Invested in New Zealand and the world

—

Kaingākau ana ki Aotearoa me te ao

ANNUAL
REPORT
2017

NZSUPERFUND
Te Kaitiaki Tahua Penihana Kaumātua o Aotearoa

We invest locally and globally to deliver greater certainty for New Zealanders in their retirement.

—

Ka haumi pūtea mātou i te motu me te ao, e māoriori ake ai te noho a ngā tāngata o Aotearoa hei te ahungaruatanga.

With nearly $5 billion invested in New Zealand the Fund spans core industries like agriculture, farming, banking and aged care right through to emerging sectors like technology.

We're proud of our investment track record and the key role the quality and breadth of our local portfolio has played in delivering it.

NZD INVESTED IN NEW ZEALAND

4.9b

NZD INVESTED GLOBALLY

29.6b

NZD INVESTED IN NEW ZEALAND LISTED EQUITIES

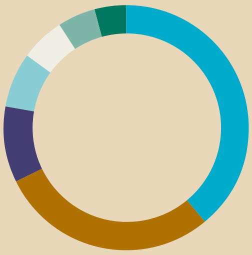
1.7b

NZD COMMITTED TO NEW ZEALAND EXPANSION CAPITAL*

454m

* since inception

COMPANIES ENGAGED BY ESG ISSUE GLOBALLY*



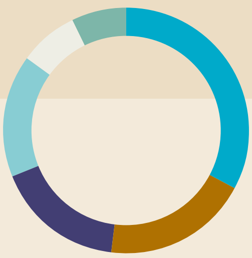
Environmental Standards	39%
Corporate Governance	29%
Labour Standards	10%
Social and Environmental Governance	7%
Business Ethics	6%
Public Health	5%
Human Rights	4%

* conducted on our behalf by our engagement service provider, BMO

NUMBER OF NEW ZEALAND FARMS OWNED

22

NZ EQUITIES BY SECTOR



Consumer	33%
Industrial	19%
Utilities	17%
Telcos, Media & Technology	16%
Financial	8%
Energy & Materials	7%

NZD REALLOCATED INTO LOW-CARBON COMPANIES GLOBALLY

950m

OUR MISSION:

Maximise the Fund's return over the long term, without undue risk, so as to reduce future New Zealanders' tax burden.

2016/17 MAJOR ACHIEVEMENTS:

- Climate change – finalised and implemented the first stage of our strategy to deal with the risks and opportunities associated with climate change.
- Collateral optimisation – implemented a securities lending programme to generate returns and help manage collateral in the most efficient manner possible.
- Concentrated portfolio – investigated the use of a concentrated portfolio to implement the Fund's passive global equities allocation.

PRIORITIES FOR 2017/18:

- Generating domestic proprietary deal flow – progress development of the domestic Investment Hub to help drive direct investment opportunities in New Zealand.
- Climate change – continue implementation of the strategy to make the Fund more resilient to the risks posed by climate change.
- Data management – build a single multi-purpose data warehouse to implement our target information architecture and support end-user data queries and analytics; improve our data governance to ensure our key portfolio and market data remains well-governed, defined and understood.

FUND SIZE

$35,373,065,000

(AFTER COSTS, BEFORE NZ TAX)

2016/17 RETURN

20.71%

(AFTER COSTS, BEFORE NZ TAX)

INCREASE IN FUND SIZE 2016/17

$5.27b

(BEFORE NZ TAX)

VALUE ADDED IN 2016/17

$1.28b

(VS REFERENCE PORTFOLIO, AFTER COSTS)

VALUE ADDED

$6.25b

(SINCE INCEPTION)

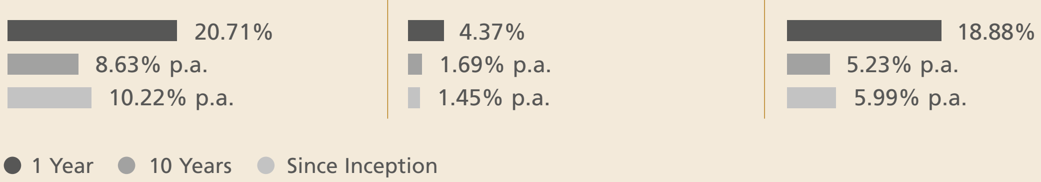
FUND RETURNS

As at 30 June 2017

ACTUAL FUND RETURN
(after costs, before NZ tax)

VALUE ADDED BY GUARDIANS
(compared to passive Reference Portfolio benchmark)

NET RETURN
(returns over and above the Treasury Bill return – the Government's marginal cost of debt)



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CATHERINE SAVAGE
CHAIR

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HOW TO READ THIS REPORT

This Annual Report has been prepared in accordance with the Global Reporting Initiative (GRI) standards core option. It describes the performance of the New Zealand Superannuation Fund (the 'Fund') and the Guardians of New Zealand Superannuation (the 'Guardians'), the Crown entity that manages the Fund, over the 2016/17 financial year.

The Overview of the Guardians and the Fund section provides the basics: a performance summary; who we are and what we do; key achievements; and future priorities. For more depth, the remainder of the report details four important aspects of the Guardians and Fund: investment performance and activities; governance; an overview of operations during the year; and financial statements.

An overview of the report and supplementary information are available on www.nzsuperfund.co.nz and www.ar2017.nzsuperfund.co.nz. The overview includes video interviews with our Chair and Chief Executive Officer. The supplementary information includes a detailed explanation of 'How We Invest'; a GRI Index; and a list of the Fund's global equity holdings as at 30 June 2017.

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OPERATIONAL REPORT

Information on our operational and people initiatives, as well as our environmental performance, is covered in the Operational Report.

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APPENDIX

Where possible, we have tried to avoid the use of industry-specific words and language. In some cases, however, in the interest of brevity and clarity, these words are unavoidable. Industry terms are explained in our Glossary. This section also provides our compliance statements.

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Note: Previous annual reports, including the last report (2015/16), are available on **www.nzsuperfund.co.nz/publications/annual-reports**.

There were no significant changes from previous reporting periods in the list of material topics and topic boundaries.

We welcome feedback to help us improve our reporting. Comments can be directed to **enquiries@nzsuperfund.co.nz**.

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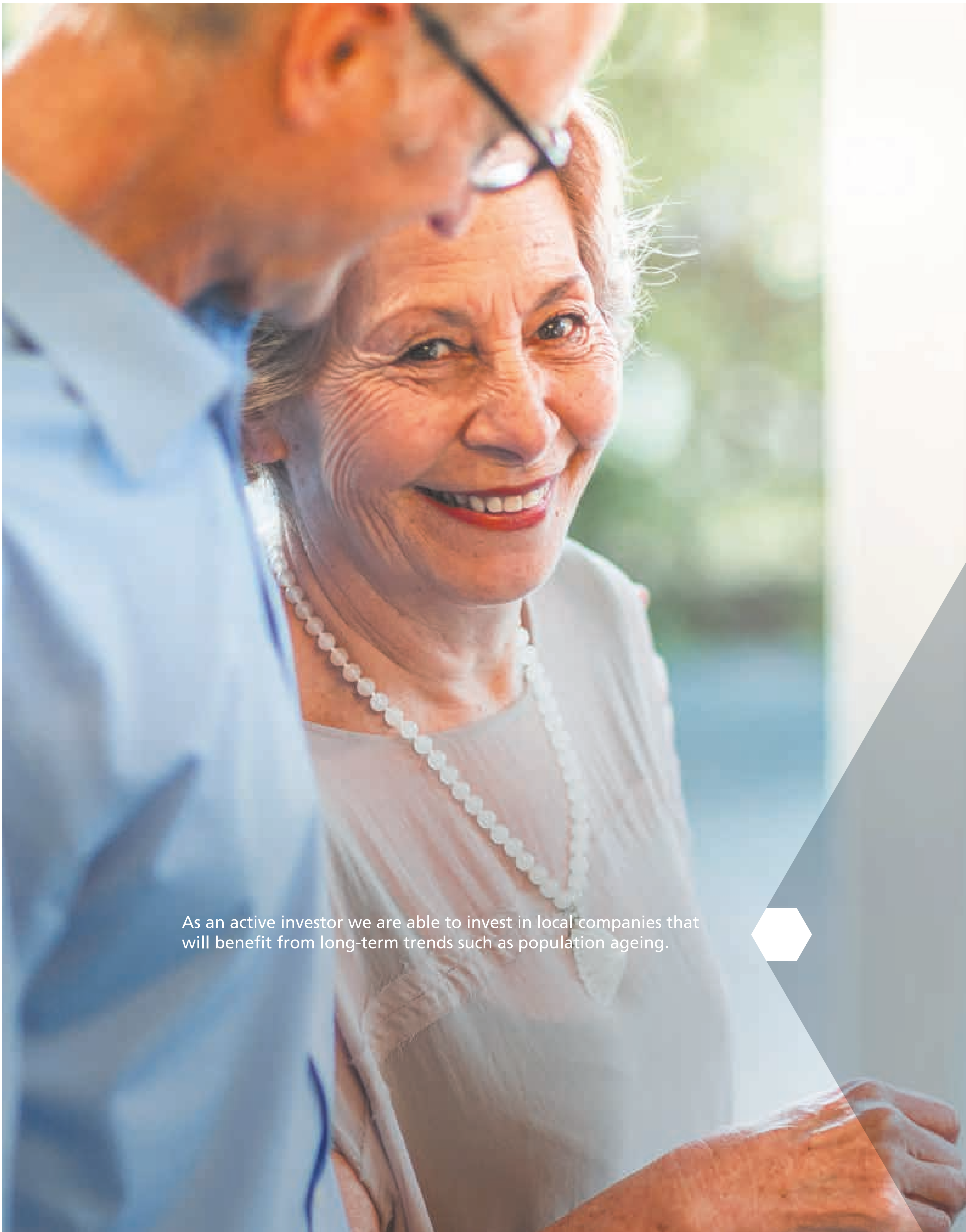

As an active investor we are able to invest in local companies that will benefit from long-term trends such as population ageing.

SECTION

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Overview of the Guardians and the Fund

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Image courtesy of **Metlifecare**

Investing for the long term

WHAT IS THE CHALLENGE THE FUND IS HELPING TO SOLVE?

All New Zealanders aged 65 and over are eligible to receive New Zealand Superannuation payments (also known as the pension, National Super, Government Superannuation or Super). The government pays for these through taxes paid by today's taxpayers. With New Zealand's population ageing, there will eventually be fewer taxpayers as a proportion of the working age population to support those receiving superannuation. These demographic changes mean that in order to keep funding universal superannuation, future generations face a much higher tax burden than their predecessors.

HOW DO WE FIT IN?

To help pre-fund future retirement benefits, the New Zealand Superannuation and Retirement Income Act 2001 (the Act) established:

- the New Zealand Superannuation Fund (the Fund), a pool of assets on the Crown's balance sheet; and
- the Guardians of New Zealand Superannuation (the Guardians), a Crown entity charged with managing the Fund.

Between 2003 and 2009, the government contributed NZD14.88b to the Fund. Contributions are scheduled to restart once core Crown net debt is 20% of GDP, currently forecast to occur in 2020/21. From around 2029/30, the government is expected to begin to withdraw money from the Fund to help pay for New Zealand Superannuation. Withdrawals will continue for an eleven year period, before switching back to contributions for a further 17 years. A larger, more permanent withdrawal period will commence in 2057/58. The Fund is expected to peak in size as a percentage of GDP in the 2070s (see **www.treasury.govt.nz/government/assets/nzsf/** the contribution rate model for projections by New Zealand Treasury).

WHAT DO WE DO?

The Guardians invests the money the government has contributed to the Fund. The Fund is a growth-oriented and highly diversified global portfolio of investments. In this way, the Fund adds to Crown wealth, improves the ability of future governments to pay for superannuation and, ultimately, reduces the tax burden on future New Zealanders. The Guardians has operational independence from the government regarding its investment decisions.

Watch a short animation video that explains our purpose at
www.ar2017.nzsuperfund.co.nz/our-purpose

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Our mandate

The Fund is investing today to help meet future retirement needs by reducing the cost of New Zealand Superannuation for future generations.

OUR MANDATE

Under the Act, the Guardians must invest the Fund on a prudent commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with:

- best-practice portfolio management;
- maximising return without undue risk to the Fund as a whole; and
- avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

OUR MISSION

Maximise the Fund's return over the long term, without undue risk, so as to reduce future New Zealanders' tax burden.

OUR VISION

A great team building the best portfolio.

PERFORMANCE BENCHMARKS

We compare the performance of the Fund to a passive, low-cost Reference Portfolio in order to benchmark the value we have added through active investment. We also compare the performance of the Fund with that of 90-day Treasury bills – a measure of the 'opportunity cost' to the government of contributing capital to the Fund instead of using the money to retire debt.

OUR VALUES

- **Inclusiveness**: We combine diverse skills, and seek relevant views and rigorous analysis, in a supportive environment.
- **Innovation:** We encourage initiative taking, continuous learning and smart decision making.
- **Integrity**: We consistently behave in a transparent and commercial manner for the long-term benefit of the Fund.

NEW ZEALAND GOVERNMENT

GUARDIANS OF NEW ZEALAND SUPERANNUATION
('DOUBLE-ARM'S-LENGTH' CROWN ENTITY. SEE PAGE 60)

The Guardians is the Auckland-based manager of the Fund.

NEW ZEALAND SUPERANNUATION FUND
(LONG-TERM SAVINGS VEHICLE)

The Fund is a pool of assets on the Crown balance sheet.

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Growing capital for future generations

Te whakatupu rawa mō ngā uri whakaheke

Kua tino angitu anō ngā Kaitiaki i tēnei tau. E whakaputa hua nui tonu ana te Tahua i ngā haumitanga, i kōkirihia e mātou tētahi rautaki tōtōpū hei whakatau i te noho mōrea ā-haumi i ngā panonitanga ā-taiao, ā, i whakatūria e mātou te hui ā-tau a te International Forum of Sovereign Wealth Funds (IFSWF).

TE WHAI HUA O TE TAHUA

Ko te tau pūtea 2016/17 tētahi o ngā tau kaha katoa ā mohoa, i te ekenga o te hua haumi ki te 20.71 ōrau, he 1.2 piriona tāra Aotearoa nei, e 4.37 ōrau rānei, te tuhene i te Paerewa Tūāpapa. Kei tua noa atu tēnei i te mea kua roa e manakohia ana e mātou, arā, kia 1 ōrau i te tau te tuhene o te Tahua i te Paerewa Tūāpapa, i te rerenga o ngā tau e 20.

I autaia te whai hua o te Paerewa Tūāpapa ake, nāna i whakaputa ngā hua 16.34 ōrau te rahi, i muri mai i te pikinga o ngā tauhokohokonga tūtanga ā-ao. I ahu mai te uara nui ake i puta i te Tahua, kia tuhene i te Paerewa Tūāpapa, i te kaha o te tū o tā mātou rautaki honga, o ngā haumi poro rākau me ngā whakahau ā-moni tāwere e whakahaerehia ana i roto. Ka kitea i te whārangi 30 he taipitopito anō e pā ana ki te uara i āpitihia ki te Tahua nā ngā haumi mōrea nui.

I ngā tau 13 mai i te whakatūnga o te Tahua hei tuku pūtea ki te penihana kāwanatanga whānui, kua nui ake ngā hua i tā mātou i manako ai, mā roto mai i ngā hua haumi 10.22 ōrau i te tau. E 6.25 piriona tāra Aotearoa nei te tuhene i te paeraro o te Paerewa Tūāpapa e takoto noa ana.

Kei te 35.37 piriona tāra Aotearoa nei te rahi o te Tahua i tēnei wā - he pikinga tērā i te 14.88 piriona tāra Aotearoa nei o ngā tukunga kāwanatanga i waenga i te tau 2003 me te tau 2009. Mai i tōna tīmatanga, e 5.56 piriona tāra Aotearoa nei te nui o te tāke kua utua e te Tahua ki te kāwanatanga o Aotearoa. Nā konei, kua hoki ki te kāwanatanga tētahi 37 ōrau o tāna i tuku ai ki te Tahua hei tāke, hāunga rā ngā hua haumi, more nei.

TE MAHI A TE TAHUA

I te wāhanga tōmua o tēnei tau, i tohea e te marea āe rānei e kaha ana te Tahua ki te panoni i te penihana kāwanatanga, me te whai tikanga anō o taua panonitanga, hei ngā tau kei te heke mai.

The Guardians has had another highly successful year. The Fund continues to generate excellent investment returns, we introduced a comprehensive strategy to address climate change investment risk and we successfully hosted the International Forum of Sovereign Wealth Funds' (IFSWF) annual meeting.

FUND PERFORMANCE

The 2016/17 year was one of the strongest on record with a 20.71% total return that exceeded the Reference Portfolio by NZD1.28b or 4.37%. This is well ahead of our long-run expectation that the Fund will exceed the Reference Portfolio return by 1% p.a. over rolling 20-year periods.

The Reference Portfolio itself performed well, generating 16.34% off the back of rising global equity markets. The additional value produced by the Fund over the Reference Portfolio return can be attributed to strong performances by, in particular, our strategic tilting strategy, timber investments and our internally managed credit mandates. More detail on the value our active investments added to the Fund can be found at page 30.

In the 13 years since the Fund was established to help pre-fund universal superannuation, it has exceeded expectations in returning 10.22% p.a. This is NZD6.25 billion more than its passive Reference Portfolio benchmark.

The Fund now stands at NZD35.37b – grown from NZD14.88b in government contributions between 2003 and 2009. Since inception, the Fund has also paid the government NZD5.56b in NZ tax. In effect, 37% of what the government has contributed to the Fund, it has now received back in tax payments alone, ignoring net investment returns.

FUND ROLE

Earlier this year there was some public debate about the capacity of the Fund to make a meaningful difference to superannuation funding in the future.

The government suspended contributions to the Fund in 2009. The gap between the funding formula and actual contributions made, as calculated by Treasury, is currently NZD14.00b.

I whakatārewangia e te kāwanatanga ngā tukunga ki te Tahua i te tau 2009. Ko te āputa i waenga i te tauira ā-tahua me ngā tukunga motuhenga, e ai ki ngā tātaitanga a Te Tari Tātari Pūtea, ko te 14 piriona tāra Aotearoa nei, i tēnei wā. I tēnei wā, e matapaetia ana ka tīmata anō ngā tukunga hei te tau 2020/21.

I te taumata o ngā tangohanga pūtea i te Tahua e matapaetia ana ka tū hei te tau 2080, e whakapae ana Te Tari Tātari Pūtea hei taua wā, ka ea i te Tahua tētahi 11.8 ōrau o te nama more a te motu mō te penihana kāwanatanga (mehemea ka tīmata anō ngā tukunga, ā, ka whakaturehia te pikinga o te pakeketanga e riro ai te penihana i te tangata kua tohua)[1] Ka eke te tāke e matapaetia ana ka utua e te Tahua ki tētahi 8 ōrau atu anō o te nama penihana kāwanatanga o Aotearoa, nō reira, hui katoa, ka ea i te Tahua tētahi 19 ōrau o ngā utu penihana kāwanatanga o anamata. He mahi nui tāna hei whakamāmā i te utu o te penihana kāwanatanga ki ngā kaiutu tāke, i roto i te wā.

E whai wāhi nui ana anō hoki te Tahua ki ngā wāhi tauhokohoko haupū rawa o Aotearoa, i kōrerotia rā e te Tumu Whakarae i ngā whārangi 15-17. Kua horahia ā mātou mahere kia whakaterehia ngā mahi haumi torohū i Aotearoa i tā mātou pūrongo mō ngā haumitanga i Aotearoa, kei ngā whārangi 34-41.

NGĀ PANONITANGA Ā-TAIAO

I a Whiringa-ā-nuku, i pānui mātou i te rautaki haumi e pā ana ki ngā panonitanga ā-taiao hei whai mā te Tahua. I hangā tēnei rautaki hei whakaiti i ngā mōrea ā-haumi nunui tonu ka puta i ngā panonitanga ā-taiao. I te whakarere haeretanga a te pūnaha pūngao ā-ao i ngā kora mātātoka, ko ētahi o ngā rawa ka hokona e mātou i tēnei wā kāore pea e whai hua ā-ōhanga nei i roto i te wā, ka ngaro rānei, ka heke rānei te hiahiatia. E whakapono ana mātou mā te karo i te noho mōrea ā-haumi a te Tahua, i te pānga hoki ā-tinana o ngā panonitanga ā-taiao, ka noho pai te huinga haumitanga, ka hāngai hoki ki tā mātou whakahau kia nui rawa atu ngā hua haumi ka hoki mai, me te kore i noho mōrearea noa. He huarahi hoki te rautaki, ki tā mātou titiro, hei whai i ngā huarahi haumi torohū ka puta i te whakawhitinga hei ōhanga ā-ao, waro-iti nei, e haere ake nei.

Hei wāhanga mō te rautaki, kua panonitia e te Poari te Paerewa Tūāpapa, kia tīmata i muri i te 1 o Hōngongoi, i te tau 2017, hei whakaū i te hāngai o te rautaki ki te kaupapa, mā te whakaitinga o te noho mōrea o te Tahua ki te waro, ā, kua whakaritea he taumata e whakahekea anō ai ngā utu i mua i te tau 2020.

I mua i te paunga o te tau pūtea, i tutuki i a mātou tētahi mahi matua i te whakatinanatanga o te rautaki, i te whakawhitinga o tā mātou huinga tūtanga torohū ā-ao ki te waro iti.

He kōrero anō e takoto ana i ngā whārangi 46-47.

IFSWF

I a Whiringa-ā-rangi, i whakatūria e ngā Kaitiaki te hui ā-tau a IFSWF, ki Tāmaki Makaurau. Neke atu i te 200 ngā māngai i piri mai ki ngā Kaitiaki i Tāmaki Makaurau ki te matapaki i ngā take, i te āhua o te ōhanga ā-ao ki te noho mōrea ā-haumi i ngā panonitanga ā-taiao me te whanaketanga ā-ōhanga o ngā iwi taketake. Ko ētahi o ngā kaikōrero, ko Tā John Key, ko ia te Pirimia o Aotearoa i taua wā, rāua ko Hōnore Bill English, ko ia te Minita mō te Tahua i taua wā.

Nā tā mātou whakahaere i taua hui, ka toa ngā Kaitiaki i te Wāhanga Tahua o ngā Tohu Kairangi o Āhia-Te Moana nui a Kiwa i te tau 2016. He kōrero anō e takoto ana i te whārangi 73.

* Ehara te taumata e matapaetia ana i te taumata ā-tāra, engari he wāhanga kē nō te whakapaunga mō te penihana kāwanatanga o Aotearoa e matapaetia ana.

The resumption of contributions is currently forecast for 2020/21.

At the projected peak of withdrawals from the Fund in 2080, Treasury estimates that the Fund will be covering 11.8% of the country's net superannuation bill at the time (assuming contributions re-start and the signalled increase in the age of entitlement is passed into law).* The projected tax paid by the Fund will equate to a further 8% of the New Zealand super bill, meaning the Fund could cover, in total, 19.8% of future superannuation costs. It therefore has an important role to play in smoothing the cost to taxpayers of superannuation over time.

