject to certain exceptions, create or permit to exist any charge or lien over any of our assets.

(ii) Economic gain (loss) account

Transpower operates its revenue-setting methodology within an economic value (EV) framework that analyses economic gains and losses between those attributable to shareholders and those attributable to customers. Under Commerce Commission regulations, Transpower is required to pass onto or claim from customers the EV of the net balance of any historical gains or losses incurred prior to 30 June 2012 over the regulatory periods until June 2020. Historical balances are those that pre-date the input methodologies developed by the Commerce Commission. In addition to the historical balances, further economic gains or losses arising from the beginning of Regulatory Control Period 1, which commenced on 1 July 2012, are required to be passed on or claimed from customers in the following pricing year.

The provisional balances and expected cash flows from the EV accounts for HVAC and HVDC customers at 30 June 2017 are set out below. The 30 June 2017 provisional numbers do not take into account the EV balances to be recovered (paid) in the period 1 April 2018 to 31 March 2019. These figures will not be finalised until October 2017.

	HVAC $M	HVDC $M	TOTAL $M
30 June 2017 provisional balance			
Pre-input methodology EV balances to be recovered (paid) 1 July 2017 to 31 March 2020	(21.5)	42.9	21.4
Post-input methodology EV balances to be recovered (paid) 1 July 2017 to 31 March 2018	19.6	(1.0)	18.6
Total to be recovered (paid)	(1.9)	41.9	40.0
30 June 2016 balance			
Pre-input methodology EV balances to be recovered (paid) 1 July 2016 to 31 March 2020	(29.6)	59.0	29.4
Post-input methodology EV balances to be recovered (paid) 1 April 2017 to 31 March 2018	26.2	(1.4)	24.8
Post-input methodology EV balances to be recovered (paid) 1 July 2016 to 31 March 2017	(10.3)	2.1	(8.2)
Total to be recovered (paid)	(13.7)	59.7	46.0

(iii) Environmental hazards

Transpower has a programme of identifying, mitigating and removing environmental hazards such as asbestos at its sites. The cost of mitigating and/or removing identified hazards will vary, depending on the particular circumstances at the site. Where a reasonable estimate of the cost of mitigating or removal of a hazard can be made then a provision has been established. There are a number of hazards that have been identified and mitigated but we have not yet determined if or how the hazard will be removed. In these situations we are unable to determine the cost of the removal with sufficient reliability to record a liability at June 2017.

(iv) Various lawsuits, claims and investigations

Various lawsuits, claims and investigations have been brought or are pending against the Group. The directors of Transpower cannot reasonably estimate the adverse effect (if any) on the Group if any of the foregoing claims are ultimately resolved against the Group's interests.

19. SUBSEQUENT EVENTS

On 17 August 2017 the directors approved the payment of a dividend of $99.0 million. The dividend will be fully imputed and is expected to be paid on 20 September 2017.

The directors are not aware of any other matter or circumstance since the end of the financial year that has significantly or may significantly affect the operations of Transpower or the Group.

Independent Auditor's Report

Building a better working world

Chartered Accountants

TO THE READERS OF TRANSPOWER NEW ZEALAND LIMITED'S GROUP FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2017

The Auditor-General is the auditor of Transpower New Zealand Limited group (the Group). The Auditor-General has appointed me, Grant Taylor, using the staff and resources of Ernst & Young, to carry out the audit of the consolidated financial statements of the Group on his behalf.

Opinion

We have audited the consolidated financial statements of the Group on pages 2 to 34, that comprise the consolidated statement of financial position as at 30 June 2017, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and the notes to the consolidated financial statements that include accounting policies and other explanatory information.

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 30 June 2017, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

Basis for opinion

We conducted our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the Auditor-General's Auditing Standards, which incorporate Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

In addition to the audit we have carried out assignments in the areas of other assurance services, training and remuneration benchmarking, which are compatible with those independence requirements. Other than the audit and these assignments, we have no relationship with or interests in the Group.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

How our audit addressed key audit matters

<table>
<tr><th>KEY AUDIT MATTER</th><th>HOW WE ADDRESSED THE KEY AUDIT MATTER</th></tr>
<tr><td colspan="2">Regulated assets</td></tr>
<tr><td>Transpower's regulated assets (consisting of property, plant and equipment, intangible assets and associated capital work in progress) described in Note 5 represent 80% of total assets at 30 June 2017.

Judgements required to be made by management in relation to regulated assets include:
■ determining what costs ought to be capitalised;
■ determining the appropriate time to commission an asset and commence depreciation;
■ the period over which regulated assets should be depreciated; and
■ whether there are any regulated assets that ought to be impaired.
Transpower reviews regulated assets for indicators of impairment annually.