The Fund is also an increasingly important presence in New Zealand's capital markets, as outlined by the CEO on pages 15-17. We feature our plans to accelerate potential domestic investment opportunities in our New Zealand investment report at pages 34-41.

CLIMATE CHANGE

In October 2016, we announced a climate change investment strategy for the Fund. This strategy is designed to mitigate the significant investment risks presented by climate change. As the global energy system transitions away from fossil fuels, some of the assets we invest in today may become uneconomic, made obsolete or face a dwindling market. We believe that reducing the Fund's exposure to these risks, and to the physical impact of climate change, is good for the portfolio, and consistent with our mandate to maximise returns without undue risk. We also see the strategy as a means of capturing the potential investment opportunities from the forthcoming transition to a low-carbon global economy.

As part of the strategy the Board has amended the Reference Portfolio, effective 1 July 2017, ensuring it is fit for purpose by reducing the Fund's exposure to carbon and has set targets for further reductions to be achieved by 2020.

By the end of the financial year we had reached a major milestone in our implementation of the strategy, transitioning our global passive equity portfolio to low carbon.

Further information is available at pages 46-47.

IFSWF

In November, the Guardians hosted IFSWF's annual meeting in Auckland. More than 200 delegates joined the Guardians to discuss topics ranging from the state of the global economy to climate change investment risk and indigenous economic development. Speakers included Sir John Key, at the time the Prime Minister of New Zealand, and Rt Hon Bill English, the then-Minister of Finance.

Our management of the event led to the Guardians winning the Finance Category in the 2016 Asia-Pacific Excellence Awards. Further information is available on page 73.

CEO ANNIVERSARY

On behalf of current and former Board members, it is appropriate to congratulate Adrian Orr on marking his 10-year anniversary with the Guardians in February 2017. Over that decade, Adrian has been instrumental in building an internationally-recognised investment organisation and attracting a strong team to the Guardians' Auckland base. Adrian's talents have also been recognised globally via his appointments as Chair of IFSWF and of the Pacific

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* The projected peak is not a dollar peak, but a percentage of the projected New Zealand superannuation expenditure.

TE HURITAU O TE TUMU WHAKARAE

Hei māngai mō ngā mema o te Poari o nāianei, o mua hoki, me mihi ka tika a Adrian Orr, i tana huritau tuangahuru i roto i ngā Kaitiaki, i a Hui-tanguru o te tau 2017. I taua tekau tau, i tino whai wāhi a Adrian ki te whakatūnga o tēnei whakahaere haumitanga e mōhiotia nei i te ao whānui, ki te whakakaonga hoki o tētahi rōpū kaha kia tau ki te tumu o ngā Kaitiaki i Tāmaki Makaurau. Kua whakanuia ngā pūkenga o Adrian i te ao, i te kopounga ōna hei Toihau mō te IFSWF me te Pacific Pensions Institute. Nā reira, rekareka ana mātou i te whakawhiwhinga o Adrian ki tētahi tohu matua mō te Mataaho o te Whai Wāhi ki ngā Take Tahua me te Pakihi i ngā tohu CFO o Aotearoa i te tau 2017.

TE UTU I TE TUMU WHAKARAE

I tēnei tau, i puta ētahi kōrero i te ao tōrangapū me te marea e pā ana ki te utu o te Tumu Whakarae. Ko tā te Poari, tairite ana, hāngai ana anō hoki te utu o te Tumu Whakarae, kua whakatairitea ki ō ētahi kamupene nō Aotearoa. I te tau pūtea 2016/17, e 2.7 ōrau te pikinga o te utu taketake i whakawhiwhia ai ki te Tumu Whakarae. E āta whakahāngaitia ana te tapeke o te utu o te Tumu Whakarae ki te whai hua o te Tahua, e kaha tonu nei. Nā konei, 14.7 ōrau te pikinga o te tapeke o te utu o te Tumu Whakarae i te tau, i tērā o te tau 2015/16. Tirohia ngā whārangi 82-83 e kitea ai ētahi kōrero anō.

NGĀ KOPOUNGA ANŌ KI TE POARI

E rekareka ana mātou ki te whāki, i kopoua anō e te Minita mō te Tahua a Lindsay Wright rātou ko Pip Dunphy, ko Craig Ansley ki te Poari i tēnei tau pūtea.

NGĀ KAUPAPA MĀTĀMUA A TE POARI

Ko ngā kaupapa mātāmua a te Poari mō te tau e haere ake nei, ko te āta tirotiro i te āhua o tā mātou mahi tahi hei Poari me te arotahi tonu ki te whakapiki ki te taumata, ki te whakawhanake hoki i ngā pūmanawa o ngā Kaitiaki, kia hāngai ai ki tā ngā Kaitiaki arotahi ki ngā take ahurea o te wāhi mahi (tirohia te whārangi 88 e kitea ai ētahi taipitopito anō.) Ka tautoko tonu hoki mātou i te arotahi tonu a te ohu whakahaere ki te haumarutanga-tāurungi me te pakari o tō mātou hanganga hangarau mōhiohio, ā, ka whiriwhiri tonu hoki mātou i ngā tikanga whai hua katoa i te hautūtanga, mō te taha ki ngā Kaitiaki me te pae o ngā kamupene ka whai haumitanga.

E hiahia ana au ki te mihi, ki te whakamānawa hoki i ngā kaimahi katoa o ngā Kaitiaki, i te angitu me te whai hua o te Tahua i tēnei tau. Kua tōpāparu te waka o ngā kaimahi i te hui a te IFSWF me ngā mahi e pā ana ki te rautaki mō ngā panonitanga ā-taiao. E whakamānawatia nei tō koutou takatū ki te whakapeto ngoi ki te whai i te kairangitanga.

Pensions Institute. It was very pleasing, therefore, for Adrian to be presented with a major award for Outstanding Contribution to Finance and Business at the New Zealand CFO awards in 2017.

CEO REMUNERATION

During the year, there was some political and public comment regarding the CEO's remuneration. The Board's view is that the CEO's remuneration, which is benchmarked against New Zealand companies, is competitive and appropriate. In 2016/17, the CEO received a 2.7% increase to his base remuneration. The CEO's total remuneration is closely aligned with Fund performance, which continues to be very strong. This has resulted in a 14.7% increase in the CEO's total remuneration for the year, compared to 2015/16. See pages 82-83 for further information.

BOARD REAPPOINTMENTS

We are pleased to note that the Minister of Finance reappointed Lindsay Wright, Pip Dunphy and Craig Ansley to the Board during the financial year.

BOARD PRIORITIES

The Board's priorities for the coming year include devoting time to how we work together as a Board and continuing to focus on maximising and developing talent across the Guardians, consistent with the Guardians' focus on workplace culture matters (see page 88 for further details). We will also continue to support management's ongoing focus on cyber-security and the robustness of our IT infrastructure, and to consider governance best practice both in respect of the Guardians and at investee company level.

I would like to congratulate and thank the entire Guardians staff for another successful and rewarding year for the Fund. The IFSWF event and the climate change strategy work have added significantly to staff workload. Your readiness to go the extra mile in pursuit of excellence has been appreciated.

CATHERINE SAVAGE
CHAIR

See Catherine talk about the past year at www.ar2017.nzsuperfund.co.nz/year-review

Investing in New Zealand and globally

Te haumi pūtea i Aotearoa me te ao

Kua tukuna tētahi wāhanga nui tonu o te Tahua Penihana Kāwanatanga o Aotearoa ki tāwāhi hei haumi. E hāngai ana tēnei rautaki ki ngā tikanga whai hua katoa e whāia ana e te ao. Mā te haumi pūtea i te ao whānui e whānui ake ai ngā haumitanga, e wātea ai hoki ētahi huarahi haumi kāore e wātea ana i tēnei motu.

Heoi, i ngā tau torutoru kua pahemo ake nei, kua whai hua tā mātou whakamahi i ngā moni matua o te Tahua, pēnei i tana noho hei tahua nā te kāwanatanga me te pae tawhiti, ki te whakatupu i tētahi huinga rawa nui tonu nō Aotearoa. Ko te uara o ngā haumitanga a te Tahua i Aotearoa, ko te 4.9 piriona tāra Aotearoa nei. Kei roto i te huinga haumi ko ngā tūtanga e rārangi ana i te wāhi tauhokohoko tiri kamupene, ko te haupū rawa hei whakawhānui, ko ngā whenua ki tuawhenua, ko te papa rākau, ko te hanganga ā-pāpori me ngā tiri nunui o ētahi kamupene rahi kāore anō kia hoko tiri ki te marea, pēnei i a Datacom me Kiwibank. Kua whai hua hoki te tauhokohokonga o ngā haumitanga nunui ki Z Energy me Scales Corporation.

Ki te whai wāhi mai te 5.56 piriona tāra Aotearoa nei kua utua e te Tahua hei tāke i Aotearoa mai i tōna tīmatanga, ka kitea ake kua whai wāhi nui te Tahua ki ngā tauhokohokonga haupū rawa o Aotearoa me te ōhanga. Otirā, ko te 1.2 piriona tāra, Aotearoa nei, i utua e te Tahua hei tāke i te tau 2016/17 tētahi 9 ōrau o te tapeke o ngā tāke i tangohia i ngā kaporeihana i Aotearoa whānui.

Ka tupu tonu te Tahua hei ngā tautini o anamata, ā, e matapae ana mātou ka whānui kē ake te whai wāhitanga ki te motu nei. Heoi, e herea ana tēnei tupuranga ki tō mātou kaha ki te whai huarahi haumitanga i konei e rite ana ki ō te ao whānui te kounga, e pērā rawa ana te nui e tupu kaha ai te whai hua o te Tahua whānui. Waihoki, kāore tonu e ea i tēnā - e angitu ai mātou, me nui te kounga me te hāngai o ngā hoa-haumi. Kei ngā whārangi 94-95 o tēnei pūrongo e whakaatuhia ana tō mātou ohu Haumi Hāngai i Aotearoa me ngā whakaritenga mō te Pūtahi Haumitanga hei āwhina i a mātou ki te whakatutuki i tēnei mahi nui.

Ka matapakihia hoki e mātou, i te whārangi 28, ngā rerekētanga i waenga i te haumi mōrea nui me te haumi mōrea

A significant proportion of the NZ Super Fund is invested offshore. This strategy is consistent with global best practice. Investing globally gives us diversification and access to investment opportunities that are not available domestically.

Over the last few years, however, we have successfully used the Fund's endowments, such as its sovereign status and long-term horizon, in building a considerable portfolio of New Zealand assets. The Fund's New Zealand investments are now worth NZD4.9b. The investments encompass listed equities, expansion capital, rural land, timber, social infrastructure and substantial stakes in large unlisted companies such as Datacom and Kiwibank. Sizeable investments in Z Energy and Scales Corporation have also been profitably listed and exited.

When you factor in the NZD5.56b in New Zealand tax that the Fund has paid since inception, you can see that the Fund has become a significant presence in the New Zealand capital markets and economy. In fact, the Fund's NZD1.2b tax bill for 2016/17 represented 9% of the total New Zealand corporate tax take.

The Fund will continue to grow in size in future decades, and we expect that its local presence will extend even further. This is, however, contingent on our ability to find world-class investment opportunities here that are of a big enough scale to make a difference to the performance of the overall Fund. And even that is not enough – to be successful, we also need high quality, compatible co-investors. At pages 94-95 in this report, we feature our New Zealand Direct Investment team and our Investment Hub plans to help meet this challenge.

We also discuss, at page 28, the differences between active and passive investment and how we combine the best of both approaches. Selective active investment continues to create value for the Fund – NZD1.28b over 2016/17 and NZD6.25b since inception. Active investment is particularly critical if we are to invest in New Zealand, iti me te huarahi hei hono i ngā āhuatanga pai katoa o ia momo. E tupu tonu ana te uara o te Tahua i ngā haumi mōrea nui e āta kōwhiria ana, arā ko te 1.2 piriona tāra, Aotearoa nei, i te tau pūtea 2016/17 me te 6.25 piriona tāra Aotearoa nei mai i tōna tīmatanga. E tino whakahirahira ana ngā haumi mōrea nui ki te hiahia mātou ki te haumi i Aotearoa nei, e eke noa iho ai te putunga rawa nō Aotearoa ki te 0.1 ōrau o te tapeke o ngā haumitanga o te Tahua ina whāia te huarahi mōrea iti anake e hāngai ana ki te uara o te kamupene, kaua ko te 14.6 ōrau o te tapeke o ngā haumitanga ināianei.

Ka āta arohia e mātou tā mātou whakaawenga me ō mātou haepapa hei kaihaumi i Aotearoa. Mātua rā, ka whai mātou kia whakaatuhia ngā paerewa ā-ao, ā, kua whakanuia e te ao tā mātou pērā, ka kitea tēnei i tā mātou pae tukutuku: https://www.nzsuperfund.co.nz/performance/awards.

Tuarua, ka arotahi mātou ki te whakapiki i te kounga o te mana hautū puta noa i te wāhi tauhokohoko, hei arotahitanga arorau mā te Tahua. Hihiri ana, rite tonu ana hoki tā mātou pāhekoheko ki ngā poari o konei me ngā ohu whakahaere; kua arahina e mātou te whakatūnga o te Pae Mana Hautū ā-Rangatōpū o Aotearoa (www.nzcgf.org.nz), ā, i tēnei tau tonu nei, kua whai wāhi nui tonu mātou ki te arotakenga o ngā Tikanga Mana Hautū ā-Rangatōpū NZX hou, i whakaputaina i a Haratua o te tau 2017. Ka kitea ētahi kōrero anō mō ēnei take i te Pūrongo mō ngā Haumi Haepapa, kei ngā whārangi 48-57.

NGĀ PANONITANGA Ā-WHAKAHAERE

Kua whakapikihia tonuhia e mātou te tokomaha o ngā kaimahi, kua eke te tōpū o ngā mema o te ohu ki te 127. E āta whakapakari ana mātou i ngā pūkenga o tō mātou ohu haumi ā-roto, nō mātou e whai nei kia pā tonu ō mātou ringa ki te whakahaere i ā mātou haumi, ki te taumata e taea ana; kia whakanuia hoki te korenga i moumou o te pūtea. I ngā tau ngahuru kua pahemo, kua heke iho te utu whakahaere i te Tahua i te 0.74 ōrau ki te 0.32 ōrau, he mea ine ki te pāpātanga o te utu ki te rawa (tirohia te whārangi 113 e kitea ai ngā taipitopito).

Kua tokomaha ake ngā kaimahi i te ohu Haumi Hāngai i Aotearoa, e whakaatuhia ana i te whārangi 94, e whai pūkenga ai mātou ki te whakatinana i tā mātou mahere mō te Pūtahi Haumitanga.

Kua piki hoki te tokomaha o ngā kaimahi i te tari Hangarau Mōhiohio hei tautoko i te ranga whānui tonu, hei whakahaere hoki i tā mātou arotahi ki te haumarutanga-tāurungi, i tā mātou neke ki te kapua me ō mātou huarahi hou hei whakahaere mōreatanga (tirohia te whārangi 88).

I ētahi atu panonitanga, i honoa e mātou te tātari haumi me te toha rawa i ngā ohu haumi hāngai me ngā ohu haumi ā-waho. E āwhina ana tēnei panonitanga ā-hanganga ki te whakawhāiti i te tukanga haumitanga mai i te tautohu huarahi tae atu ki te hoko tūtanga.

Nā ēnei panonitanga me te tupuranga o te ohu whānui, e whakahirahira ana te arotahi ki te ahurea o te wāhi mahi. E whakapau kaha tonu ana mātou, i ngā taumata katoa o te

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where a purely passive approach in line with market capitalisation would see us hold just 0.1% of the Fund's exposure in New Zealand assets, not the 14.6% of exposure we do currently.

We take our influence and responsibilities as investors in New Zealand seriously. First, we aim to display global standards and have won international recognition for doing so, as outlined on our website at: https://www.nzsuperfund.co.nz/performance/awards.

Second, we focus on lifting governance and sustainability standards across the entire market as a logical priority for the Fund. We engage actively and often with local boards and management teams; have led the establishment of the New Zealand Corporate Governance Forum (www.nzcgf.org.nz) and, in the most recent year, made a strong contribution to the review of the new NZX Corporate Governance Code, published in May 2017. Further information on these matters can be found in our Responsible Investment Report at pages 48-57.

ORGANISATIONAL CHANGES

We have continued to increase staff numbers, with the team now totalling 127 people. We are actively building the capability of our internal investment team as we look to manage our investments as directly as possible and maximise cost-efficiency. Over the past 10 years, the cost of running the Fund, as measured by our cost-asset ratio, has declined from 0.74% to 0.32% (see page 113 for more detail).

We have lifted staffing in the New Zealand Direct Investment team, profiled on page 94, in order to give us the capacity to execute on our Investment Hub plans.

Staffing has also increased in IT in order to support the larger overall team and manage our focus on cyber-security, our shift to the cloud and our new risk management tools (see page 86).

In other changes, we merged our investment analysis into our asset allocation, direct and external investment teams. This structural change is helping to streamline the investment process from opportunity identification right through to ownership.

With these changes and a growing team overall it is important to focus on our workplace culture. We continue to devote considerable time at all levels of the organisation to ensuring we are working well together. Our good progress in embedding our desired constructive culture is discussed further at page 88.

OUTLOOK

The Fund has been a significant beneficiary of a strong market recovery since the global financial crisis. We now consider most markets globally to be fully-priced. An abundance of liquidity is supporting prices and reducing volatility. Most economies are performing well across a broad base of indicators, boding well for economic growth in the short-term. Asset prices are already reflecting this.

whakahaere, ki te whakaū i te pai o te mahi tahi. Ka kōrerohia anō te pai o te haere o te whakaū i te ahurea mārohirohi e whāia ana, i te whārangi 88.

TE ANGA WHAKAMUA

Kua whai painga nui te Tahua i te pikinga o te kaha o te wāhi tauhokohoko mai i te horonga ā-tahua o te ao. Ki tā mātou titiro, kua kaha anō te utu o te nuinga o ngā wāhi tauhokohoko i te ao. E tautoko ana te ranea o te moni i ngā utu, e whakahekea ana hoki te noho mōrearea. E pai ana te whai hua o te nuinga o ngā ōhanga, i te whānuitanga o ngā tohu, ka mutu he tohu pai ēnei ki te tupuranga ā-ōhanga i te pae tata. E whakaata kēhia ana tēnei i ngā utu o ngā rawa.

Nā te mea kua kaha kē te tupuranga ā-ōhanga o anamata, me whakaōhiti tonu au i te hunga whai pānga, ka heke te kaha o te Tahua ki tētahi taumata autaia nei, hei ngā tau kei te heke mai, tē kaha piki kē ai te nui o ngā hua pērā i ngā tau tata kua hori nei. Ka oha tonu te utu a te Tahua i ngā kaiutu tāke, i ā rātou tukunga i roto i ngā tau, engari e kore e rere noa te wawaenga o ngā hua haumi i waenga i te 13 me te 19 ōrau. I tā mātou tū hei kaihaumi tē whai noa i tā te marea e whai ai, hei kaihaumi wā roa hoki, e arotahi tonu ana mātou ki ā mātou whāinga pae tawhiti, e takatū ana hoki ki te whai hua i ngā ngāueuetanga i te wāhi tauhokohoko o anamata.

Given the already full pricing of future economic growth, I must continue to caution stakeholders to expect more normal performance from the Fund over coming years, rather than the very high returns we have experienced in recent years. While the Fund will continue to repay taxpayers generously for their contributions over time, we cannot expect investment returns averaging in the teens to continue indefinitely. As a contrarian, long-term investor, we remain focused on our long-term goals and primed to take advantage of future market dislocations.

ADRIAN ORR
CHIEF EXECUTIVE OFFICER

See Adrian talk about the global investment environment at www.ar2017.nzsuperfund.co.nz/year-review

Here we provide an overview of progress made during 2016/17 against the medium-term objectives in our 2016–2021 Strategic Plan.

For more information, see our 2016–2021 Statement of Intent and 2016–2017 Statement of Performance Expectations, available at **www.nzsuperfund.co.nz/publications/statement-intent**.

OBJECTIVE:
BEST PORTFOLIO

WHAT DOES SUCCESS LOOK LIKE IN 2021?

- Single top-down view across a wide range of opportunities.
- Greater internal capabilities in identifying opportunities.
- Structured and consistent opportunistic investing.
- Broad assessment of access points (e.g. investment managers).
- Institutionalised systematic monitoring of strategies and managers.
- Best practice across governance, enterprise risk management, data and information management.

The implementation of which will:

- Add value (net of costs) to the Reference Portfolio.
- Improve the Sharpe ratio (a ratio of return achieved vs risk taken).
- Maximise cost efficiency and effectiveness.

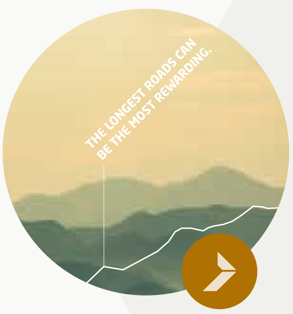
ACHIEVEMENTS DURING 2016/17:

- **Collateral optimisation** – implemented a securities lending programme to generate additional return and to help manage collateral in the most efficient manner possible.
- **Concentrated portfolio** – investigated the use of a concentrated portfolio to implement the Fund's passive global equities allocation. The recommendation to the Investment Committee was that the balance of costs to benefits did not support a move to a concentrated portfolio.
- **Cost management** – increased visibility of costs by establishing a cost allocation methodology for quarterly cost reporting and undertaking 'deep dives' into trading costs, the impact of access point selection on reported costs and manager fees.
- **Investment Hub** – initiated to create new direct investment opportunities of scale in the New Zealand market that would otherwise be unachievable. The project leverages our unique institutional knowledge and networks, return profile, certainty around liquidity and long-term investment horizon.
- **Climate change** – agreed and began to implement a climate change strategy to make the Fund more resilient to the risks posed by climate change. The strategy will be implemented over several years and comprises four work streams: (see Fund website for more information)
  - **Reduce** – reduce our exposure to the highest risk companies
  - **Analyse** – incorporate climate change risk into our analysis and decision making toolkit
  - **Engage** – manage climate change risks by being an active owner
  - **Search** – actively seek new investment opportunities resulting from climate change risk impacts.

PRIORITIES FOR 2017/18:

- **Collateral optimisation** – complete implementation of initiatives commenced in 2016/17 to generate a return and manage collateral supply and demand in the most efficient manner possible.
- **Generating domestic proprietary deal flow** – we are currently establishing the Investment Hub; however, this will still require significant focus throughout 2017/18.
- **Climate change** – continue implementation of the strategy to make the Fund more resilient to the risks posed by climate change.

2016/17 AWARDS



WINNER
Environmental, Social and Governance Institutional Proficiency Award, 2016 Asian Investor Institutional Excellence Awards

WINNER
Finance Section, Asia-Pacific PR Excellence Awards

GOLD AWARD
2017 Australasian Reporting Awards

GOLD AWARD
2017 International ARC Awards

WINNER
Governance Reporting – Public Sector, 2017 Australasian Reporting Awards

WINNER
Outstanding Contribution to Finance and Business Award, 2017, NZ CFO Awards (Adrian Orr)

BRONZE AWARD
2016 YWCA Equal Pay Awards

OBJECTIVE:
STRONG EXTERNAL RELATIONSHIPS

WHAT DOES SUCCESS LOOK LIKE IN 2021?

- Active membership and leadership of influential global forums.
- Co-ordinated programme of engagement and collaboration with international and domestic parties.

ACHIEVEMENTS IN 2016/17:

- The IFSWF annual meeting was held in Auckland in November 2016, hosted by the Guardians. The meeting provided an opportunity for us to learn from and contribute to the development of best practice among sovereign wealth funds globally, promote opportunities for peer collaboration and showcase New Zealand as an investment destination.

PRIORITIES FOR 2017/18:

- Strategic engagement – build strategic relationships that involve deep and broad relationships across the Guardians and target firms/key stakeholders.

OBJECTIVE:
BUILDING AND MAINTAINING A GREAT TEAM

WHAT DOES SUCCESS LOOK LIKE IN 2021?

- Strong leadership throughout the Guardians.
- Culture and values strongly defined and identified with.
- Focus on talent development and staff retention.
- Diversity of perspectives encouraged, understood and used.

ACHIEVEMENTS DURING 2016/17:

- Engagement survey recommendations implemented.
- Bronze Award (Emerging Leaders) for Equal Pay, supported by the introduction of the diversity and inclusiveness and flexible work policies.
- Stronger focus on, and transparency in, developing talent plans.

PRIORITIES FOR 2017/18:

- People/Culture – leverage talent agenda programme with a particular focus on maximising (and growing) team members from a whole of Fund perspective.

OBJECTIVE:
EFFICIENCY, SCALABILITY AND INNOVATION

WHAT DOES SUCCESS LOOK LIKE IN 2021?

- Frameworks and processes are embedded and guide efficient operations by managing uncertainties and simplifying decisions.
- These frameworks and processes are also scalable and flexible to accommodate new initiatives and products.

ACHIEVEMENTS DURING 2016/17:

- Data management – upgraded our central data management platform, known as SuperMART, to improve the speed and throughput of changes to it through better solution design, development standards and supporting infrastructure.
- Risk system – commenced implementation of a new risk platform to replace existing models across a range of investment risk areas.

Replacement of the Document and Records Management System was identified as a potential activity in the 2016-17 Statement of Performance Expectations. After completing the discovery and planning phase of this project, it was decided that the new product would not deliver sufficient benefit to justify the potential cost.

PRIORITIES FOR 2017/18:

- Cloud – assessment currently underway to replace end-of-life Guardians IT infrastructure. This will involve, in part, moving to cloud services.
- Data management – developing data warehouse capabilities and rolling out a data governance framework.
- Risk system – complete implementation of the new risk platform.

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IDENTIFYING OUR MATERIAL TOPICS

Prior to our last annual report, we carried out a four-part process to better understand the 'material topics' of our organisation. Our aim was to understand what our stakeholders considered important when they evaluated our performance and the impact of those issues on our performance.

The following materiality assessment process was used:

1. Review of the Guardians' strategic plan, media stories, culture survey results, risk registers, stakeholder survey, requests received under the Official Information Act and parliamentary questions
2. Engagement with New Zealand government stakeholders and senior Guardians' staff
3. Prioritisation of issues by the Guardians' Leadership Team
4. Validation by the Guardians' Board
5. Using the GRI Guidelines, we canvassed government stakeholders to understand what issues/risks they considered important when evaluating the performance of the Guardians. A similar survey was sent to senior Guardians staff to understand the impact of these issues and risks on the Fund.

These issues are displayed on page 21 to illustrate their relative importance and impact.

This year we undertook an abbreviated materiality analysis to reflect the aspects of our organisation that may have increased or decreased in importance over the last financial year.

This process has included:

- identifying issues of significant media and stakeholder interest during the year. These included climate change, remuneration, and palm oil;
- reviewing feedback from our most recent stakeholder perception research from 2015;
- seeking feedback from Treasury on our proposed annual report content and discussing reporting priorities with them; and
- considering the 2016 Letter of Expectations received from the Minister of Finance, which sets out his expectations for a greater emphasis on the risk-adjusted performance of the Fund.

As a result of this process, we have:

- included features about our climate change strategy and progress toward implementation (see page 46) and our work on palm oil (see page 54);
- introduced more content on remuneration, particularly around CEO remuneration, to more clearly articulate the Guardians' remuneration philosophy and the bonus structure (see page 79);
- included Sharpe ratio figures, an industry-standard measure for calculating risk-adjusted returns, in our Investment Performance Report (see page 31);
- themed the report 'Invested in New Zealand and the World'. This is consistent with feedback from the stakeholder research indicating a need to communicate more strongly about our domestic investment approach.

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Our annual report aligns with our Statement of Intent (which is based on our 5-year Strategic Plan) and our Statement of Performance Expectations. In the Statement of Performance at pages 100 – 103, we report against the 1, 5 and 10 year performance measures set out in the Statement of Intent, as well as on our achievement of the priority Strategic Plan activities for 2017/18.

Decisions about the information we include in our annual report are also based on:

- legislative reporting requirements for New Zealand Crown entities and for the Guardians and Fund; and
- best practice disclosure guidelines for sovereign wealth funds and financial institutions, including the:
  - New Zealand Financial Markets Authority's Corporate Governance Principles;
  - New Zealand Corporate Governance Forum's Best Practice Guidelines;
  - New Zealand Human Rights Commission's Good Employer Obligations;
  - International Forum of Sovereign Wealth Fund's Santiago Principles;
  - United Nations Principles for Responsible Investment; and
  - Global Reporting Initiative (GRI standards).

GRI is an international, independent reporting standard for best practice disclosure and reporting. The GRI defines Material Topics as reflecting significant economic, environmental and social impacts of an organisation or issues and risks that influence stakeholders' assessment of that organisation.

MATERIAL TOPICS IDENTIFIED AND THEIR BOUNDARIES

The GRI Standards define topic boundaries as the description of where impacts occur for each material topic. In setting the topic boundaries, an organisation should consider impacts within and outside the organisation. Topic boundaries vary based on the topics reported.

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BOARD MEMBERS

DOUG PEARCE — PIP DUNPHY — JOHN WILLIAMSON — CATHERINE SAVAGE — CRAIG ANSLEY — LINDSAY WRIGHT — STEPHEN MOIR

CATHERINE SAVAGE

CHAIR

APPOINTED TO GUARDIANS' BOARD IN 2009
COMMITTEES: Employee Policy and Remuneration (Chair) and Audit

LINDSAY WRIGHT

DEPUTY CHAIR

APPOINTED TO GUARDIANS' BOARD IN 2012
COMMITTEES: Audit (Deputy Chair)

CRAIG ANSLEY

APPOINTED TO GUARDIANS' BOARD IN 2011
COMMITTEES: Audit

PIP DUNPHY

APPOINTED TO GUARDIANS' BOARD IN 2012
COMMITTEES: Audit (Chair)

STEPHEN MOIR

APPOINTED TO GUARDIANS' BOARD IN 2009
COMMITTEES: Employee Policy and Remuneration

JOHN WILLIAMSON

APPOINTED TO GUARDIANS' BOARD IN 2016
COMMITTEES: Audit

DOUG PEARCE

APPOINTED TO GUARDIANS' BOARD IN 2016
COMMITTEES: Employee Policy and Remuneration

For bios of our Board members, visit
www.nzsuperfund.co.nz/nz-super-fund-explained-governance/board

DAVID SARA — MARK FENNELL — SARAH OWEN — MATT WHINERAY — ADRIAN ORR — MIKA AUSTIN — STEWART BROOKS

ADRIAN ORR
BSocSci, MA (Dist)

CHIEF EXECUTIVE OFFICER

AREAS OF RESPONSIBILITY:
General management of the Guardians under delegation from the Board

MATT WHINERAY
BCom, LLB (Hons)

CHIEF INVESTMENT OFFICER

AREAS OF RESPONSIBILITY:
Asset allocation, macroeconomic strategy, responsible investment, appointment of investment managers, New Zealand and international direct investments, public and private market investments

MIKA AUSTIN
BA, LLB

GENERAL MANAGER HUMAN RESOURCES

AREAS OF RESPONSIBILITY:
People and performance, culture, administration

STEWART BROOKS
BCom, CA

GENERAL MANAGER FINANCE AND RISK

AREAS OF RESPONSIBILITY:
Chair of Risk Committee, enterprise risk (including records management), external audit process, financial control, financial reporting, portfolio risk and compliance, tax

MARK FENNELL
MSocSci (Hons), DipAcc, ACA, CTP

GENERAL MANAGER PORTFOLIO COMPLETION

AREAS OF RESPONSIBILITY:
Treasury operations, including passive exposure, currency overlay, liquidity management and portfolio rebalancing; portfolio investments

SARAH OWEN
BA, LLB, DipAcc

GENERAL MANAGER CORPORATE STRATEGY AND GENERAL COUNSEL

AREAS OF RESPONSIBILITY:
Board Secretariat, communications, legal, strategic development

DAVID SARA
BMS (Hons), MBS (Dist)

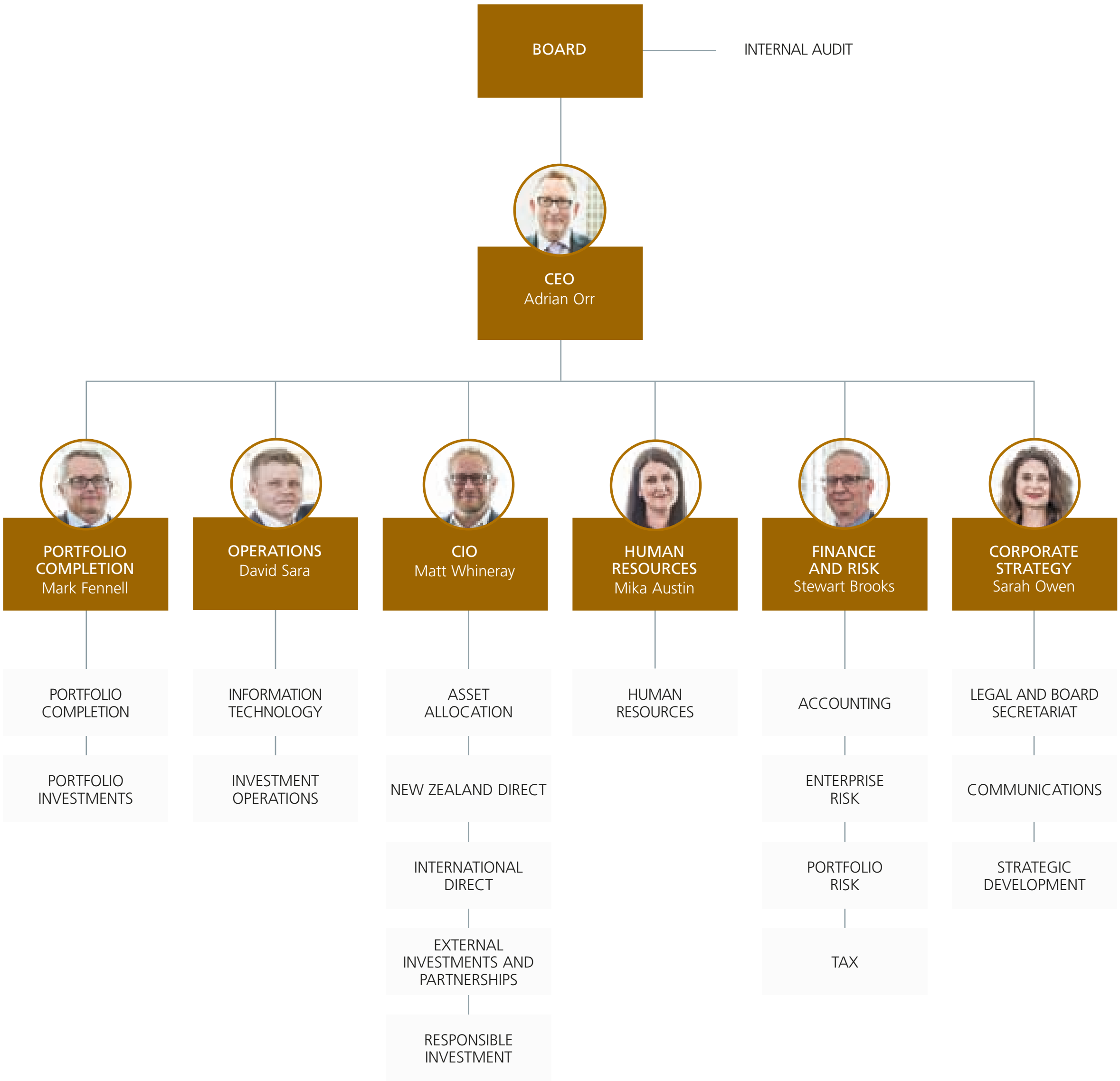
GENERAL MANAGER OPERATIONS

AREAS OF RESPONSIBILITY:
Chair of Funding Treasury Group, information technology, investment operations

For bios of our Leadership team, visit
www.nzsuperfund.co.nz/nz-super-fund-explained-management/leadership-team

GUARDIANS OF NEW ZEALAND SUPERANNUATION

Organisational Chart



SECTION

02

Investment Report

Te Pūrongo Haumi Pūtea

We're tapping into New Zealand's pool of economic potential: our local expansion capital strategy targets small and medium sized New Zealand companies that need our capital to reach the next phase of growth.

26. PERFORMANCE REPORT

28. OUR CIO ON ACTIVE V PASSIVE INVESTMENT

30. VALUE-ADD IN 2016/17

31. RISK-ADJUSTED RETURN PERFORMANCE

32. WHERE WE INVEST

34. INVESTMENT ACTIVITY – NEW ZEALAND

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48. RESPONSIBLE INVESTMENT REPORT

50. Q&A WITH HEAD OF RI:ESG DUE DILIGENCE IN THE PRIVATE MARKETS

Image courtesy of **Icebreaker**

TOTAL RETURN 2016/17 (AFTER COSTS AND BEFORE NZ TAX)

20.71%

FUND SIZE UP BY

$5.27b

THE YEAR IN SUMMARY

The Fund again out-performed global markets, returning 20.71% (after costs, before NZ tax) over 2016/17. The Guardians' active investment activities added value of 4.37% (NZD1.28b) on top of a Reference Portfolio (market) return of 16.34%.

The Fund finished the year at NZD35.37b before New Zealand tax, an increase of NZD5.27b.

The overall Fund's out-performance of the Reference Portfolio was due mainly to the success of its strategic tilting programme and a positive performance by its single largest investment, Kaingaroa Timberlands. See page 30 for more details.

Reference Portfolio	Weight	2016/17 Return
Global Equities – developed markets	65%	21.85%
Global Equities – emerging markets	10%	19.68%
New Zealand Equities	5%	10.35%
Global Fixed Income	20%	0.91%
Total	100%	16.34%

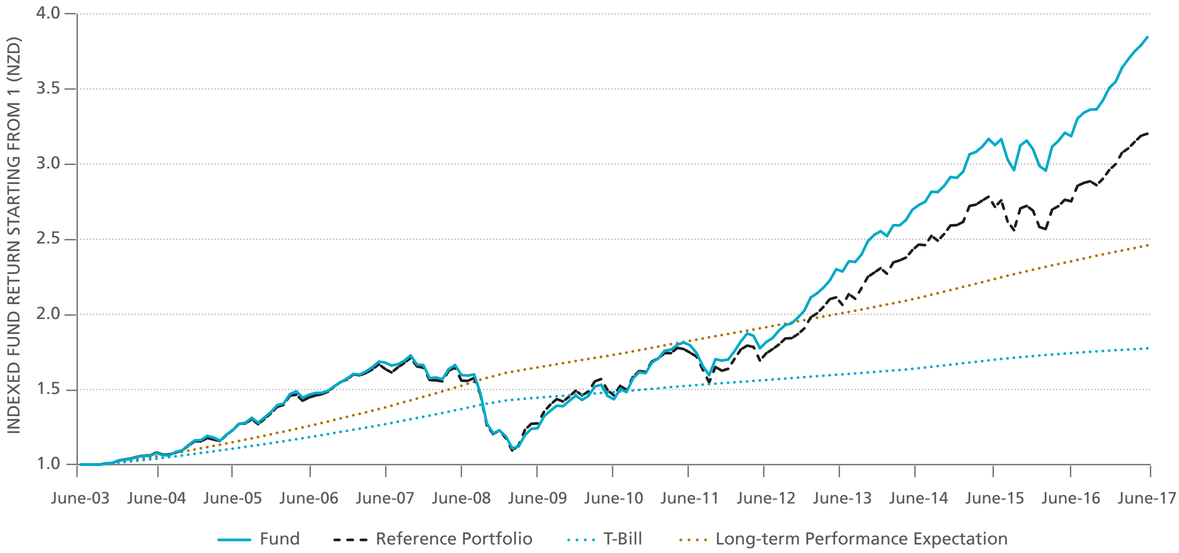
RETURN DRIVERS

Around two-thirds of the Fund is invested passively, in line with the Reference Portfolio. Therefore, the composition of the Reference Portfolio is the biggest single influence on Fund returns. The above table shows how the components of the Reference Portfolio performed during the year. The returns are shown on a hedged to NZD basis.

PERFORMANCE SINCE INCEPTION

As detailed in the Chair's Statement on page 12, the Fund is well ahead of its performance benchmarks since inception.

CUMULATIVE FUND RETURN SINCE INCEPTION



201-1

The preceding graph shows the cumulative NZD Fund return since inception, relative to its key benchmarks:

- The Reference Portfolio return;
- Treasury bills – a measure of the cost to the government of contributing capital to the Fund, instead of using the money to retire debt; and
- Long-term Reference Portfolio Performance Expectation (Treasury bill return + 2.7%).

The gap between the Reference Portfolio return and the actual Fund return, as at 30 June 2017, illustrates the value the Fund's active investment strategies have added since inception (NZD6.25b or 1.45% p.a.).

The gap between the Treasury bill return and the Fund return shows the return earned in excess of the government's marginal cost of short-term debt (NZD19.09b or 5.99% p.a.).

Note: the Reference Portfolio was introduced in July 2010. Figures prior to then are based on the Strategic Asset Allocation model of the time. From 1 July 2015, the long-term performance expectation changed from Treasury bills + 2.5% to Treasury bills + 2.7%.

Fund Performance as at 30 June 2017	**Fund Size NZD35.37b before Tax**				
	ONE YEAR	THREE YEARS	FIVE YEARS	10 YEARS	SINCE INCEPTION (SEPT 2003)
Actual Fund returns (after costs, before NZ tax)	20.71%	12.12%	16.18%	8.63%	10.22%
Reference Portfolio return (after costs, before NZ tax)	16.34%	9.11%	12.95%	6.94%	8.77%
Value-Added (Actual return – Reference Portfolio return)	4.37%	3.01%	3.23%	1.69%	1.45%
Estimated $ earned relative to Reference Portfolio	$1,285m	$2,809m	$4,802m	$5,559m	$6,247m
New Zealand income tax paid	$923m	$1,614m	$3,379m	$4,444m	$5,561m
New Zealand Treasury Bill (T-Bill) return	1.83%	2.61%	2.56%	3.40%	4.23%
Net Return (Actual return – T-Bill return)	18.88%	9.51%	13.62%	5.23%	5.99%
Estimated $ earned relative to T-Bills	$5,562m	$8,328m	$16,984m	$15,531m	$19,088m
$ change in net asset position	$5,268m	$8,936m	$16,377m	$22,223m	$35,373m

Our CIO on active versus passive investment

One of the topics brought up in recent debates about the New Zealand Superannuation Fund is the difference between active and passive investment.

The contention is that the Fund, which invests actively, will not be able to sustain its track record of out-performing the market over time and a wholly passive fund would be better.

We disagree.

Active investing is difficult and is not worth doing in many markets, and we agree that active investing costs more. This is why the majority of the Fund is managed passively – two-thirds is invested in line with an index-linked Reference Portfolio. This is a diversified growth portfolio (80% shares, 20% bonds) that is fully implemented passively at a low cost.

But active investment has some big benefits: in our case, it allows us to increase diversification and fully utilise our natural advantages. As a result, we have earned significant rewards with little additional risk.

We have two relevant investment beliefs:

- true skill in generating excess returns versus a manager's benchmark is very rare. This makes it hard to identify and capture consistently.
- investors with a long-term horizon can outperform more short-term focused investors over the long-run.

The first belief forces us to be very clear about why any particular active strategy could improve the performance of the Fund (whether through lower risk or higher return, or both). Our commitment to selective active investing is informed by research and best practice in the investment industry and supported by well-established views in the industry. (ACC's highly successful investment team is also an active investor.)

201-1 The second belief is relevant to how we choose to undertake active investing. The Fund has some natural advantages which means it is ideally placed to be a successful active investor. It has a long time horizon, a known liquidity profile, operational independence from the government of the day and sovereign status. We combine these advantages with a disciplined, transparent approach that keeps all active and passive investment decisions separate.

The Reference Portfolio forms both the core of the Fund's actual portfolio and its passive benchmark, a hurdle that active investments have to surpass to add value. It clearly establishes the opportunity costs of all of the Fund's active investment decisions.

We invest actively only when there are clear benefits (after all costs) in doing so. We carefully determine the amount of risk that can be taken in different areas.

Our active investments fit into three broad categories.

The first contains investments that help diversify the Fund's portfolio. Examples include our New Zealand timber and rural assets. These investments exploit the Fund's long investment horizon and known liquidity profile.

The second category, which also exploits the Fund's long investment horizon, contains investments that respond to current market pricing, adding exposure to asset classes that are relatively cheap and lowering exposure to those that are relatively expensive. Our decision to 'double down' on equities during the global financial crisis is a case in point.

The third category, asset selection, contains investments that rely on the ability to select individual assets that will outperform relevant benchmarks. This is what is usually referred to by detractors of active investment. We agree with the contention that picking stocks in efficient markets is a zero-sum game (what one manager gains, another loses, and everyone pays fees). This is why we use very little of this type of active investing and, where we do, it is focused on specific opportunities where there is persistent evidence of market inefficiency.

Active investing, within well-defined constraints, is both prudent and commercial for an institutional investor with a long horizon and the discipline to stay the course. Its value is highlighted by the fact that the Fund has outperformed its Reference Portfolio by NZD6.25b after all costs since inception. In doing so, the Fund has earned more return per unit of risk than the passive alternative. Taxpayers have had great value to date from our active investment approach.

Not every active investment (nor every passive one) will work out. And not every year will see a positive return from our active investments – trying to target this for each year would stop us from properly exploiting our long horizon.