Transpower allocates its regulated assets between cash generating units and compares the carrying amount against the regulated book value to identify possible indicators of impairment.

As described in Note 5 the recoverable amount for regulated assets is generally its regulatory book value. Regulatory book value is the amount Transpower is able to recover from customers through future revenue under the terms of the regulations per Part 4 of the Commerce Act 1986.

Differences may exist between the financial statement asset carrying values and regulatory book values of a group of assets.</td><td>Our approach focused on the following procedures:
■ Assessing the appropriateness of capitalised costs to ensure they meet the criteria contained in NZ IAS 16
■ We reviewed a sample of assets commissioned in the period to ensure depreciation was charged from the appropriate date.
■ We reviewed a sample of large capital work-in-progress project balances to determine whether they ought to have been commissioned at 30 June 2017.
■ Understanding how Transpower has re-assessed the appropriateness of the assumed asset useful lives that are the basis on which depreciation is charged.
■ We assessed cash generating units identified by management against the requirements of NZ IAS 36 Impairment of Assets and the allocation of regulated assets between cash generating units.
■ We tested management's identification of differences between the financial statement carrying amounts and regulatory book values at 30 June 2017 and understanding the reasons for such differences.
■ Independently considering the completeness of management's assessment of indicators of impairment.
■ Detailed testing of a sample of management's assessment of key upgrade projects where the level of spending risks exceeding the regulatory maximum allowable cost.
■ Reviewing relevant correspondence between Transpower and the regulator where the spending is at risk of exceeding the regulatory maximum allowable cost.</td></tr>
<tr><td colspan="2">Fair value of debt and derivatives</td></tr>
<tr><td>Transpower has significant debt and derivative financial instruments. The total debt and derivative portfolio at 30 June 2017 was a net liability position of $2.96b and is detailed in Note 6 of the financial statements.

Debt and derivatives are both recorded at fair value. Movements in the fair value of debt and related derivative financial instruments impact profit or loss in the same period.

The valuation of these instruments involves the application of valuation techniques which involve the exercise of judgment and the use of the assumptions and estimates as described in Note 6 to the financial statements.</td><td>Our approach focused on the following procedures:
■ We obtained counterparty confirmations for all debt and derivatives held at 30 June 2017.
■ We assessed the appropriateness of the valuation models and significant inputs.
■ We compared observable inputs used against independent sources and externally available market data.
■ We performed our own independent valuations for a sample of instruments.
■ We also assessed whether the Group's disclosures in the consolidated financial statements in relation to the valuation of debt and derivatives are compliant with the relevant accounting requirements.</td></tr>
</table>

Other Information

The directors of the company are responsible for the Annual Report, which includes information other than the consolidated financial statements and the auditor's report which is expected to be made available to us after the date of this auditor's report.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

When we read the Annual Report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance and, if uncorrected, to take appropriate action to bring the matter to the attention of users for whom our auditor's report was prepared.

Directors' responsibilities for the consolidated financial statements

The directors are responsible on behalf of the Group for the preparation and fair presentation of the consolidated financial statements in accordance with New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible on behalf of the Group for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The directors' responsibilities arise from the Financial Markets Conduct Act 2013.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of readers taken on the basis of these consolidated financial statements.

As part of an audit in accordance with the Auditor-General's Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of the use of the going concern basis of accounting by the directors and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the directors, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Our responsibilities arise from the Public Audit Act 2001.

Grant Taylor
Ernst & Young
On behalf of the Auditor-General
Wellington, New Zealand

17 August 2017

BOARD OF DIRECTORS

CHAIR
HON TONY RYALL

DEPUTY CHAIR
DON HUSE

DIRECTORS
DEAN CARROLL
PIP DUNPHY
PROFESSOR JAN EVANS-FREEMAN
BILL OSBORNE
TIM LUSK

GENERAL MANAGEMENT TEAM

CHIEF EXECUTIVE
ALISON ANDREW

CHIEF FINANCIAL OFFICER
ALEX BALL

GENERAL MANAGER SYSTEM OPERATIONS AND INNOVATION
JOHN CLARKE

GENERAL MANAGER GRID DEVELOPMENT
STEPHEN JAY

GENERAL MANAGER PEOPLE
JENNIFER KERR

GENERAL COUNSEL AND COMPANY SECRETARY
DAVID KNIGHT

GENERAL MANAGER AUCKLAND DEVELOPMENT AND TRANSFORMATION
RAEWYN MOSS

GENERAL MANAGER INFORMATION SERVICES AND TECHNOLOGY
COBUS NEL

GENERAL MANAGER CUSTOMERS AND PROJECTS
KEVIN SMALL

GENERAL MANAGER GRID PERFORMANCE
JIM TOCHER

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