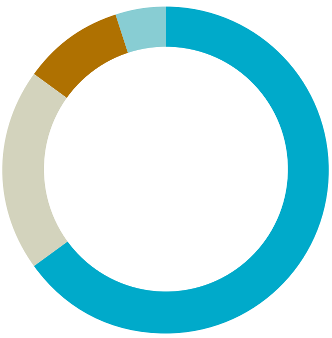
We have every confidence, however, that the Fund's active investment portfolio will continue to create substantial value for taxpayers.

The Fund is well-diversified across many thousands of companies, sectors and global markets; the amount of risk being taken is carefully managed; our approach to active investment is highly selective and aligned to the Fund's natural advantages; our active risk positions are, themselves, diversified; and we are very transparent about whether or not active investment strategies are adding value. Everyone can see it every month in our performance reports.

This article first appeared in the Dominion Post.

MATT WHINERAY
CHIEF INVESTMENT OFFICER

REFERENCE PORTFOLIO



- Developed Markets Equity **65%**
- Fixed Income **20%**
- Emerging Markets Equity **10%**
- NZ Equity **5%**

ACTUAL PORTFOLIO – 30/06/2017*

- Developed Markets Equity **55.3%**
- Fixed Income **11.1%**
- Emerging Markets Equity **10.7%**
- Timber **5.6%**
- Private Equity **5.5%**
- NZ Equity **4.2%**
- Other Private Markets **2.5%**
- Infrastructure **2.6%**
- Other Public Markets **1.6%**
- Rural **0.9%**

*excludes the impact of any strategic tilts.

201-1

NZD1.28b

IN VALUE-ADD (NET OF COSTS)

In this section, we report on value added or detracted by our active investments, by risk basket*, relative to our passive Reference Portfolio benchmark.

In total, the Fund out-performed the Reference Portfolio by 4.37% (NZD1.28b) over the year. This compares with a 0.52% (NZD155m) out-performance in 2015/16 and a 1.45% p.a. (NZD6.25b) out-performance since inception.

We expect to out-perform the Reference Portfolio by 1% per year, over the long-term, based on the level of risk we take.

It is important to appreciate that our active investment strategies are designed to maximise returns over the long term. Negative returns as well as positive, and movements up and down between years, are expected.

Risk baskets	Performance vs Reference Portfolio 2015/16	Performance vs Reference Portfolio 2016/17
ASSET SELECTION e.g. Opportunistic, Buyout This basket contains opportunities that involve the skill to pick assets. These include internal and external mandates such as NZ active equities or one-off direct investments. The performance of these investments, which are expected to be long-term ones, reflected small revaluations relative to a rallying global equity market.	0.29%	-0.21%
MARKET PRICING – ARBITRAGE, CREDIT AND FUNDING e.g. Active Collateral, Merger Arbitrage These opportunities are mainly in the area of credit and funding that often draw on the Fund's sovereign status and liquidity endowments. These opportunities tend to have lower risks than those in the other two market pricing baskets since interest rate risks are generally hedged and trades are often implemented via arbitrage strategies. Active collateral, merger and direct arbitrage strategies all added value in this basket.	0.20%	1.20%
MARKET PRICING – BROAD MARKETS e.g. Global Macro, Strategic Tilting The opportunities in this basket draw on the Fund's endowment of having a stable risk aversion compared with the market. These opportunities include strategic tilting, one of our internal mandates that systematically takes on risk after markets have fallen and takes risk off again after markets have recovered. Our tilting programme had a very strong year and has now returned 1.4% p.a. since it commenced. A white paper on our tilting programme is available on our website at: **https://www.nzsuperfund.co.nz/news-media/guardians-publish-white-paper-strategic-tilting**.	-0.53%	2.27%
MARKET PRICING – REAL ASSETS e.g. Energy, Infrastructure, Real Estate These opportunities are mainly driven by our views of the pricing attractiveness of real assets in their respective markets, which include infrastructure, real estate, energy investments and expansion capital. Infrastructure as a whole made a positive contribution, but this was offset by the performance of our energy growth assets, which are at an early stage and not expected to deliver strong returns until they are more mature. In addition, the benchmark for these assets performed well off the back of rising global equity markets.	0.78%	-0.05%
STRUCTURAL e.g. Emerging Markets Equity Up-weight, Timber This basket includes diversifying assets such as timber, life settlements and catastrophe bonds that are not represented in the Reference Portfolio. The basket also includes opportunities that we intend to maintain an allocation to (e.g. an overweight to emerging market equities) based on our favourable views on the medium to longer term opportunity drivers. The vast majority of the value added by this basket during the year can be attributed to positive cash returns and a revaluation of our Kaingaroa forest investment.	0.10%	1.05%
TOTAL	**0.84%**	**4.26%**

201-1

For more information about how we invest, including details of our investment beliefs, investment managers, risk allocation process and Reference Portfolio approach, please see: www.nzsuperfund.co.nz/how-we-invest

* We have grouped opportunities under five broad classes ('baskets') based on our primary investment rationales of structural/diversification, market pricing and asset selection.

Focusing solely on returns ignores how smooth the ride was in generating those returns. A commonly used risk-adjusted performance metric, the Sharpe ratio, compares the portfolio returns above cash returns as a ratio to the volatility of returns. The higher the ratio, the greater the return for the risk, and vice-versa.

The Sharpe ratio enables us to compare the risk-adjusted performance of our benchmark, the Reference Portfolio, with that of our Actual Portfolio and against our expectations. This is shown below.

	Since introduction of Reference Portfolio (July 2010) to 30 June 2017	Dec 2003 to 30 June 2017	
Reference Portfolio Sharpe ratio[1] (expected)	0.20	0.20	
Reference Portfolio Sharpe ratio (realised)	1.20	0.43	
Actual Portfolio Sharpe ratio (expected)	0.26	0.26	What we thought we would do
Actual Portfolio Sharpe ratio (realised)	1.36	0.50	What we actually did

[1] The Sharpe ratio is the portfolio return in excess of the T-Bill return (excess return) divided by the volatility of the excess return.

The Actual Portfolio's realised Sharpe ratio of 0.50 since inception is better than we expected and also better than that realised by the Reference Portfolio. This has been driven by higher than expected returns and lower than expected risk over the period. Given that the Fund operated under a Strategic Asset Allocation framework between 2003 and 2009, with more limited active investments, we provide Sharpe ratio figures for both the period since then and for the Fund since inception. The Actual Portfolio's realised Sharpe ratio since 2010 has been 1.36, greater than the Reference Portfolio Sharpe ratio and greatly exceeding our expectations. Again, this has been driven largely by returns exceeding expectations and, to a lesser extent, lower than expected risk.

201-1

NEW ZEALAND

The Fund is highly diversified, with investments in a range of markets and sectors all around the world. More than 80% of the Fund is invested offshore, in both developed and emerging markets. This diversification is in keeping with the Guardians' mandate to manage the Fund in line with best practice portfolio management and to invest it on a prudent, commercial basis.

The majority of the Fund's global investments are held passively. These holdings give us cost-effective, diversified exposure to global sharemarkets. We also invest globally in a range of active investment opportunities, including timber, private equity, insurance-linked securities and distressed credit.

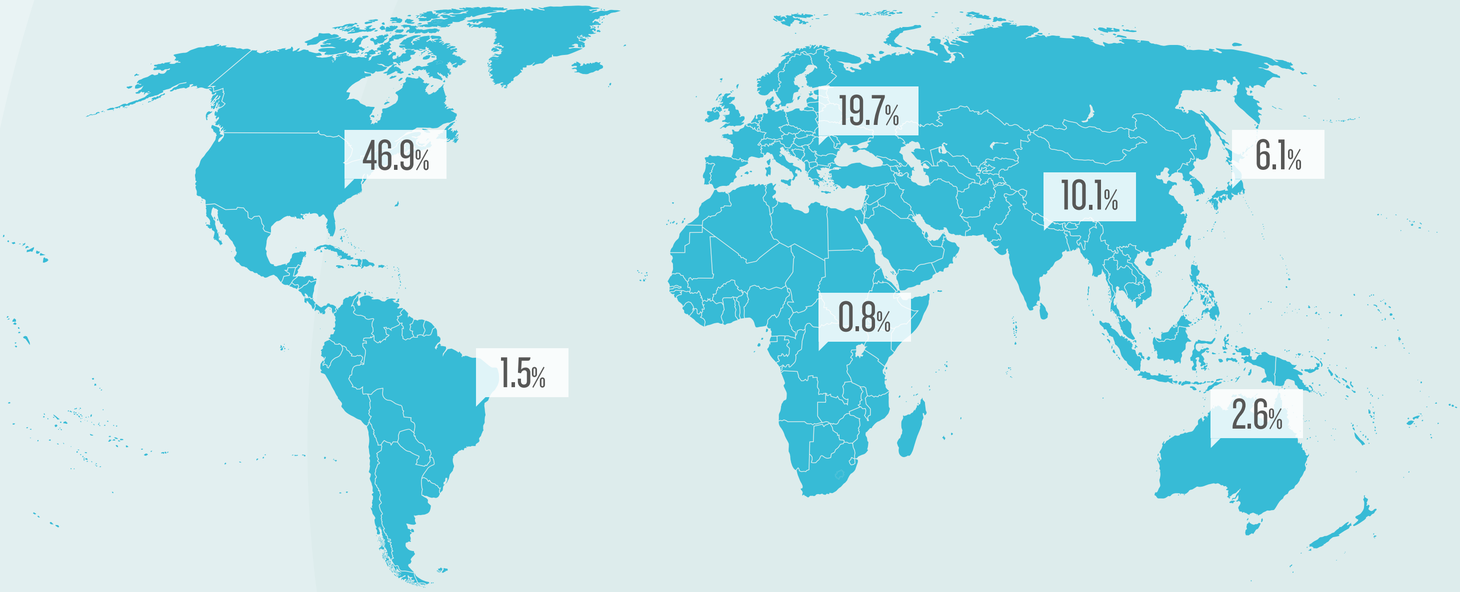
Exposure	30 June 2017	30 June 2016	30 June 2015	30 June 2014
New Zealand	12.0%	12.6%	13.5%	13.8%
Australia	2.6%	2.1%	2.7%	2.5%
Africa	0.8%	0.8%	1.1%	0.7%
Europe	19.7%	21.2%	20.9%	24.5%
Asia (excl. Japan)	10.1%	8.9%	9.3%	6.0%
Japan	6.1%	6.1%	6.2%	6.5%
North America	46.9%	46.7%	44.3%	44.6%
South America	1.5%	1.6%	2.0%	1.4%

The main driver of changes to the Fund's geographic exposure over time is relative performance of the different markets over time and as a consequence their weightings in international equity indices.

See page 34 for further information on our New Zealand investments.

102-4

THE WORLD



0.9%

INVESTED IN RURAL LAND AND FARMS ACROSS NEW ZEALAND

$2.0b

INVESTED IN FORESTRY WORLDWIDE AND IN NEW ZEALAND

1.7%

INVESTED IN NATURAL CATASTROPHE REINSURANCE AND LIFE SETTLEMENTS

$1.7b

INVESTED IN NEW ZEALAND EQUITIES

102-4

INVESTMENT ACTIVITY – NEW ZEALAND

OUR APPROACH TO INVESTING IN NEW ZEALAND

The Fund is one of the largest institutional investors in New Zealand and has a significant role in New Zealand's capital markets.

While we believe the Fund has a comparative advantage when investing domestically, in a global context, New Zealand is a very small investment market. For our New Zealand investments we require a return that will compensate us sufficiently for the risk of concentrating too much of the Fund's portfolio here. As one of only a few investors of scale in the country, we also maintain a high level of price discipline.

The Fund takes an active approach to New Zealand investment, targeting five specific investment opportunities to add value to the Fund: listed equities; direct investment; expansion capital; rural land and small-medium sized infrastructure. Notable domestic investment activities for 2016/17, including the establishment of our Investment Hub, are detailed in the following pages.

See page 94 for a profile of our NZ Direct Investment Team.

THE INVESTMENT HUB

The Investment Hub seeks to create unique investment opportunities in New Zealand where the Fund can leverage its unique attributes, such as its institutional knowledge and networks, return profile, certainty around liquidity and long-term investment horizon to drive business strategy and deal flow.

It seeks to do this through:

- taking better advantage of value gaps in illiquid and unlisted markets to reap returns not otherwise accessible;
- aggregating and rationalising to provide economies of scope and scale;
- lowering the cost of providing bulk commodities, pushing more products up the value chain or owning more of the value chain;
- rectifying capability and technology gaps caused by New Zealand's size and location constraints;
- creating long-term value through sustainability and building brand stories; and
- establishing lasting partnerships with like-minded peers.

102-10

> "Active investing is particularly critical if we are to invest in New Zealand, where a purely passive approach in line with market capitalisation would see us hold just 0.1% of the Fund in New Zealand assets, not the 14.6% we do currently." ADRIAN ORR

VALUE OF NEW ZEALAND INVESTMENTS

The graph below illustrates the growth in the value of the Fund's New Zealand investments since 2009, when we received a direction on New Zealand investment from the Minister of Finance. In the eight years since 1 July 2009, the value of the Fund's New Zealand investments has risen from NZD2.4b to NZD4.9b.

For more information on the Fund's approach to investing in New Zealand including a video of CIO Matt Whineray please see our website: https://www.nzsuperfund.co.nz/investing-nz

PROPORTION OF NEW ZEALAND INVESTMENTS

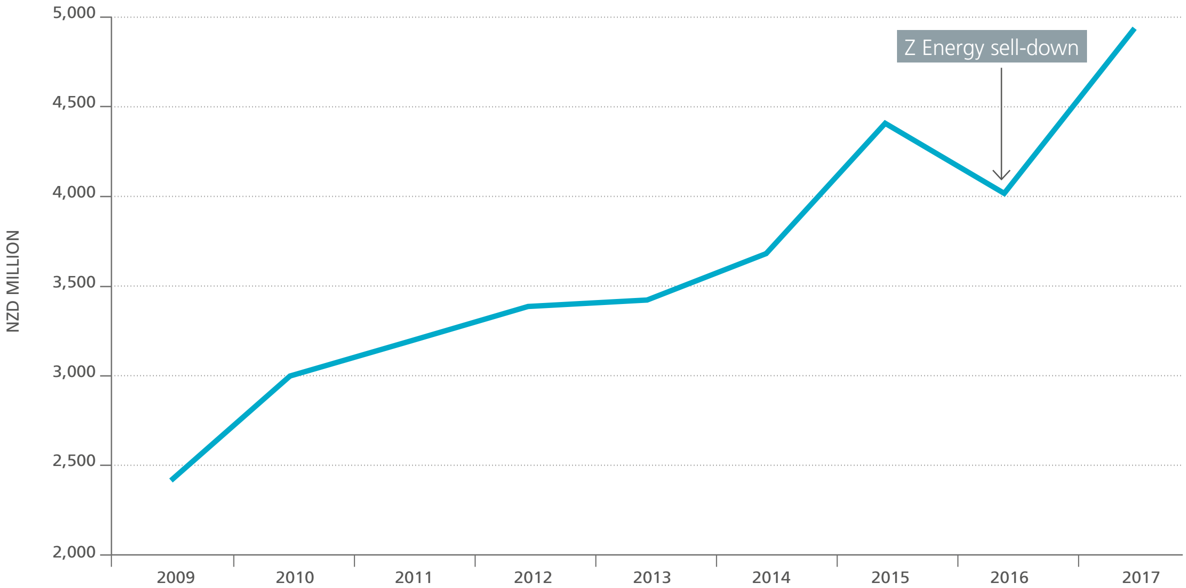
While the dollar figure of our investments in New Zealand has increased from 2,415 million to 4,904 million in the eight years since 1 July 2009, the proportion of the overall Fund that is invested in New Zealand (in value terms) has reduced from 21.3% to 14.6%. Active investing is particularly critical if we are to invest in New Zealand, where a purely passive approach in line with market capitalisation would see us hold just 0.1% of the Fund in New Zealand assets, not the 14.6% we do currently.

In contrast to the exposure analysis provided in the 'Where we invest' section on page 32, this figure is calculated based on the value of our New Zealand investments, as a proportion of the value of our 'investments' figure in our financial statements.

This calculation includes investments in rural and forest land, but excludes foreign exchange hedging instruments such as FX contracts and cross-currency swaps.

The proportional drop reflects the strong performance of global equities in recent years.

VALUE OF NEW ZEALAND INVESTMENTS



102-10

EXPANSION CAPITAL MANDATES

In December 2016, the Fund announced three new expansion capital mandates. The Fund has committed up to NZD90m in Direct Capital's Fund V, up to NZD120m in Pioneer Capital's Fund III and up to NZD50m in Movac's Fund IV.

The three mandates target different parts of the expansion capital stage of the private equity market in New Zealand, with Direct Capital operating at the larger end of the growth spectrum, Pioneer targeting mid-market companies seeking international growth and Movac focused on earlier stage, high growth (typically technology) companies. Each fund is expected to invest in between eight and fifteen individual companies.

WHAT IS EXPANSION CAPITAL?

New Zealand expansion capital is a type of private equity investment focused on mid-market companies that have a clear high growth plan.

Our capital is typically necessary to support the portfolio company's expansion. The private equity funds achieve this through strategic acquisition, industry consolidation, technology upgrades or expanding their market share. As the individual portfolio company investments are small relative to our total portfolio, it is more cost-efficient for us to access New Zealand capital expansion via external private equity investors.

COMPANIES THE FUND IS INVESTED IN

As at 30 June 2017, the Fund was invested (via external managers) in the following New Zealand companies. The size of the Fund's share of each company varies, but is typically between 2% and 20%. The list is not exhaustive, and represents only a selection of the New Zealand companies the Fund is invested in through its expansion capital mandates.

NAME	BUSINESS	MANAGER
ARANZ Geo	Provides visualisation and interpretation of geological sciences for the mining, hydrogeology and geothermal industries	Pencarrow
Bayley Corporation	A full-service real estate company	Direct Capital
BeGroup	Provides affordable and modern retirement villages with a full range of care options	Pencarrow
Cavalier Woolscourers	A wool scourer that services the New Zealand wool industry	Direct Capital
Energyworks	Provides mechanical maintenance and engineering services to clients across the oil and gas, power generation and petrochemical industries	Direct Capital
Fishpond	An e-commerce company based in New Zealand	Direct Capital
Healthcare Holdings	Owns and operates the Mercy Ascot hospitals in Auckland and is a majority shareholder in Kensington Hospital in Whangarei	Waterman
HealthLink	Provides a communications system that links the information technology systems of more than 10,000 medical organisations	Waterman
Hiway Stabilizers	Provides specialist technology, equipment and services in the roading and civil infrastructure sector	Direct Capital
Icebreaker	A premium outdoor active wear company with a focus on natural fibres and adhering to environmental and social ethics	Pencarrow
K9 Natural	Produces natural pet food for dog and cat owners	Pioneer
Lifestream	Develops and manufactures products for the vitamins, minerals and supplements market	Pioneer
Magic Memories	Provides innovative content and photography solutions to owners of large volume visitor attractions	Pioneer
Partners Life	Offers life insurance (life and income protection products) to New Zealanders	Waterman
Pet Doctors	Operates a group of veterinary clinics under multiple brands	Pioneer
PF Olsen	An independent forestry services group	Direct Capital
Rockit Apple	Produces and markets the world's first specially bred miniature high-quality apple	Pioneer
Solarcity	Provides solar panels to residential and commercial users in New Zealand	Pencarrow
Stratex	Supplies flexible packaging materials to food producers in Australia and New Zealand	Pencarrow
Umbrellar	Provides cloud hosting, domain name services and e-commerce payment services across New Zealand and Australia	Pencarrow
Vend	Provides a cloud-based retail point of sale system	Movac
Waikato Milking Systems	Provides milking systems and technologies to commercial dairy farms	Pioneer
WhereScape	Provides data warehouse and big data automation solutions	Pioneer

102-10

We explored 59 transactions over the 2016/17 financial year (31 in 2015/16), with 8 proceeding to due diligence (14 in 2015/16).

MINISTER OF FINANCE'S DIRECTIVE

14 MAY 2009

"… I direct the Guardians to note that it is the Government's expectation, in relation to the Fund's performance, that opportunities that would enable the Guardians to increase the allocation of New Zealand assets in the Fund should be appropriately identified and considered by the Guardians.

This direction is not considered to be inconsistent with the Guardians' duty to invest the Fund on a prudent, commercial basis, in accordance with section 58 of the Act, and the above paragraph is subject to that duty."

KIWIBANK AND DATACOM

Our investment in Kiwibank settled in October 2016. In December 2016, we appointed Kevin Malloy to the Kiwibank Board. See the case study on page 40.

The Kiwibank investment marks our second transaction with New Zealand Post, the first being our purchase of a minority stake in technology company Datacom (www.datacom.co.nz) in 2013. The Fund currently owns 39% of Datacom, having built its holding over time from 35% through the purchase of shares from Datacom employees. Datacom continues to perform very strongly and has grown market share in New Zealand and Australia since our investment.

102-10

The Fund is a significant minority investor in technology company Datacom.

Members of the Guardians, Ngāi Tahu and New Ground Capital visit the Hobsonville site.

HOBSONVILLE UPDATE

In late 2015, the Fund partnered with Ngāi Tahu Property and New Ground Capital to invest in a new housing development at Hobsonville Point in Auckland. Kerepeti, as the development is now known, is located across two super lot sites totalling two hectares called Kerewhenua (111 homes) and Uku (97 homes). Each super lot will consist of a mix of apartments, terraced homes and walk up apartments, with around 70% of the total properties priced under the Auckland median house price and 30% of the total properties being priced at 600k or less, in keeping with the Hobsonville Point affordable homes Axis Programme.

Construction began in early 2017. The construction programme is expected to progress quickly, with the first homes to be completed by early next year and available for sale off-plan from October. The development as a whole is due to be completed by the end of 2018.

102-10

CASE STUDY
NO. 1

Kiwibank

In October 2016, the Fund acquired a partial stake in Kiwi Group Holdings Limited, Kiwibank's holding company. The deal saw the Fund pay NZ263m to take a 25% stake in Kiwibank, with co-investor ACC taking 22%. NZ Post retains a 53% majority shareholding.

WHY DID WE INVEST?

Investing in Kiwibank is consistent with our long-standing investment strategy to target transactions of scale in the New Zealand market. With Kiwibank, we were able to use the Fund's unique endowments, including a long-term investment horizon, sovereign status, and ready access to capital, to leverage our preferred partner status and attain the stake at an attractive price.

Investing in Kiwibank gives the Fund direct exposure to the New Zealand banking sector, a sector characterised by high profitability and favourable industry economics. Since its inception in 2002 Kiwibank has grown quickly to occupy a competitive market position within the industry, capitalising on a point of difference as a 100% New Zealand owned and operated alternative. Its strong brand, highly engaged team and publicly-recognised value proposition has seen the company grow its market share to 12%, with a customer base in excess of 1 million.

We believe our investment will offer long-term benefits to Kiwibank. As an active investor, we intend to use our significant investment and financial expertise, along with our ongoing commitment to best practice Environmental, Social and Governance (ESG) management to continue Kiwibank's growth and help it achieve its long-term promise. We are also confident that in ACC and NZ Post, we will be working with like-minded organisations with compatible values and a similar, long-term investment approach.

We have appointed Kevin Malloy to the Kiwibank Board. Mr Malloy has had an extensive career in New Zealand and overseas, including 29 years with global media agency Starcom in roles including Global Client Director for both Coca-Cola and P&G. Mr Malloy is currently on the boards of TVNZ, the Halberg Trust, the Graeme Dingle Foundation and St Peter's College Auckland.

IS NZSF ABLE TO SELL ITS STAKE IN KIWIBANK?

ACC and NZSF are not able to sell outside the existing circle of shareholders for a period of five years from October 2016. After that point, if we do wish to sell, the government has the option to buy the shares before they are offered to any third parties.

In Kiwibank we have added another major New Zealand investment to the Fund. We believe Kiwibank will make an important contribution to return over the long-term.

CAPITAL CONTRIBUTION

Regulatory capital is the amount of capital a bank is required to hold by its financial regulator. In New Zealand, this regulator is the Reserve Bank of New Zealand. In April 2017, following a preliminary view from the Reserve Bank that two capital instruments issued by Kiwibank no longer qualified as regulatory capital under their Capital Adequacy Framework, the Fund, together with ACC and NZ Post, pre-emptively injected NZD247m of common equity into Kiwibank. The Fund's share of this contribution was 25%, in line with its shareholding in the company. The capital injection ensured that Kiwibank's capital position would be maintained regardless of the Reserve Bank's final decision on the matter. Kiwibank made some changes to address the Reserve Bank's concerns. In August 2017 the Reserve Bank advised it had no objection to the capital investments as modified and that these investments qualified as regulatory capital. Any capital return to shareholders is a decision for the Kiwibank Board, which is continually assessing the bank's current and future capital requirements.

In June, the Guardians and ACC made a joint submission on the Reserve Bank's issues paper: Review of the Capital Adequacy Framework for Locally Incorporated Banks.

A copy of this submission is available on our website at:
https://www.nzsuperfund.co.nz/publications/submissions.

CASE STUDY
NO. 2

Global and New Zealand Timber and Farm Land

The Fund's minority shareholding in Kaingaroa Timberlands is our largest single investment.

Kaingaroa is managed in an environmentally sustainable manner by Rotorua-based Timberlands Ltd.

Our investment partners in Kaingaroa include PSP Investments and Kakano Investments, a collective of iwi groups which is also part-owner of the underlying land.

As a long-term investor with a known liquidity profile, the Fund is in a good position to look through short-term volatility and invest where others cannot. In our view, both the timber and rural land sectors align well with our endowments and continue to exhibit very strong long-term potential. They are also good diversifiers for the Fund, with low correlation to both bond and equity markets.

TIMBER

The Fund's timber portfolio has delivered strong returns since inception. In New Zealand, the Fund owns a 42% stake in Kaingaroa Timberlands, the owner of the Kaingaroa forest plantation. Located in the central North Island between Taupo and Rotorua, Kaingaroa covers around 180,000 hectares of planted forest, the bulk of which is radiata pine, with a small quantity of douglas fir and other species. Our investment in Kaingaroa Timberlands continued to perform well this year, both in terms of cash returns and valuation uplift.

Outside New Zealand, the Fund holds timber investments in a diverse range of geographies, including Australia, Brazil, Uruguay, Chile, Guatemala and Cambodia, via its investments in two funds, Global Timber Investors 8 and 9. The funds are managed by Global Forest Partners LP (GFP), a specialist timber investor based in New Hampshire. The Fund has also partnered with GFP as a co-investor, including the purchase of a share of some Eucalyptus plantation assets in Western Australia.

The Fund also holds a small interest in a forest estate in the USA managed by Hancock Timber Investment Group. These investments expand the Fund's timber investments beyond New Zealand, helping to diversify our exposure by geography and species.

RURAL

In 2010, the Fund began to invest in rural land. We see rural land as providing additional diversifying benefits to the Fund. We believe we will be able to add value, over the long term, through increases in productivity and application of additional capital. As at 30 June, the Fund owns 22 dairy farms located across New Zealand: in Southland, Waikato, Otago and Canterbury. We settled on a group of seven farms in Southland and one farm in Canterbury over the 2016/17 year.

As a long-term, responsible investor, we take an active governance role and require our farm manager, FarmRight (www.farmright.co.nz), to adopt high standards. FarmRight works to ensure health and safety, animal welfare and environmental systems meet and exceed minimum legal requirements and minimise as much as possible some of the inherent risks involved in farming.

After successfully negotiating several difficult years of a structural low in the commodity cycle, the rural portfolio performed strongly in the 2016/17 financial year. We continue to seek further investment opportunities in other rural sectors, both locally and offshore.

See page 54 for information on the cessation of palm kernel extract use on our farms.

SECTION 02 INVESTMENT REPORT

NEW DIRECT INVESTMENTS

No new international direct investments were made during 2016/17. We consider markets to be fairly expensive and are being discerning about considering further direct investments in the current environment.

The Fund participated in capital raising rounds for its existing investments in waste-to-energy company LanzaTech (**www.lanzatech.com**) and smart glass company View, Inc. (**www.viewglass.com**). Both companies continue to make good progress.

We invested an additional USD10.5m in LanzaTech, bringing total invested capital to USD87m. LanzaTech has continued to develop carbon reduction solutions across a variety of industrial sectors producing fuels and chemicals that can also be processed into higher value applications, including the aviation and consumer goods markets. The major milestone for the company, however, was the commencement of construction for its first commercial plants in China and Europe.

We invested an additional USD40.5m in View Inc., bringing total invested capital to USD137.5m. View Dynamic Glass offers intelligent, electrochromic digitally-connected windows that tint to create more comfortable, productive and energy efficient environments by maximizing natural light, reducing heat and glare and providing unobstructed views.

We are likely to make further follow-on investments in both these companies and Longroad (discussed at page 43), as they mature and their risk profiles change.

WRITE-DOWN OF WIND TURBINE INVESTMENT

US wind turbine company Ogin was wound down after selling its wind turbine platform for applications of 100 kW and above to global wind energy leader Vestas, for an undisclosed amount.

Our NZD47.5m investment in Ogin was written-off in the 2016 financial year and publicly announced in April 2017, at the start of the process to wind down the company.

We invested in Ogin knowing that the company was early-stage and accepted that there was a broader range of possible outcomes associated with the potential for high returns. Our decision to invest was based on a wide range of supporting expert evidence, and we continued to support the company for a number of years. Ogin received independent power curve validation and certification for its wind turbine prototype design. Over time and following market changes, it was, however, unable to raise the growth capital needed to continue towards commercialisation.

The write-off did not have a material impact on Fund returns.

It is important to understand that the Fund may well experience further individual investment write-offs in the future. Expansion capital investments such as Ogin are growth investments that have the potential to add value that is significant at a Fund-wide level, without being detrimental to overall Fund performance in a meaningful way should they not succeed. Such investments make up only a small part of the overall Fund and are an appropriate part of the mix for a long-term investor seeking to maximise returns.

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RETIREAUSTRALIA

RetireAustralia is the fourth largest retirement village operator in Australia. The Fund has invested NZD264m in RetireAustralia, holding a 50% shareholding in the company since December 2014. RetireAustralia's vision is to be the recognised leader in customer-centric retirement communities and care services to make it the first choice for older Australians and their families. In a growing market underpinned by the retiring baby boomer generation, RetireAustralia is continuing to enhance the value proposition of its existing portfolio, building its development capabilities to accelerate the rate of growth and enhancing its services to residents.

HORIZON ROADS

Horizon Roads, in which the Fund has invested NZD396m and owns a 9.91% interest, is a private investment vehicle that acquired listed toll road operator ConnectEast in October 2011. It owns the concession to toll and operate the 39 kilometres EastLink motorway located 25 kilometres east of Melbourne's CBD until 2043. In addition to delivering a strong financial performance since acquisition, EastLink's design and operations help make it the safest motorway in Melbourne. According to GRESB (www.gresb.com), EastLink is a world leader in transport infrastructure sustainability.

Trials of automated vehicle technologies have already identified potential opportunities to improve performance with aligned partners on payment gateways, intelligent congestion management and freight platooning.

BLOOM ENERGY

The Fund invested USD100m investment in fuel cell manufacturer Bloom Energy in 2013. Milestones reached by Bloom during the year included the formation of a partnership with GAIL, India's leading natural gas company.

LONGROAD

In October 2016, the Guardians, in conjunction with Infratil Limited, announced an investment in Longroad Energy Holdings, a renewable energy development and operating vehicle headquartered in Boston, Massachusetts.

Longroad's focus is primarily in the development of utility-scale wind and solar generation throughout North America. As at 30 June 2017, the Fund had invested USD25.3m in Longroad. In addition to development projects, we expect Longroad to provide an option for further investment in stable, low-risk operating assets. The potential investment targeted for development expenditure is up to USD100m.

Longroad is a way for the Fund to access the global renewables sector and the shifting trend to clean energy in the United States. The investment is managed on our behalf by investment management firm H.R.L. Morrison & Co.

SECURITIES LENDING

In May 2017, the Fund appointed State Street Bank and Trust Company as an agent to lend a portion of the Fund's securities in a securities lending programme. The programme began operating in June 2017.

Securities lending is common practice for institutional investors and will help us to earn additional returns from our large passive holdings of equities and bonds. Securities lending involves institutional investors, such as the Fund, lending securities (e.g. shares) to other investors in order to generate revenue.

NZ equities are not part of the securities lending programme. We may withhold or recall securities from lending for voting purposes as outlined in Section 5 of the SIPSP (Responsible Investment) and the Responsible Investment Framework.

OAK FINANCE UPDATE

As outlined in previous annual reports, the Guardians is pursuing legal actions in the United Kingdom and in Portugal, seeking to recover a USD150m loan made through Oak Finance to Banco Espírito Santo and challenge a December 2014 decision by the Bank of Portugal about the loan.

While we won our initial jurisdiction hearing in the United Kingdom in regards to the Oak Finance loan, the UK Court of Appeal later upheld an appeal by Novo Banco, concluding that proceedings should be held in Portugal rather than in the UK. During 2016/17, we received leave to appeal to the English Supreme Court and are co-ordinating with other Oak Finance investors in this regard. A date for the hearing has not yet been set, but we do not expect it to be before the first quarter of 2018.

We are also continuing to pursue our related legal actions in Portugal.

For background information and updates see
www.nzsuperfund.co.nz/publications-disclosures/oak-finance.

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NEW MANDATES*

LIFE SETTLEMENTS

We committed USD200m in Apollo Global Management's third US life settlements fund. The fund closed shortly after year end, which is why it is not shown in the table of Fund investment managers at pages 104-107. The Fund is also invested in Apollo's two previous life settlements funds.

Life settlements are an investment transaction where an insured person sells the pay-out benefit of their life insurance policy to a third party, for a sum greater than the usual surrender value for the policy. The third party maintains the premiums and receives the pay-out when the insured person dies.

Insurance-related investments help diversify the Fund and are a good fit with our long investment horizon. Life settlement returns are not correlated to equities or bonds and are an increasingly common investment for pension funds.

The Fund is also invested in life settlements through a synthetic swap with Credit Suisse.

We are comfortable that the investments are consistent with our Responsible Investment Framework and that key risks relating to transparency and distressed sales are carefully managed.

MERGER ARBITRAGE

BlackRock (www.blackrock.com) was appointed to a USD200m merger arbitrage mandate. This is the second merger arbitrage mandate we have awarded; we also appointed Ramius (www.ramiusmutualfunds.com), to a USD200m mandate, in the 2015/16 financial year.

Merger arbitrage aims to earn steady returns over the long-term by realising value from targeted merger and acquisition deals across a broad cross-section of industries while managing any risks, including the potential for individual deal failure.

The Fund's relationship with BlackRock, which dates from 2010, is a good example of our approach to knowledge-sharing partnerships with external investment managers. We started working with BlackRock simply to get passive equity and bond exposure as part of our Reference Portfolio. Given BlackRock's global research capability, over time we have expanded our interactions with them to share knowledge around investment opportunities, responsible investment and global macroeconomic trends. Appointing BlackRock to the merger arbitrage mandate, which is an active investment mandate, marks a new phase in our partnership and is consistent with our preference for fewer, but deeper, manager relationships.

CANYON

The Fund first invested with Canyon Capital Advisors in 2010. This USD100m investment was into the Canyon Distressed Opportunities Fund, a commingled, close-ended fund. That fund's investment period ended in December 2011. In 2016 we again invested with Canyon, putting USD250m into a distressed credit investment mandate alongside Canyon's second commingled Distressed Opportunities Fund. The mandate focuses on distressed credit in North America and Europe.

MANDATES CLOSED

A number of investment mandates were closed during the year. Secured Capital successfully exited all investments in the SCJREP IV Loan Fund, which invested in non- and sub-performing commercial property loans in Japan.

Following the sale of timber assets in New Zealand, we also ended an investment mandate with GMO Renewable Resources and one of our two mandates with Hancock Natural Resource Group.

102-10 * An allocation of capital to a specific manager or activity.

CASE STUDY NO. 3

Factor Investing

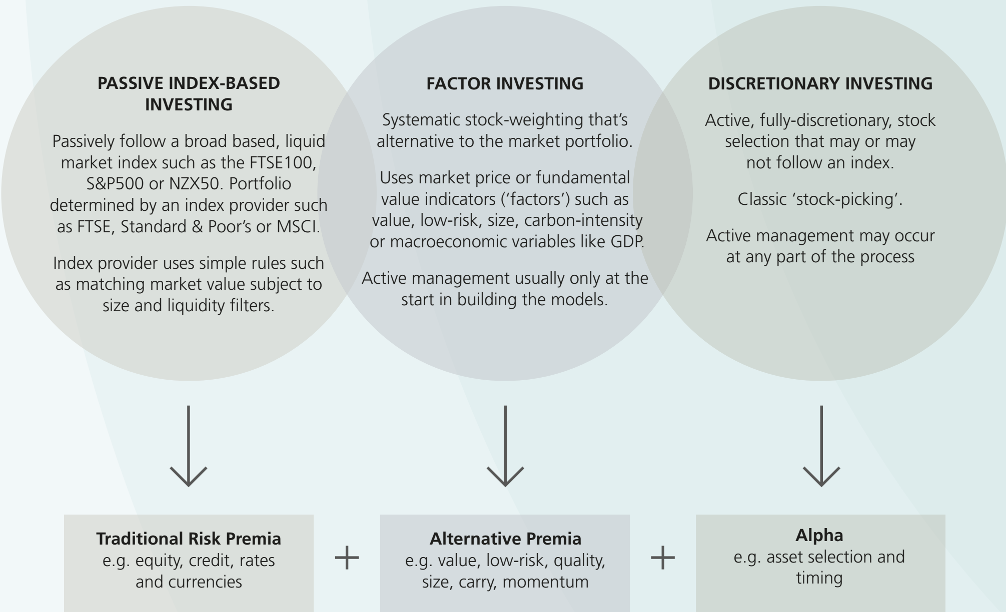
We appointed Northern Trust Asset Management (www.northerntrust.com) to manage two USD300m factor investing mandates and AQR (www.aqr.com) to manage two USD250m factor investing mandates.

Factor investing (shown in the middle circle below) involves systematically constructing an alternative to a passive, market capitalisation index by weighting towards companies possessing pre-determined factors. These factors are expected to deliver superior risk-adjusted returns for investors over the long-term.

There are many different factors that investors can choose to weight their holdings towards.

Our factors strategy targets excess returns from systematically investing in value and low-risk stocks. Value investing involves buying stocks which look relatively cheap on fundamental measures with the expectation they revert to normal levels. A simple example of fundamental measures includes price-to-book or price-earnings ratios. The Guardians uses a combination of such metrics. Low-risk investing involves buying stocks that are below average market risk.

There are many reasons why such investing may yield above-market returns for the same risk. These include the fact that many investors are constrained by liquidity, time-horizon or mandate restrictions. For example, value-investing works on average but can underperform in periods of market stress. This may be above the risk tolerance of investors with shorter time horizons. The Guardians has targeted strategies that are consistent with the Fund's long investment horizon and liquidity profile.



CASE STUDY
NO. 4

Climate Change

In late 2016, we announced a climate change strategy for the Fund, the result of several years' work to identify:

- where carbon emissions and carbon reserves were concentrated in the Fund;
- how best to reduce exposure and carbon risk in the Fund; and
- where to focus our efforts in seeking additional low-carbon and climate-resilient investments that meet our risk-adjusted return requirements.

An important foundation for this work was the 2015 Mercer-led research study, Investing in a Time of Climate Change, which we co-funded.

We found that the bulk of the Fund's exposure to carbon emissions was contained in our global equities portfolio. This is the largest part of the Fund and one with significant exposure to carbon-intensive sectors. Within this, we found that carbon exposures were highly concentrated in a relatively small group of companies.

WHY DID WE NEED A STRATEGY?

It is becoming increasingly clear that in coming years the global economy will transition away from fossil fuels for energy needs. Governments, technology and society are driving an energy transformation. The forces for change include national and global policy, investments in new energy technologies and pressure from society at large.

These forces are likely to disrupt all industries to different degrees, as energy is an input for all industries.

For investors, the shift to a low-carbon global economy creates investment opportunities and presents material risks. Some assets we invest in today may become 'stranded', rendered uneconomic by proper pricing of the carbon pollution externality, made obsolete by new technologies or face a dwindling market as consumers vote with their feet. Investors also need to consider the potential unpredictability of national and global policy initiatives.

Reducing the Fund's exposure to these risks and to the physical impact of climate change is consistent with our mandate to maximise returns without undue risk to the Fund as a whole.

We believe that financial markets currently under-price carbon risk over the horizon that matters for the Guardians' investment purposes. This gives long horizon investors like the Fund an advantage, as we only need to believe that changes *will* occur and can be less concerned with *when* they will occur.

CLIMATE CHANGE INVESTMENT RISK STRATEGY

GOAL A portfolio more resilient to climate-related risks.

TARGETS By 2020: to reduce the carbon emission intensity of the Fund by at least 20%; and reduce the carbon reserves of the Fund by at least 40%.

PRINCIPLES

1 — **Whole portfolio**
Manage climate risks and opportunities of the whole portfolio.

2 — **Consistency**
Be as consistent as we can across all investments (listed and unlisted; active and passive).

3 — **Best tools**
Use the full range of tools available to us. There is no single solution.

WORKSTREAMS

REDUCE — Reduce exposure to fossil fuel reserves and carbon emissions.

ANALYSE — Incorporate climate change into investment analysis and decisions.

ENGAGE — Manage climate risks by being an active owner through voting and engagement.

SEARCH — Actively seek new investment opportunities, for example in renewable energy.

PASSIVE PORTFOLIO TRANSITIONED TO LOW-CARBON

Since we finalised the climate change strategy, we have been in implementation mode, working on all four of the work streams, and particularly on the 'reduce' element. Within this work stream, our first priority was the 40% of the Fund held in global passive physical equities, which was transitioned to a low-carbon approach by the end of the financial year.

The transition resulted in the reallocation of NZD950m away from companies with high exposure to carbon emissions and reserves into lower-risk companies. Passive holdings in 297 companies were sold, meaning we have been able to significantly reduce exposure to carbon while maintaining a good level of diversification – there are still around 6,000 companies in the Fund's passive portfolio. Maintaining portfolio diversification is important if we are to meet our mandate to maximise returns without undue risk to the Fund as a whole and to manage the Fund in line with best practice.

The focus on carbon reduction was based on a bespoke carbon measurement methodology for listed equities, focused on stocks with high carbon footprints without regard to sector. We created rules for including companies in the passive portfolio based on third-party data on carbon emissions and reserves provided by independent investment adviser MSCI ESG Research.

We chose to retain holdings in stocks in the top quartile of MSCI ESG Research's 'Carbon Emissions' score – reflecting less risk and better management than their peers. The decision will help to ensure that the Fund captures the potential investment upside from companies that are well placed to succeed within the rapidly transforming energy sector.

We will reapply our carbon methodology to the passive portfolio on an annual basis and expect to adjust and refine it over time as the available carbon measurement tools and data improve.

Our next priority is to reduce carbon exposure in our active investment portfolio. Shortly after year end, we completed the first step in this, applying our bespoke carbon methodology to the Fund's New Zealand active equity mandates.

We are also continuing to engage with our external investment managers and with the boards and management teams of investee companies on climate change risk and identifying attractive investment opportunities in alternative energy and transformational infrastructure.

CHANGES INCORPORATED IN REFERENCE PORTFOLIO

Because we consider climate change to present material, uncompensated investment risks to the Fund, our bespoke carbon methodology was incorporated into the Reference Portfolio benchmark effective 1 July 2017. We have also taken this opportunity to incorporate our responsible investment exclusions (for tobacco, whaling, nuclear explosive devices, cluster munitions, landmines and individual breaches of standards) into the benchmark.

These changes reflect that if the Fund just invested in the Reference Portfolio, it wouldn't include those stocks. They ensure the Reference Portfolio is fit for purpose given the requirements in our mandate to maximise returns without undue risk to the Fund as a whole and to not prejudice New Zealand's reputation in the global community.

More information on our Reference Portfolio approach is available at: https://www.nzsuperfund.co.nz/how-we-invest/reference-portfolio

CARBON FOOTPRINT

Carbon foot printing is a tool we use to measure carbon exposure across the whole of the Fund.

The 2017 Carbon Footprint, which is based on data from MSCI ESG Research, found that the total Fund's carbon emissions intensity is 19.6% lower, and its exposure to carbon reserves is 21.5% lower than if the changes to our passive equity portfolio hadn't been made. The Fund's global equity exposure to the energy, materials, utilities, industrials and consumer staples sectors has been reduced and its exposure to the telecommunications, consumer discretionary, information technology, health care and financial sectors has increased.

REPORTING

We will report each year in our annual report on our progress towards meeting our 2020 targets and, from next year, against the guidelines published by the Task Force on Climate-Related Financial Disclosures (https://www.fsb-tcfd.org/).

For further information, including the Carbon Footprint, a Q&A and videos explaining the strategy and the transition to a low carbon passive equity portfolio, see: https://www.nzsuperfund.co.nz/how-we-invest-balancing-risk-and-return/climate-change

The Guardians is committed to being a responsible investor. We do this because we believe that environmental, social and governance (ESG) factors are material to long-term returns, both as a source of opportunities and a means of managing investment risks.

Alongside maximising returns without undue risk and best practice portfolio management, our governing legislation requires us to invest the Fund in a manner that avoids prejudice to New Zealand's reputation as a responsible member of the world community.

Our Responsible Investment Framework sets out how we seek to enhance shareholder value and protect New Zealand's reputation. It guides all our responsible investment decision making and activities. Key elements of the framework are summarised below.

INTEGRATION

ESG considerations are integrated across the Fund's activities, with the degree of integration varying according to the nature of each investment. ESG factors are considered when we identify investment opportunities, allocate investment risk, appoint investment managers, undertake due diligence for direct investments, manage our investments and engage with companies.

OWNERSHIP

We are committed to being an active owner of our investments. We use our influence as a shareholder to encourage companies to manage their ESG risks.
We do this by:

- encouraging high governance standards across markets and asset classes, particularly in the New Zealand market.
- exercising our voting rights. In general, we vote according to guidelines set out by an elected proxy voting advisor and applicable good practice standards. In New Zealand we generally vote in line with the New Zealand Corporate Governance Forum guidelines.
- monitoring and engaging with portfolio companies when we identify companies that have breached – or might breach – recognised ESG standards. If engagement is ineffective, we may make a decision to exclude that company. However, in most cases, we believe that engagement is the best tool for encouraging companies to improve their behaviour. Exclusion is a last resort.
- taking a substantial interest in the management of ESG issues with companies in which we have a significant stake; and
- employing an engagement service provider, Bank of Montreal (BMO), to engage on behalf of the Guardians.

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EXCLUSIONS

Our governing legislation requires us to have an ethical policy. This has been implemented through specific exclusion categories. Our current product exclusion categories cover the following:

- manufacture of cluster munitions;
- manufacture or testing of nuclear explosive devices;
- manufacture of anti-personnel mines;
- manufacture of tobacco;
- processing of whale meat.

In addition, we have a company-specific category of exclusions based on breaches of ESG standards.

DISCLOSURE

Our integration and ownership activities are dependent on access to relevant ESG information. Therefore, we engage with investee companies and other relevant organisations to encourage disclosure on ESG and performance. We then encourage our investment analysts and managers to use this information to make more informed investment decisions.

COLLABORATION

We participate in relevant international and local investor groups where we believe working collaboratively will help deliver better ESG outcomes. These groups include:

- United Nations Principles for Responsible Investment (UNPRI);
- CDP (Carbon Disclosure Project);
- Investor Group on Climate Change Australia/New Zealand;
- International Corporate Governance Network;
- Responsible Investment Association of Australasia;
- Australian Council of Superannuation Investors; and
- New Zealand Corporate Governance Forum.

BENCHMARKING

We benchmark our performance against international standards and initiatives including:

- International Forum of Sovereign Wealth Funds' Santiago Principles (see page 101);
- Sovereign Wealth Fund Institute Transparency Index (see page 101);
- UNPRI (www.unpri.org) – the internationally accepted benchmark for how institutional investors should manage environmental, social and governance issues. Our responsible investment work programme is aligned closely to its principles and priorities. On pages 52–53, we provide a report of our activities against the six UNPRI principles during 2016/17, and on page 53, we outline the Fund's performance in the UNPRI's annual benchmarking process;
- Global Reporting Initiative (GRI) sustainability reporting guidelines.

ACHIEVEMENTS AND PRIORITIES

Key priorities this year were the implementation of our climate change strategy, reviewing our listed equity voting policy and continuing to embed RI responsibilities, skills and processes into the investment team.

Next year, we will focus on:

- continuing the implementation of our climate change strategy;
- strengthening ESG integration across the investment team; and
- implementing the revised listed equity voting policy.

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Responsible Investment in the Private Markets:

ANNE-MAREE O'CONNOR
HEAD OF RESPONSIBLE INVESTMENT

Q+A WITH THE HEAD OF RESPONSIBLE INVESTMENT

The Guardians seeks to actively identify and manage ESG factors across the whole Fund. Over the last financial year, the Responsible Investment team undertook ESG due diligence on five new investment opportunities and three existing managers where investment exposure was increased. The investment team sent ESG due diligence questionnaires to 27 managers and reviewed the RI capabilities and scores of 29 managers.

The Responsible Investment team is headed by Anne-Maree O'Connor. Anne-Maree's knowledge and expertise are highly regarded in the investment community, and she has served on numerous committees and expert panels. She has worked extensively with the United Nations, and currently sits on the policy committee for the United Nations Principles for Responsible Investment (UNPRI). She is also on the board of the Responsible Investment Association Australasia and was a driving force behind the establishment of the New Zealand Corporate Governance Forum in 2015.

Anne-Maree was named the winner of the Board and Management category at the 2017 Women of Influence Awards.

In this Q&A, Anne-Maree talks about our approach to managing ESG factors when investing in the private markets.

How material are ESG risks to your decision to invest?

ESG due diligence on potential investments is an important part of our process. This reflects our investment belief that ESG factors are material to a company's long-term performance. As we see it, companies with good ESG management are likely to outperform their competitors.

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When carrying out ESG due diligence, our investment teams look to identify material risks. If we believe the risks identified cannot be managed post-investment, we may choose not to pursue the investment. If, on the other hand, we have confidence that we can be a part of the change process, we consider whether we're going to be able to add value to that asset over time. As with everything else you consider when investing in the private markets, it's a matter of value-add. We're not just along for the ride.

What kind of process do you go through when evaluating ESG risks or opportunities for a prospective new investment?

First, we need to make sure we have a firm understanding of the industry, sector or asset class. This will involve extensive research and analysis in the office, as well as site visits where we go out and meet the teams. Having a firm grounding allows us to be more targeted in our questions – we can narrow down our focus to the most relevant, material issues facing the company.

As a part of this, we will identify whether there are any risks that warrant external advisors, an environmental or safety consultancy for example. We may identify whether customers have done detailed due diligence and how the company responded. This also gives us an understanding of how important these issues are to a company's customers.

We also carry out a review of the company's governance framework and management's awareness of ESG issues. This helps us to understand to what extent things are being taken care of top down versus purely bottom up, or not at all.

If we are investing through a private markets' manager, then we expect them to go through a similar process. Since private equity managers focus on governance, management quality and business risks or opportunities, they can integrate ESG issues relatively naturally.

What trends have you seen in how willing and able external managers are when it comes to integrating ESG into their investment processes?

There has been a significant shift over the last 10 years. When I first arrived at the Guardians, managers thought that ESG considerations in their investments fell outside their remit. It was difficult to include any reference to ESG in mandates, and it was unusual to do so in manager selection.

There's been a significant shift in mindset. We've moved from 'this isn't an issue we need to know about – and neither should you' to 'this is a requirement in our mandate and we need it to win business' to today where managers also see ESG integration as a value-add and part of good practice. Private market managers are now driving the development of best practice guidelines through organisations like UNPRI.

What kind of reporting do you require of external managers in the private markets?

ESG reporting has become more sophisticated over time, but it depends on how tangible, direct and material the ESG issues are to the organisation in question. Reporting can range from the UNPRI annual assessment report to really specific information on management systems such as targets, safety data or environmental performance.

In markets where the risks are higher, such as some of our emerging markets, we've needed to work with managers to increase their awareness of the types of issues to manage and how we want them reported. This might involve helping our managers get the right external advice: introducing them to consultants or certification type expertise that they can use when assessing the assets they are investing in.

There is an aspect of 'long arms' reaching into the assets through managers. Today this kind of approach has become an expectation, largely thanks to the significant adoption of UNPRI's principle on ESG integration.

How do you incorporate ESG issues into your own internal decision making?

Within our organisation, we have a small team specialising in responsible investment. Over time, their roles have evolved to include support for integrating ESG into senior investment professionals' skills and responsibilities.

This enables the RI team to focus on trickier, or new types of ESG risks, and to develop appropriate guidance for different asset classes. This is really important in assisting our investment professionals when they're out in the field conducting their due diligence on managers or direct investment assets.

Once you've decided to invest, how do you engage with boards and management on ESG issues?

When we're going into co-investment situations or sitting on boards of companies in which we have a direct investment, we seek agreement in principle that companies develop and meet best practice on ESG. This way, you've got the shareholders and board aligned that this is an important part of what we do and that this will add rather than detract value over time.

One of the challenges in engaging with boards is that typically there is a lot on the agenda in the early stage of the investment. However, if you set the governance up properly, ESG policies and reporting flows from that. That way the management team can just get on with executing those policies in the best way for the company.

What is an example you can give of where the Fund has successfully used its influence to improve the management of an ESG issue in a private markets investment?

We have developed a good RI rating process for all our external managers. This helps our teams benchmark good practice, identify areas for improvement and engage with the manager to address areas of underperformance over time. This helps to build continual improvement into our private markets portfolios through manager relationships.

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PRINCIPLE

Report against UNPRI principles*

1. **INTEGRATION**

We will incorporate ESG issues into investment analysis and decision-making processes.

Achievements for 2016/17:

- Implemented the 'reduce' phase of the Fund's four-part climate change strategy: transitioned to a low-carbon passive equity portfolio by undertaking a material sell-down of physical holdings in companies with the highest exposures to greenhouse gas emissions.
- Incorporated climate change considerations in the ESG clauses of two new manager mandates.
- Integrated climate change considerations into the Risk Allocation Process (RAP).
- Received an AAA rating in the latest Asset Owners Disclosure Project Global Climate Index, ranking at 15 in its list of top global asset managers. The report covers 500 of the world's biggest asset owners and rates them in terms of their strategies in responding to the risks from climate change.
- Reinvigoration of responsible investment training and education across the team, including induction training sessions for new employees and participation in the UNPRI Academy. As at 30 June 2017, 35 of our investment staff have successfully completed the UNPRI's RI Academy.

2. **ACTIVE OWNERSHIP**

We will be active owners and incorporate ESG issues into our ownership policies and practices.

Achievements for 2016/17:

- BMO continued to expand its engagement across our portfolio and deepen its focus on key themes.
- Participated in New Zealand corporate governance meetings and working groups.
- Refreshed palm oil research and engagement project (see page 54 for case study), including UNPRI site visit to palm oil plantation in Indonesia.
- Signed a letter to the G20 Leaders requesting they ratify the Paris Agreement swiftly, double global investment in clean energy, strengthen climate disclosure, adopt carbon pricing and phase out fossil-fuel subsidies.
- Reviewed securities lending and global voting policy practices (ongoing).

3. **DISCLOSURE**

We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Achievements for 2016/17:

- Lodged submissions, on behalf of the Guardians and the New Zealand Corporate Governance Forum, to the NZX in regard to the revised Corporate Governance Code. The new code incorporated a number of our recommendations.
- Hosted a Carbon Disclosure Project workshop for institutional investors in Auckland.
- Requested that the IGCC, UNPRI and BMO provide submissions to the recommendations of the Taskforce on Climate-Related Financial Disclosures (TCFD).
- Participated in a working group as part of the New Zealand Corporate Governance Forum with the objective of improving ESG disclosure in New Zealand companies.
- Participated in a focus group on integrated reporting.

4. **BEST PRACTICE AND COLLABORATION**

We will promote acceptance and implementation of the Principles within the investment industry.

5. We will work together to enhance our effectiveness in implementing the principles.

Achievements for 2016/17:

- Completed UNPRI benchmarking assessment, achieving A+ rating for strategy and governance and either an A+ or an A for all other modules (see page 53).
- Hosted the International Forum of Sovereign Wealth Funds (IFSWF) annual conference. The meeting theme was 'Investing in a Climate of Change: The Sovereign Wealth Fund Response'. It featured prominent international speakers discussing the world economic context and the impact of climate policy on investment. It also included workshops on divestment strategies (tobacco, cluster munitions). We invited the Chair and a Director of the UNPRI to speak at the conference, providing the opportunity to promote the UNPRI.
- Sponsored business and human rights training for staff and Board members, in conjunction with the Human Rights Commission, as well as the RIAA NZ Benchmark Report and annual RIAA NZ Conference.
- Spoke on RI topics at a number of forums, including the Australian Council of Superannuation Investors (ACSI) annual conference, the i3 conference for Pacific Island asset owners and funds and a Philanthropy NZ conference for charities and community trusts.
- Hosted a UNPRI signatory meeting for New Zealand signatories.

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* Achievements are over and above implementing day-to-day responsible investment activities.

6. **COMMUNICATION**

We will each report on our activities and progress towards implementing the principles.

Achievements for 2016/17:

- Won Gold Award and Governance Reporting (Public Sector) Award at the 2017 Australasian Reporting Awards.
- Finalist in Global RI Reporting Awards.
- Sixth annual report against GRI criteria.
- Underwent an internal audit on our UNPRI assessment response (pre-submission).

UNPRI Benchmarking Report

The UNPRI supports signatories' efforts in their implementation of the Principles for Responsible Investment through an annual reporting and assessment process based on standardised indicators. Reporting is mandatory for all asset owners such as the Fund. We were very pleased to receive an A+ rating from the UNPRI for overall RI governance and strategy and either A+ or A ratings in all other categories in which we reported. We reported against seven categories this year, compared with eight in 2015. We decided not to report on our RI activities as they relate to private equity due to the decrease in exposure to this asset class.

The full UNPRI report is available on our website at:
www.nzsuperfund.co.nz/performance/esg-management

Module	Global Median	2017 Level	2016 Level	2015 Level	NZSF Score out of Maximum Possible
Strategy and Governance	A	A+	A+	A+	29/30
Indirect:					
Listed Equity	B	A+	A+	A	38/39
– Fixed income (Sovereigns/Supranationals and Agencies)	C	A	A	Not reported	30/36
– Fixed Income (Corporate Non-Financial)	C	A	A	Not reported	30/36
– Fixed Income – Securitised	E	A	A	Not reported	30/36
– Private Equity	–	Not reported	A	Not reported	–
Direct and Active Ownership:					
– Listed Equity – Incorporation	A	A+	A+	Not reported	Screening: 15/15 Integration: 18/18
– Listed Equity – Active Ownership	B	A	A	A	25/27

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CASE STUDY NO. 5

Palm Oil

Palm oil engagement continues to be a key focus for the Fund.

WHAT IS PALM OIL AND WHAT ARE SOME OF THE MAIN ISSUES WITH ITS USE?

Palm oil is derived from the fruit of the oil palm tree, native to West Africa. Its versatility and high productivity have made it a popular choice in the production of edible oil and consumer products. The WWF estimates that 50% of products in the supermarket contain palm oil, including margarine, toothpaste, lipstick, soap, detergent, chocolate, biscuits and bread.

The increasing use of palm oil is controversial. Unsustainable farming practices at palm oil plantations raise concerns about environmental, human rights and other social consequences of its production. The issues range from, for example, deforestation or the illegal clearing of land, the release of carbon during the conversion of peat lands into palm oil plantations, biodiversity loss and air pollution.

HOW HAS THE NEW ZEALAND SUPER FUND RESPONDED TO THESE ISSUES?

Our Responsible Investment Framework includes an ongoing commitment to engagement as the best way of encouraging companies to change their practices and policies.

We have been part of the UNPRI (United Nations Principles for Responsible Investment) palm oil working group since its inception in 2011. The working group has focused its efforts on palm oil buyers, growers, traders and processors, as well as on the sustainable certification of palm oil through the Roundtable on Sustainable Palm Oil (RSPO). The working group's efforts have focused predominantly on palm oil operations in Malaysia and Indonesia. Specific objectives of the group include:

- improving the transparency and quality of the disclosure related to land ownership and levels of RSPO certification;
- achieving full commitment by companies to no deforestation, no development on peatlands and no human rights violations throughout the entire supply chain;
- improving the traceability of certified sustainable palm oil (CSPO) throughout companies' supply chains in a way that supports a fully segregated supply chain;
- encouraging yield/land efficiency methods to support production growth with reduced need for further plantation expansion.

In mid-2017, the UNPRI working group joined forces with sustainability advisers Ceres to expand engagement on palm oil to include other commodities. Building on the respective undertakings of both organisations in this area, engagement efforts will grow to encompass palm oil, soy, beef and timber, and other regions, such as Latin America. The group will renew its focus on the elimination of deforestation, as well as the resolution of issues related to soft commodity production, such as poor working conditions and land rights.

Over 2016/17, both directly and indirectly (the latter through the UNPRI working group), the Guardians engaged with 18 companies, aiming to improve and promote the certification of sustainable palm oil. Our global engagement service provider, BMO, has also been working to advance sustainable palm oil production practices.

See https://www.nzsuperfund.co.nz/performance-esg-management/engagement-reports for further information.

Over the years that we have been engaging with companies and standard setters, the palm oil industry has been slowly transforming. For the last two years in particular, our engagement insights have been encouraging: we have seen evidence of companies lagging in sustainability commitments responding to our concerns and showing signs of evolution. In addition, sustainability initiatives have gained traction and governments are recognising the imperative to act. For example, in 2016, the Indonesian government implemented a five year moratorium preventing the development of new palm oil plantations in forested areas. The speed of change has also been driven by the devastating Indonesian peat fires in 2015.

Despite this progress, there is still a lot to be achieved. For example, most company commitments to 'No Deforestation, No Peat, No Exploitation' (NDPE) policies are not time bound and are yet to be rolled out across a company's entire operations. Our future engagement efforts will focus on industry standard setting, encouraging companies to improve their policies and practices, and holding companies to account for the sustainability commitments that they have made.

PALM KERNEL EXTRACT

A large number of New Zealand dairy farmers use palm kernel extract (PKE), the waste by-product of the palm fruit, as a supplementary feed for cows. Our farms are mainly a grass-fed system with some supplementary feed which includes PKE. In response to increased concern about the palm oil industry and difficulties in sourcing supplies of sustainably certified product in New Zealand, we have made the decision to stop using PKE on our farms. We will honour existing contractual arrangements and expect to have eliminated the use of PKE from 1 June 2018.

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Engagement

THE FUND'S ENGAGEMENT ACTIVITIES DURING 2016/17

Engaging with companies helps us to understand how they are managing ESG issues that may affect their business. It is a tool we can employ, as a share owner, to influence a company's management if we identify that it is not adequately mitigating risks or adapting to opportunities.

Voting on resolutions that challenge companies to understand and manage ESG issues is another tool to influence change.

Our current global engagement effort prioritise engagements with companies when there have been incidences of severe environmental damage, human rights abuses and bribery and corruption. This year, we have added a new focus to our engagement priorities: encouraging companies to take action to address climate related risks and manage climate opportunities.

Currently, engagement on behalf of the Guardians is undertaken through the following avenues:

- directly (Guardians staff);
- collaboratively (New Zealand and global);
- through our service provider, BMO.

In addition, our investment managers engage on our behalf.

BMO'S ENGAGEMENT PROGRAMME

Appointing BMO in May 2015 has expanded our engagement reach. On behalf of the Guardians, BMO conducted in-depth engagement with 728 companies, in 44 countries, on a range of ESG issues over the year ending 30 June 2017. They recorded that 185 milestones were achieved over the period.

BMO is also involved in eight thematic engagement projects, involving multiple companies, on a range of topics spanning labour standards, human rights, climate change, operations in sensitive habitats, natural resources and corporate governance.

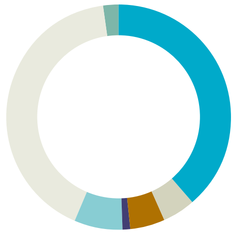
COMPANIES ENGAGED BY COUNTRY

United Kingdom	13%
Continental Europe	19%
North America	26%
Asia (ex Japan)	13%
Japan	15%
Other	14%
Total	**100%**

COMPANIES ENGAGED BY ISSUE

Environmental Standards	39%
Business Ethics	6%
Human Rights	4%
Labour Standards	10%
Public Health	5%
Corporate Governance	29%
Social and Environmental Governance	7%
Total	**100%**

MILESTONES ACHIEVED BY ISSUE



Environmental Standards	39%
Business Ethics	5%
Human Rights	5%
Labour Standards	1%
Public Health	7%
Corporate Governance	42%
Social and Environmental Governance	2%
Total	**100%**

SUMMARY OF BMO ENGAGEMENT ON CLIMATE CHANGE JULY 2016 – JUNE 2017

Stats July 2016 – June 2017	
Number of unique companies engaged on climate change	331
Total engagements	460
Total milestones (see examples below)	183

Sector Breakdown	Total	%
Materials	86	26.0%
Utilities	65	19.6%
Consumer Discretionary	48	14.5%
Industrials	37	11.2%
Financials	31	9.4%
Energy	26	7.9%
Consumer Staples	15	4.5%
Health Care	12	3.6%
Information Technology	10	3.0%
Telecommunication Services	1	0.3%
Total	**331**	**100%**

Examples of milestones achieved by BMO with their climate change engagement include:

- Company committed to develop 2-degree aligned emission reduction targets
- Company strengthened Board expertise on climate risk
- Company developed energy transition strategy
- Company set group-wide carbon emissions reduction target
- Company responded to Carbon Disclosure Project
- Company published details of approach to climate risk management

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GUARDIANS' DIRECT AND COLLABORATIVE ENGAGEMENT

ESG ISSUES	INDUSTRY	OBJECTIVE	NUMBER OF FOCUS COMPANIES		OUTCOMES AND ACHIEVEMENTS
			Direct	Collaborative	
Human Rights and Safety					
Human Rights and Safety	Extractive Industries	The Guardians joined this UNPRI-led collaboration in April 2016. The engagement focuses on encouraging global oil and gas and mining companies to implement the UN Guiding Principles on Business and Human Rights and to improve the level of disclosure of human rights policies and processes.		48	Formal engagement is coming to an end and analysis of the outcomes is currently underway.
	Oil & Gas	Promote protection of human rights and improved management of local community relations/impacts.	1		Awaiting a response from the company.
	Mining	Promote protection of human rights, safety and improved management of local community relations/impacts.	1		Improved reporting on the management of human rights
Severe Environmental Damage					
Palm Oil	Palm Oil growers	Improve and promote sustainable palm oil practices.	5		Of the direct engagements, three have committed to improve practices and we are monitoring these. One provided a response that was insufficient. One has not responded. Engagement is ongoing.
		The Guardians has been participating in this UNPRI collaboration since 2011. Over the years, the working group has focused its efforts on palm oil buyers, growers, traders and processors, as well as on sustainable certification of palm oil through the Roundtable on Sustainable Palm Oil (RSPO).		13	The palm oil industry is slowly transforming. From mid-2017, the UNPRI working group will expand its focus to the more broad topic of deforestation. Palm oil will remain a key focus.
Climate Change					
Climate Change	Cross-sector	The Guardians joined this UNPRI-led collaboration in August 2016. The engagement focuses on improving the carbon footprint disclosure of companies.		126	Formal engagement ended in June 2017 and analysis of the outcomes is currently underway.
	Energy & Utilities	The Guardians joined this UNPRI led collaboration in early 2017. The engagement aims to strengthen understanding and management of the risks associated with methane in global investor portfolios and influence companies to measure, manage and reduce their methane emissions and improve disclosure.		42	The collaboration began in April 2017 and is expected to end in 2019.
	Cross-sector	As a signatory to CDP's investor climate change programme, we seek to increase the number of companies reporting on climate change emissions and risk management.		5,856	The response rate by companies where climate change information was requested was 41%. Companies from 87 countries responded to the request.

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ESG ISSUES	INDUSTRY	OBJECTIVE	NUMBER OF FOCUS COMPANIES		OUTCOMES AND ACHIEVEMENTS
			Direct	**Collaborative**	
NZ Engagement					
ESG Management	Cross-sector	Promote good practice in corporate governance and environmental and social management.	19*		Over the last year, the Active NZ Equities team engaged with investee companies on issues including board composition, remuneration, ESG disclosure and sustainability. Some progress on director nominations, board assessment processes and company disclosures are at least partly the result of our engagement. Our focus on climate change as a topic for engagement has increased.
Reporting					
Sustainability Reporting	Banking	Improve awareness of material sustainability issues	1		The company is seeking input from a number of stakeholders.
		Total companies engaged	**26**	**229**	

* Note that some companies may be engaged with more than once.

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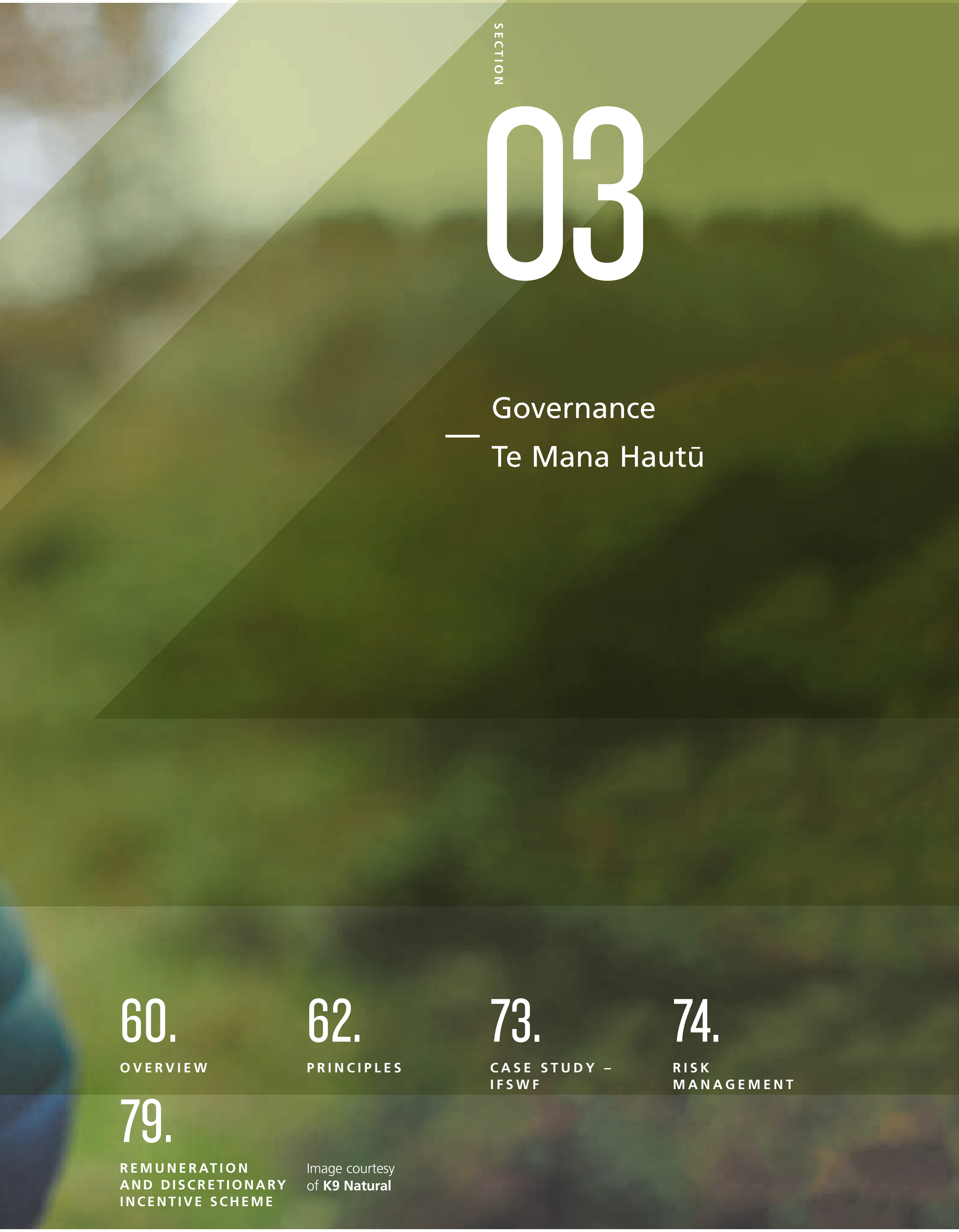
We believe corporate governance in New Zealand should be up with the best in the world. We actively promote best practice corporate governance to support the long-term health of our local capital markets.



SECTION

03

Governance — Te Mana Hautū

60. OVERVIEW

62. PRINCIPLES

73. CASE STUDY – IFSWF

74. RISK MANAGEMENT

79. REMUNERATION AND DISCRETIONARY INCENTIVE SCHEME

Image courtesy of **K9 Natural**

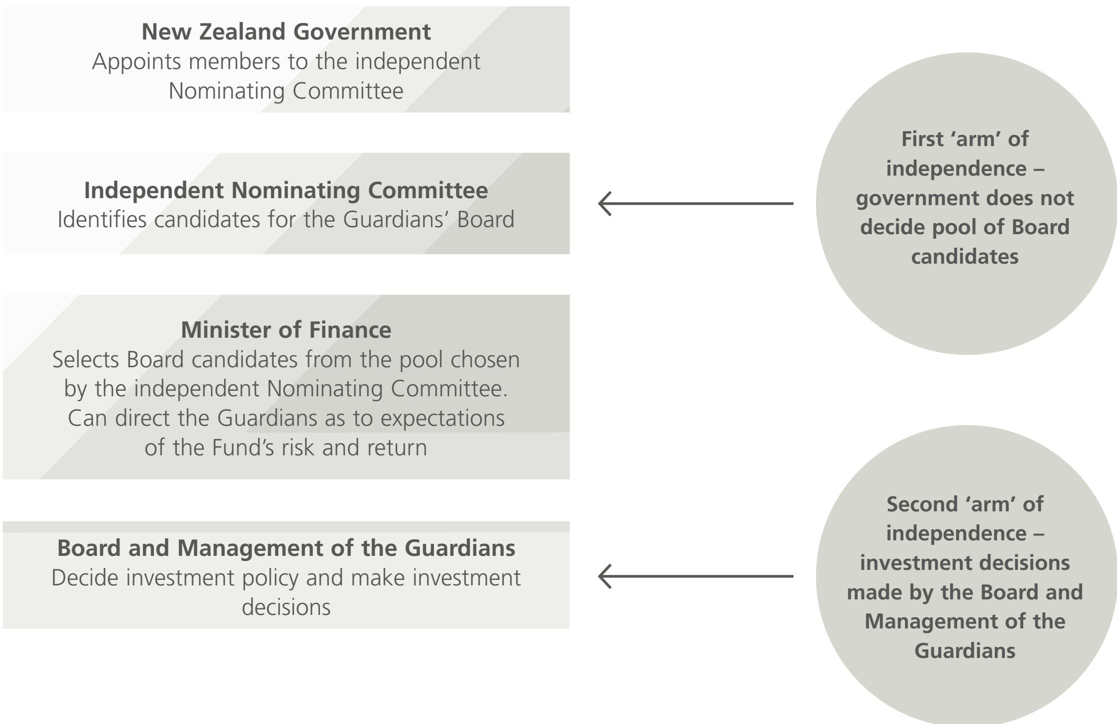
The Guardians has been vested with the powers and responsibilities to allow it to perform its investment mandate. In turn, sound governance and quality public reporting, with a high degree of transparency, are critical to maintaining stakeholder confidence in the Guardians and the Fund.

The Guardians has a governance framework that:

- exemplifies best practice in the operation of a sovereign wealth fund;
- ensures investment decisions are made on a purely commercial basis;
- reflects the New Zealand Financial Market Authority's corporate governance principles;
- has a strong focus on transparency, legislative compliance, risk awareness and ethical behaviour; and
- provides clarity over accountability, roles and responsibilities.

GOVERNANCE FRAMEWORK

As an autonomous Crown entity, the Guardians is legally separate from the Crown and operates at 'double arm's length'. The functions of the Guardians are to manage and administer the Fund. The Fund is a pool of Crown assets but is not an entity in its own right.



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HOW WE IMPLEMENT GOVERNANCE

The way that governance is implemented at the Guardians and Fund is recorded in the Board Charter (including the Board Code of Conduct) and the following organisational policies:

Great Team
- Our Policies -
Communications
Diversity & Inclusiveness
Human Resources
Procurement & Outsourcing
Risk Management
Travel & Sensitive Expenditure

Best Portfolio
- Our Policies -
Derivatives
Direct Investments
Externally Managed Investments
Investment Risk Allocation
Investment Valuation
Portfolio Completion & Internally Managed Securities
Strategic Tilting

Delegations
Statement of Investment Policies, Standards and Procedures (SIPSP) including Responsible Investment Framework

Consistent with our commitment to transparency, the Board Charter, SIPSP and the Guardians' policies are available on www.nzsuperfund.co.nz.

BOARD CODE OF CONDUCT

The Board Code of Conduct (the 'Code') sets out the standards for appropriate ethical and professional conduct for members of the Guardians' Board. It reflects the Crown Entities Act and the expectation that Board members have the highest level of integrity and ethical standards. The Board Chair is responsible for monitoring compliance with the Code. Under the Code, it is the collective responsibility of the Board to ensure that the Guardians:

- acts in a manner consistent with its objectives, functions and Statement of Intent;
- performs its functions efficiently, effectively and consistently with the spirit of service to the public;
- operates in a financially responsible manner; and
- complies with the legal requirements regarding subsidiaries and other entities.

Each Board member's individual duties include:

- exercising appropriate care, diligence and skill that a reasonable person would exercise in the same circumstances taking into account the nature of the Guardians, the nature of the action, the position of the member and the nature of their responsibilities; and
- not disclosing information obtained in their capacity as a Board member, with some limited exceptions.

Among other items, the Code notes the desirability of having Board members with relevant investment skills and work experience, and provides detailed guidance to Board members on disclosing and managing actual or perceived conflicts of interest. The Board Code of Conduct was fully complied with in 2016/17.

STAFF CODE OF CONDUCT AND SECURITIES TRADING PROCEDURE

Our Human Resources Policy includes our employee Code of Conduct. Among other provisions, the Code of Conduct requires all staff members and contractors to:

- keep all non-public information confidential;
- not benefit from the possession of confidential information for personal gain;
- disclose conflicts or possible conflicts of interest; and
- comply with the law.

The Human Resources Policy includes a detailed Securities Trading Procedure that aims to reduce the risk of the Guardians, staff or contractors breaching the Financial Markets Conduct Act, or similar legislation. It does this by providing guidance on the law and the consequences of breaching it and by setting rules about information flows and trading. Staff members must seek permission in advance before trading securities and in the New Zealand dollar currency (over a threshold), and each quarter all staff are required to disclose any personal trading they have undertaken. For further information on our Human Resources Policy see pages 88–93. There were no major non-compliance issues in 2016/17.

All our policies including the Board Charter (which includes the Board Code of Conduct) and the Human Resources Policy are available at www.nzsuperfund.co.nz/publications/policies

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This section reports on the Guardians' governance framework in relation to each of the Financial Markets Authority's corporate governance principles in the year to 30 June 2017.

1. Ethical Standards

Directors should set standards of ethical behaviour, model this behaviour and hold management accountable for delivering these standards throughout the organisation.

Both the Board and employees have Codes of Conduct clearly setting out the ethical standards expected at the Guardians. The codes, which are discussed further on page 61, address:

- professional conduct and duties of Board members and employees;
- conflicts of interest;
- confidentiality;
- securities trading obligations;
- use of Guardians' information and assets;
- fair dealing;
- gifts and hospitality; and
- political participation.

Board members and employees must at all times act honestly and in good faith and in the best interests of the Guardians. As part of the employee Code of Conduct, the Guardians has adopted a policy for employees to report instances of suspected breaches of laws or wrongdoing by the Guardians and/or any of its employees without fear of adverse consequences and for such reporting to be properly investigated.

The Guardians' expectations concerning the giving of gifts, koha and donations is set out in its Travel and Sensitive Expenditure Policy (which can be found at www.nzsuperfund.co.nz/publications/policies).

CONFLICTS OF INTEREST

For Board members, actual or potential conflicts of interest are managed in accordance with the requirements of the Guardians' governing legislation and the Board Code of Conduct. The codes of conduct are reviewed regularly as part of the Guardians' Legislative Compliance Framework. To access a copy:

- Board Code of Conduct: www.nzsuperfund.co.nz/nz-super-fund-explained-governance/board
- Human Resources Policy (including Employee Code of Conduct): www.nzsuperfund.co.nz/publications/policies.

As well as disclosing actual interests in transactions, Board members must disclose matters that may give rise to an interest. Board members with an interest in a matter may not vote on it or participate in discussions about it.

The Guardians' approach to managing conflicts of interest is to treat a former role of a Board member as continuing to be a relevant interest for a period of time after the role ceased. The relevant period will depend on the circumstances (for instance, how long the Board member was in the role) but may be up to two years.

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2. Board Composition and Performance

To ensure an effective Board, there should be a balance of independence, skills, knowledge, experience and perspectives.

The skills and attributes required for a person to be a Board member are set out in the Act.

Board members are chosen for their experience, training and expertise in the management of financial investments, as well as their collective mix of complementary skills. Board members are appointed by the Governor-General on the recommendation of the Minister of Finance. The Minister's recommendation follows nominations from a committee, independent of the Guardians, which is established by the Minister. On receiving those nominations, the Minister consults with representatives of other political parties in Parliament before recommending the Governor-General appoint a person to the Board.

The Board must comprise at least five, but no more than seven, members. Each Board member is appointed for a term of up to five years and is eligible to be reappointed.

The first Board members were appointed in August 2002. The Board composition at 30 June 2017 is set out on page 22.

The Guardians' governing legislation and the Board Charter define Board responsibilities, responsibilities of individual members, matters reserved for the Board and matters delegated to management. Details of individual Board members' backgrounds and the Board Charter are available on our website at **www.nzsuperfund.co.nz/nz-super-fund-explained-governance/board**.

The Board is responsible for:

- supervising the management of the Guardians and the investment of the Fund;
- establishing the Guardians' objectives, corporate strategy for achieving those objectives, the overall policy framework within which the business of the Guardians is conducted and monitoring management's performance with respect to these matters;
- ensuring the Fund's assets and the Guardians' assets are maintained under effective stewardship;
- ensuring that decision-making authorities within the Guardians are clearly defined, that all applicable laws are complied with and that the Guardians is well managed; and
- establishing the level of risk undertaken by the Guardians.

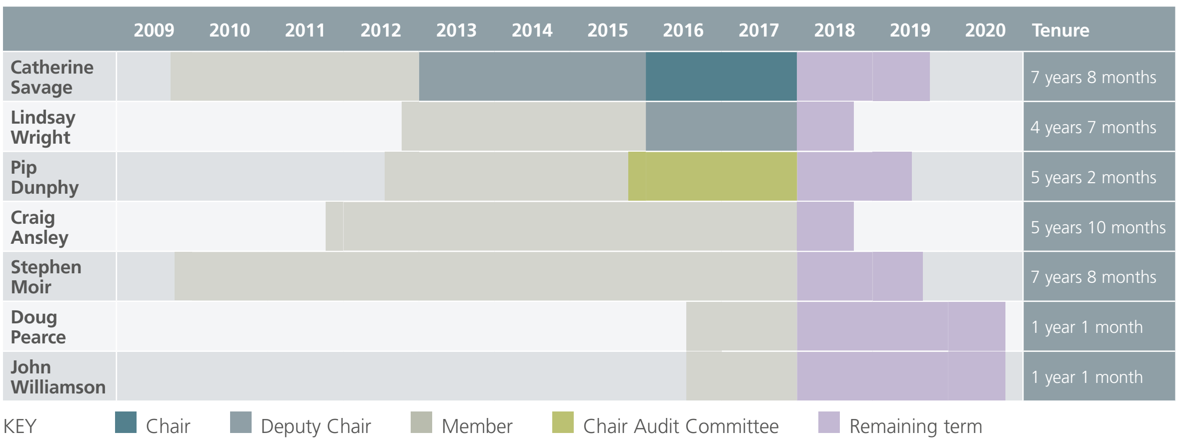
While the Board has responsibility for the affairs and activities of the Guardians, in practice the Board operates through delegation to the Chief Executive Officer and other executives who are charged with the day-to-day leadership and management of the Guardians. The Board maintains a formal set of delegated authorities, which clearly define the responsibilities that are delegated to management and those that are retained by the Board. There are some matters which, either because it is required by law or because the Board has decided it is in the interests of the Guardians to do so, are decided only by the Board as a whole. The Board regularly reviews its delegations and governance priorities. A copy of the Guardians Delegations Policy is available at **https://www.nzsuperfund.co.nz/publications/policies**.

There is a formal induction programme for new Board members, including education sessions at the Guardians' offices, one-on-one sessions with the Leadership Team and comprehensive induction papers. An ongoing education programme for Board members ensures they have the skills and expertise needed to discharge their responsibilities. The topics and calendar for the Board education programme are approved by the Board. The Board also hears directly from a range of external experts on relevant topics (e.g., investment markets and cyber security). The Board also has the opportunity to visit international peer funds or attend international forums to assess developments in best practice.

The Board Secretariat is accountable to the Board for governance matters. All Board members have access to the Board Secretariat on matters relating to the conduct of the Guardians' affairs and the corporate governance of the Guardians, and on any matter pertaining to the Board Charter. The Board Secretariat is managed by the General Counsel.

The performance of the committees, Board and individual members is evaluated at regular intervals, at least once every two years. The Board and committees undertake either self-evaluation or use an outside specialist.

BOARD TENURE (AS AT 30 JUNE 2017)



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BOARD SKILLS

The following table identifies the skills needed and possessed by the Guardians' Board. These skills reflect the purpose and mandate of the Guardians and the Fund. Not all Board members will or should possess skills in all areas – it is the strength of the entire Board that matters. Effective teamwork within the Board and between the Board and management is also important. Under the Act, all Board members are required to have substantial experience, training and expertise in the management of finance and investments. Refer to the Board biographies on **www.nzsuperfund.co.nz/nz-super-fund-explained-governance/board** for details on individual experience.

Corporate Governance	Supports strong Board and management accountability, values transparency and execution of the Fund's mandate
High Level of Financial Literacy	To understand complex financial, economic and investment concepts and oversee financial reporting and internal controls
Investments and Commercial Acumen: Financial Markets/Commercial Expertise/Academic	Necessary to evaluate the investment strategies and to set the Fund's risk appetite and Reference Portfolio
Leadership Experience – especially Chief Executive/ General Manager	To advise the Chief Executive and provide insight and guidance on key areas such as change management, strategy and culture
Risk Oversight/Management Expertise	To oversee the risk management of the Fund and the Guardians
Talent Management Expertise	Expertise in attracting, motivating and retaining skilled personnel in the context of a fund with long term objectives
Global Investment Experience	Review and understand investment strategies and benchmarking our performance against world best practice

CORE VALUES AND ENDOWMENTS

Core values and endowments that support the strength and effectiveness of the Board include:

- Innovation, inclusiveness, integrity
- Courage
- Constructive culture
- Diversity of perspective

DIVERSITY

The strength and effectiveness of the Board is supported by the diversity of its members. The following attributes inform the diversity of perspectives within the current Board:

- Professional Experience: Academia, Consulting, Banking, Funds Management, Insurance, Sales and Marketing, Manufacturing, Operational
- Academic Disciplines: Actuarial, Accounting, Arts, Economics, Finance, Law, Marketing, Mathematics and Science
- Country Experience: Australia, Canada, China, Germany, Hong Kong, Japan, Korea, New Zealand, Singapore, Thailand, United States
- Gender: Three women and four men
- Age Range: 40s–70s

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BOARD ACTIVITY

MEETINGS AND STRATEGY DAYS

The Board met six times during 2016/17 for scheduled meetings and a further day and a half for a strategy day. The Board also met three times for special meetings on remuneration, and the full Board attended an Audit Committee meeting to review the Guardians' and Fund's financial statements.

A Board education session is generally held before each scheduled Board meeting.

Regular agenda items

Regular items considered at each scheduled Board meeting are:

- Disclosures of interest
- Minutes of the previous meeting
- Matters arising report
- Chief Executive's report
- Dashboard report
- Secretariat report
- General Counsel's report

Other agenda items

Other Board papers cover three broad areas: investment strategy and performance: compliance and risk; and organisational strategy.

Dashboard reporting

The Dashboard report includes:

Item	Frequency
Risk appetite	Monthly
Portfolio performance	Monthly
Risk budgets	Monthly
Strategic tilting and markets update	Each meeting
Investment Committee update	Quarterly
Human resources	Quarterly
Communications	Quarterly
Financials	Quarterly
Derivatives	Quarterly
Counterparties	Quarterly
Liquidity	Quarterly
Collateral management	Quarterly
Risk Committee update	Quarterly
Cyber security	Quarterly

Strategy days

The Board met for one and a half strategy days.
Topics considered included:

- climate change strategy
- talent management, leadership and organisational culture
- the Fund's investment toolkit
- Board effectiveness

The Board also met with the boards of ACC and the Government Superannuation Authority for a combined education session.

KEY ACTIONS DURING THE YEAR

Key activities for the Board during the year and how those activities tie into our Strategic Plan are summarised below.

Strategic Objectives

#1 Best Portfolio
#2 Strong External Relationships
#3 Building and Maintaining a Great Team
#4 Efficiency, Scalability and Innovation

Investment Strategy and Performance	#1	#2	#3	#4
Approved a climate change strategy and consequential changes to the Fund's Reference portfolio composition	•			•
Approved targets for the Fund's carbon footprint reduction	•			•
Considered the active risk budget review	•			•
Annual review of international direct investment and NZ direct investment reports	•			•
Annual review of external investments and partnerships report	•			•
Approved changes arising from the liquidity replenishment system review	•			•
Six monthly reviews of internal investment mandates and portfolio completion reports	•			•
Six monthly reviews of portfolio overview and investment environment reports	•			•
Annual review of responsible investment report	•			•
Review of investment risk allocation framework review	•			•
Compliance and Risk				
Approved the annual review of our Statement of Investment Policies, Standards and Procedures	•			•
Approved the Direct Investments Policy review	•			•
Approved the Portfolio Completion and Internally Managed Securities Policy review	•			•
Considered cyber-security project report				•
Consideration of annual Guardians' health and safety report			•	•
Reviewed six-monthly reports on compliance with policies			•	•
Six-monthly reviews of enterprise risk reports			•	•
Reviewed the external Board evaluation results		•	•	
Organisational Strategy				
Approved changes to the Strategic Objectives metrics	•			•
Confirmed 5-year objectives fit for purpose	•	•	•	•
Approved annual Strategic Plan including the annual budget	•	•	•	•
Approved annual Statement of Performance Expectations		•		
Considered biennial Culture Survey results			•	
Considered annual cost effectiveness measurement review and internal cost reporting				•
Annual review of Chief Executive's performance			•	
Annual review of the remuneration report			•	
Considered and approved the annual report, statement of performance and financial statements for the Guardians and the Fund	•			
Approved leasing additional office space			•	•
Participated in hosting of International Forum of Sovereign Wealth Funds' annual meeting		•		•

3. Board Committees

The Board should use committees where this will enhance its effectiveness in key areas, while retaining Board responsibility.

The Board had two standing committees during the 2016/17 financial year – the Audit Committee and the Employee Policy and Remuneration Committee (EPRC).

The objective of the Audit Committee is to assist the Board to meet its financial reporting obligations and provide independent assurance on financial reporting and the Guardians' risk, control and compliance framework. As well as reviewing the financial statements of the Guardians and the Fund, the Audit Committee reviews the external and internal audit plans and monitors management's implementation of internal auditor recommendations.

The EPRC supports the Board on matters relating to staff and remuneration.

The roles and responsibilities, reporting requirements, composition, structure and membership requirements of each Board committee are set out in the respective committee's terms of reference. Copies of the terms of reference are contained within the Board Charter, available on our website at **www.nzsuperfund.co.nz/nz-super-fund-explained-governance/board**.

Each Committee's terms of reference and performance are periodically reviewed by the Board. Minutes of the committees' meetings are provided to the Board. In addition, all Board members are able to attend any committee meeting. From time to time, the Board may establish a specific subcommittee to address a particular matter or for a particular purpose. This allows the Board to function effectively and to manage conflicts of interest. The Board committees either meet quarterly or are convened as necessary. Each committee is entitled to the resources and information it requires to operate effectively. The Chief Executive Officer and other members of the management team are invited to attend committee meetings as necessary.

The following table sets out the number of scheduled Board and Committee meetings attended by each Board member relative to the total number of meetings they could have attended.

BOARD MEMBER ATTENDANCE AT BOARD AND COMMITTEE MEETINGS

	Board	Audit Committee	EPRC	Total Meetings to Attend	Total Attended
TOTAL NUMBER OF MEETINGS	6	4	4	14	
Catherine Savage (Chair)	6	4	4	14	14
Lindsay Wright (Dep Chair)	6	4	–	10	10
Pip Dunphy (Audit Com Chair)	4	4	–	10	8
Craig Ansley	6	4	–	10	10
Doug Pearce	6	1*	4	11	11
John Williamson	6	2	–	10	8
Stephen Moir	6	1*	4	11	11

* The full Board attends the Audit Committee in its review of the annual financial statements

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BOARD COMMITTEE ACTIVITY

MEETINGS

Audit Committee

The Audit Committee met four times in 2016/17 (once with full Board attendance).

Audit Committee Members

Pip Dunphy (Chair)
Lindsay Wright (Deputy Chair)
Catherine Savage
Craig Ansley
John Williamson

Employee and Remuneration Policy Committee (EPRC)

The EPRC met four times for scheduled meetings and a further four times (twice with full Board attendance) for special meetings on remuneration.

EPRC Members

Catherine Savage (Chair)
Stephen Moir
Doug Pearce

KEY ACTIONS DURING THE YEAR

Audit Committee:

- Reviewing the Valuation Group's report on annual activities and year-end valuations
- Reviewing the annual financial statements for the Fund and Guardians
- Monitoring implementation of remedial actions identified in internal audit reviews
- 'Deep dive' reviews of selected direct investments to reflect the greater valuation uncertainty of unlisted assets
- Ongoing focus on market manipulation monitoring
- Considering private market loans book review
- Considering the Guardians' tax governance framework
- Reviewing the report on NZ equity transition costs and impact
- Reviewing the risk assessment framework for the audit finding report

EPRC:

- Monitoring the achievement of strategic objective activities
- Reviewing the company culture survey results
- Ongoing focus on succession planning and key person risk
- Reviewing the CEO's performance and employment terms
- Reviewing the remuneration summary for the team
- Monitoring the bonus programme
- 'Deep dive' reviews of selected business unit talent agendas

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4. Reporting and Disclosure

The Board should demand integrity in financial reporting and in the timeliness and balance of disclosures.

As a Crown entity, the Guardians must meet all its obligations in respect of the Guardians and the Fund under the Act, the Crown Entities Act 2004 and the Public Finance Act 1989. The table below summarises the Guardians' reporting requirements.

Three Yearly	Annually	Quarterly to Minister	Monthly	As it happens
Five-year Statement of Intent setting out key strategic objectives and performance measures for the next five years	Annual Statement of Performance Expectations forecasting Fund performance and setting out priority activities for the year	Fund Performance Important developments relating to the Fund	Fund Performance Portfolio composition	Anything necessary to comply with the expectation that we will operate on a 'no surprises' basis with the Minister of Finance
	Annual report, including audited financial statements and a Statement of Performance against the Annual Statement of Performance Expectations Review by Parliamentary Select Committee annually or on request with participation from the Office of the Auditor-General	Important developments at the Guardians	Major listed holdings	Responses to questions from Parliament, media and via the Official Information Act 1982

Copies of our Statement of Intent and Statement of Performance Expectations are available at
www.nzsuperfund.co.nz/publications/statement-intent.

The latest Statement of Intent, setting out strategic objectives and performance measures for the five years from 2016–2021 was published in June 2016. The Annual Statement of Performance Expectations sets out a detailed plan of work and financial forecasts for the coming financial year.

The Guardians' objectives for the 2016/2017 financial year are reported against in the Statement of Performance at pages 99–103 of this annual report.

The annual report, which is tabled in the House of Representatives, is available to the public in hard copy and at **www.nzsuperfund.co.nz/publications/annualreports**. An online microsite is also available at **www.ar2017.nzsuperfund.co.nz/**. The report contains both audited financial statements for the Fund, which are signed by the Chair of the Board and the Chief Executive Officer, and audited financial statements for the Guardians, which are signed by the Chair and one other Board member.

The Audit Committee and Board review the Guardians' and the Fund's financial statements. The Chief Executive Officer and the General Manager Finance and Risk state in writing to the Board that the Guardians' and the Fund's financial statements present fairly, in all material respects, on the Guardians' and the Fund's financial conditions and operational results, in accordance with relevant accounting standards. They are also required to sign off on the adequacy of the systems of internal control. The Guardians was not required to appear before a Select Committee in 2016/17.

The disclosures are available at
www.nzsuperfund.co.nz/publications/disclosures.

The Guardians received twenty requests under the Official Information Act 1982 during 2016/17 (seven in 2015/16).

Copies of the Guardians' responses to Official Information Act requests, where we consider these to be of material public interest, are available at:
www.nzsuperfund.co.nz/publications-disclosures/oia.

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5. Remuneration

The remuneration of Directors and Executives should be transparent, fair and reasonable.

The remuneration of Board members is set by the Minister of Finance operating in accordance with the Fees Framework for Members of Statutory and Other Bodies Appointed by the Crown, and as such is not controlled by the Guardians. Board members' remuneration is disclosed in Note 3(a) of the Guardians' financial statements.

The Guardians' Human Resources Policy includes its remuneration policy. The Employee Policy and Remuneration Committee assists the Board in reviewing the remuneration policy and in setting the Chief Executive Officer's remuneration.

Comprehensive information regarding executive remuneration, including details of the Guardians' discretionary incentive scheme, is disclosed at pages 79–83 and at Notes 3(a) and 3(b) of the Guardians' financial statements.

6. Risk Management

Directors should have a sound understanding of the key risks faced by the business. The Board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.

The Board has a number of strategies to safeguard the Fund's and the Guardians' assets and interests and to ensure the integrity of reporting. This includes the Board's development of a risk-appetite statement outlining its expectations of the level of risk that is appropriate for the Fund to take on. Further information on the Guardians' approach to risk management is contained on pages 35–38.

7. Auditor

The Board should ensure the quality and independence of the external audit process.

The Audit Committee is responsible for overseeing the external audit of the Guardians and the Fund. Accordingly, it monitors developments in the areas of audit and threats to audit independence to ensure the Guardians' policies and practices are consistent with emerging best practice in these areas. The external auditors are not permitted to perform non-audit work assignments without the approval of the Audit Committee. Any non-audit work conducted by the audit firm is disclosed in the financial statements. The Guardians does not appoint the external auditor; this is undertaken by New Zealand's Auditor-General.

Graeme Bennett of Ernst & Young has been appointed to carry out the external audit of the Guardians and the Fund on the Auditor General's behalf. Typically the audit partner is rotated every six years. This is the second year of the new rotation.

Both the external auditor and Head of Internal Audit attend Audit Committee meetings. The Audit Committee meets with the external auditor and Head of Internal Audit independently of management as often as is appropriate, but not less than once per annum for the external auditor and twice for the Head of Internal Audit. The Guardians' Head of Internal Audit has a direct reporting line to the Chair of the Audit Committee.

8. Stakeholder Relations

The Board should foster constructive relationships with stakeholders that encourage them to engage with the entity.

PARLIAMENT AND THE MINISTER OF FINANCE

The Guardians is a Crown entity and its assets, and the assets of the Fund, form part of the Crown's assets. The Guardians is accountable to parliament, through the Minister of Finance, for those assets. A summary of the Guardians' reporting requirements is outlined on page 69. As noted on page 11, the Guardians is an autonomous Crown entity that operates at 'double arm's length' from political stakeholders. This ensures that investment decision making is on a purely commercial basis. The Minister of Finance may give directions regarding the Crown's expectations as to the Fund's performance, including its expectations regarding risk and return. The Minister may not, however, give any direction that is inconsistent with the duty to invest the Fund on a prudent, commercial basis. No directions were received in the 2016/17 financial year. We report on our progress in implementing the single direction received to date (May 2009, about our New Zealand investment activities) on page 35 of this annual report.

Along with the other New Zealand Crown Financial Institutions, the Guardians received an annual Letter of Expectations for 2017/18 from the Minister of Finance on 12 December 2016. This letter and the Guardians' response are available at www.nzsuperfund.co.nz/publications/disclosures.

As well as reporting under the requirements of its legislation, the Guardians also reports under the 'no surprises' protocol with the Minister of Finance. This protocol requires the Guardians to inform the Minister in advance of any material or significant events, transactions and other issues that could be considered contentious or attract wide public interest.

STAKEHOLDER ENGAGEMENT

We continue to implement a three-year communications strategy that was, as described in previous annual reports, developed in 2014/15 based on stakeholder perception research. We continue to refine our communications strategy to improve stakeholder and public awareness and understanding of the Guardians and the Fund.

Specific stakeholder engagement activities undertaken during 2016/17 included:

- hosting the 2016 International Forum of Sovereign Wealth Funds annual meeting (see page 73);
- engaging with iwi to help improve understanding of the Guardians and Fund and create a network of strongly aligned capital owners (see page 72);
- discussions with Treasury officials on topics including climate change investment risk, use of derivatives, NZ investment approach and short selling, and continuing to support Treasury's Crown balance sheet modelling efforts;
- giving 31 speeches to groups ranging from the Global-West Government Funds Round Table to the New Zealand Society of Local Government Managers, including a number of presentations explaining our climate change strategy (see page 46);
- developing an animated video to explain the purpose of the Guardians and the Fund – see it at https://www.nzsuperfund.co.nz; and
- releasing six-monthly reports on the investment environment.

We also repeated a survey to understand the New Zealand public's awareness of the Fund. The results were consistent with the previous year, finding high awareness of the Fund but lower levels of knowledge regarding how it is managed.

PRIORITIES FOR 2017/18 INCLUDE:

- ongoing iwi engagement;
- hosting the International Pensions Conference in Auckland. This annual event brings together a small number of senior representatives of global pension funds to discuss key issues facing the industry; and
- continuing to work with Treasury to support its Crown Asset and Liability Management Project and broader information requirements.

OUR STAKEHOLDERS

In addition to the Crown, parliament and the Minister of Finance, the Guardians' stakeholder groups include:

- asset and investment managers (for a full list of Managers and Custodians see pages 104-107);
- co-investors;
- Crown financial institutions;
- employees;
- investee companies;
- investor groups (e.g., UNPRI);
- iwi;
- media;
- non-government organisations (NGOs);
- peer funds;
- public of New Zealand;
- regulatory bodies in New Zealand and globally;
- relevant New Zealand public sector agencies (e.g. Treasury, Reserve Bank, State Services Commission, Financial Markets Authority, Serious Fraud Office, Inland Revenue, Office of the Auditor-General, Christchurch Earthquake Recovery Agency); and
- suppliers.

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9. Stakeholder Interests

The Board should respect the interests of stakeholders, taking into account the entity's ownership type and its fundamental purpose.

We strive to be as transparent as possible about our management of the Fund and the way the Fund performs. Our stakeholders can access a wealth of current and detailed information easily on our website. This includes:

- information on our purpose and mandate;
- our governance framework and policies;
- how we invest and our approach to responsible investment;
- risk management;
- monthly performance and portfolio reports;
- detailed historical performance figures for the Fund since inception; and
- copies of media statements, speeches, publications and research papers.

We made some minor enhancements to our website in 2016/17, refreshing its Home and News & Media pages to make key information more easily accessible and improve our ability to include video content on the site. We will continue to make incremental improvements to the website over the coming year.

Communications with stakeholders, and the external website, are managed in line with the Guardians' Communications Policy. This policy sets out controls and frameworks to ensure that all our communications are clear and accurate and assist in preserving and enhancing the reputation of the Guardians and of the Fund. A copy of this policy is available at **www.nzsuperfund.co.nz/publications/policies**.

A 2016 report by the Office of the Auditor-General found that "The New Zealand Superannuation Fund did well at clearly writing and communicating to stakeholders about its investment beliefs, policies, and approaches. Public entities could learn from what the New Zealand Superannuation Fund did to make technical information more accessible, understandable, and useable."*

INDUSTRY NETWORKS AND INVESTMENT GROUPS

The Guardians is an active participant in a wide range of industry networks and investor groups and has close working relationships with a number of government agencies, in particular the New Zealand Treasury.

We also put significant effort into managing our relationships with peer funds, investment managers and potential co-investors.

The Guardians continues to be involved in a wide range of global investment and responsible investment initiatives. Groups on which we are represented at Board/governance level include the following:

- International Forum of Sovereign Wealth Funds;
- Pacific Pension Institute;
- World Economic Forum Long-term Investment Council;
- New Zealand Corporate Governance Forum;
- New Zealand Corporate Taxpayer Group; and
- Responsible Investment Association Australasia (RIAA).

We also participate at all levels in the Rotman International Centre for Pension Management, International Pensions Conference, Association of Superannuation Investors, Hedge Fund Standards Board, International Corporate Governance Network, United Nations Principles for Responsible Investment and the Carbon Disclosure Project.

In 2016, we joined industry group Business NZ, with the objective of deepening our connections with major New Zealand companies and as an efficient way of improving our engagement with policy and regulatory matters affecting investee businesses in New Zealand.

MĀORI INVESTMENT FUND

The Fund is involved in a Ngāti Awa and Ministry of Business, Innovation and Employment (MBIE) project to carry out a scoping study and engagement with Māori organisations interested in contributing capital, resources and assets to a Māori Investment Fund. The benefits for us in the scheme are the potential development of a well-aligned domestic co-investor of scale, along with access to Māori-owned investment opportunities and assets.

The project is being funded by MBIE. We are making a contribution through the time of our investment professionals and access to research data.

SPONSORSHIPS

We undertake a limited number of sponsorships in New Zealand to support activities or events that are consistent with, and which positively raise awareness of, our role and responsibilities in managing the Fund.

In 2016/17, we sponsored:

- Business and human rights training, in association with the Human Rights Commission;
- RIAA's Responsible Investment Benchmark Report;
- RIAA's New Zealand Responsible Investment Briefing;
- University of Auckland NZ Superannuation Fund Accounting and Finance Stage III Prize;
- University of Auckland NZ Superannuation Fund Accounting and Finance Final Year Prize; and
- AUT Best Paper Award, Finance Symposium.

We also took steps to establish a scholarship in memory of Guardians' staff member Nicola Crowley, who sadly passed away during the year. Over the next three years, we will support three female students studying digital technology at the Manukau Institute of Technology. The scholarships involve a grant towards course fees, mentoring and internship opportunities at the Guardians.

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* Office of the Auditor-General (2016), *A review of public sector financial assets and how they are managed and governed.*

CASE STUDY
NO. 6

IFSWF

Rt Hon Bill English delivers a key note address on the New Zealand economy at the 2016 IFSWF annual meeting, hosted by the Guardians.

The International Forum of Sovereign Wealth Funds (IFSWF) is a global network of 33 members established by and for sovereign wealth funds (SWFs). Guardians' Chief Executive Adrian Orr was elected Chair of IFSWF in 2015.

Underlying IFSWF membership is a commitment to transparency, accountability and good governance as expressed in a set of best-practice guidelines for SWFs known as the Santiago Principles. The commitment to upholding such principles contributes to the maintenance of a stable, open global financial system with free flows of cross-border capital and investment.

The IFSWF works by encouraging members to share knowledge, benchmark their activities and build partnerships, underscored by their shared commitment to the Santiago Principles. In November 2016, IFSWF's eighth annual meeting was held in Auckland, New Zealand, hosted by the Guardians.

The event presented Guardians staff and guests with an opportunity to meet and strengthen relationships with our international peers. Among the 260 attendees were some of the world's largest and most influential investors, along with observers from multilateral and financial institutions, including the International Monetary Fund and the World Bank. The event also had high level involvement from the New Zealand government. Both then-Prime Minister John Key and then-Minister of Finance Bill English gave keynote addresses on the New Zealand economy.

Other speakers included Glenn Stevens, former Governor of the Reserve Bank of Australia; John Lipsky, former Deputy Managing Director of the International Monetary Fund; Martin Skancke, Chair of the PRI Association; Bob Prince, Co-Chief Investment Officer at Bridgewater Associates; and Mats Andersson, former Chief Executive at Swedish public pension fund AP4.

The theme of the event was 'Investing in a Climate of Uncertainty: The Sovereign Wealth Fund Response', with a twin focus on the risks posed by:

- an investment environment characterised by low growth and low returns;
- climate change, including the interacting drivers of climate change risk for long-term investors.

The event began with a day of technical workshops. The focus of the workshops was broad to accommodate the diverse make-up of the IFSWF membership. IFSWF members include SWFs at various stages of development with a variety of different mandates and investment approaches. Sessions were held on the purpose and practice of sovereign development funds, the insourcing of investment activity and the use of performance measurement and benchmarking. Case studies were also presented on global infrastructure investment and on the divestment of tobacco-related investments from portfolios.

The conference sessions covered a range of investment topics. Alongside sessions on climate risk, there were several panels on the New Zealand economy, the Treaty of Waitangi and indigenous economic development.

While achieving the objectives of IFSWF, the event also presented an opportunity to enhance the profile of the Fund and New Zealand as an international investment destination. The Guardians were named winners at the Asia-Pacific PR Excellence Awards, under the 'Finance' category, for our efforts in organising the event.

Risk is an important part of doing business for any investment fund. We take investment risk in order to achieve our mission. We must also manage other complex non-investment risks. Understanding and managing these risks helps us ensure that the risks taken are appropriate for the returns anticipated.

The Board is responsible for reviewing and approving the Guardians' risk management framework. It does this on a regular schedule that is set out in the Board calendar. The Board also reviews the top risks identified by the Guardians' Risk Committee on a six-monthly basis and the Guardians' Risk Appetite Statement and Risk Assessment Framework on at least a five-yearly basis.

The Guardians has extensive risk management policies, procedures and internal controls for application by staff, external investment managers and other expert service providers. Our approach to managing investment risks is set out in our Statement of Investment Policies, Standards and Procedures and Investment Risk Allocation Policy, both of which are available on **www.nzsuperfund.co.nz/publications/policies**.

The Board has developed a risk appetite statement which outlines the amount of risk that it is willing or comfortable for management to take in order to achieve the business goals of the Guardians. These are the risks the Board can tolerate. The Board expects management to take steps to manage risks within the Board's risk appetite. The full statement can be found at Schedule 2 of the Risk Management Policy.

The Guardians' performance against this statement is measured and reported to the Board on a regular basis, with any major breaches being notified on an exception basis.

The Audit Committee reviews the reports of management, and of the internal and external auditors, on the effectiveness of systems for internal control and financial reporting. The Board delegates day-to-day management of risk to the Chief Executive Officer. Inherent in this delegation is a desire to ensure that day-to-day responsibility for risk management is at the business unit level, where managing risk is seen as part of the overall business process, and a robust framework of risk identification, evaluation, control and monitoring exists.

The Chief Executive Officer and the General Manager Finance and Risk provide confirmation to the Board that their sign-off on the integrity of the financial statements is founded on a sound system of risk management and internal compliance and that control systems are operating efficiently and effectively in all material respects.

RISK REPORTING FRAMEWORK

The Board receives an enterprise-risk, dashboard-style report every six months. This report is derived from the top and emerging risks identified by the Guardians' business units and is facilitated by the Enterprise Risk Team.

Each business unit maintains a Risk Register that identifies the risks that could impact on its specific activities and includes related controls and action plans.

See page 31 for a summary of the Sharpe ratio, a measure of risk-adjusted return.

The table below summarises our risk identification and assessment process:

Activity	Purpose	Outputs	Participants
1. Environmental Assessment	Identify emerging internal and external sources of risk that could impact the business. This forms an input into Business Unit Risk Register refresh.	Summary of main changes affecting the business	Business Unit staff Risk Committee Business Unit Heads Enterprise Risk Team
2. Business Unit Risk Register refresh	Assessment of existing and potential emerging risks.	Updated business risk registers	Risk Committee Business Unit Heads Business Unit staff
3. Consolidated outputs of Business Unit Risk Register Reviews	Confirm or identify any new or any changes to existing top risks. Assess emerging risks and identify those that should be escalated in reporting.	Draft summary of top risks and emerging risks	Enterprise Risk Team Risk Committee
4. Review of top risks by Leadership Team	Evaluate identified top risks and emerging risks. Evaluate effectiveness of risk management plans and consider whether further actions are required.	Refined draft summary of top risks and emerging risks	Leadership Team Enterprise Risk Team Risk Committee representatives (if required)
5. Review of top risks by Board	Evaluate top risks and identify emerging risks. Evaluate effectiveness of risk management plans in place and consider whether further actions are required.	Finalised summary of top risks and emerging risks	Board Leadership Team Enterprise Risk Team

TOP RISKS

We have identified, through extensive internal consultation, the organisation's top risks. The risks we have identified, along with focus areas for the 2016/17 year, are set out below.

Risk	Current Actions/Focus Areas
Threat of a cyber-security breach such as malware, phishing attack or denial of service attacks	Deployment of user access system to ensure appropriate system access by users Threat monitoring Transition to business as usual for cyber-security activities Deployment of Virtual Chief Information Security Officer for consulting and resourcing cyber-security activities
Process failures leading to poor execution	Data governance pilot project
Deterioration in key stakeholder support because of negative performance or incidents	Active engagement programme with Treasury, broaden central government relationships including Crown Financial Institutions (GSF, NPS and ACC) and Minister of Finance Board education programme Accurate, clear and consistent reporting
Incidents of fraudulent activity (including rogue traders, bribery, etc.)	Automation of improved controls to reduce the risk of duplicate payments Internal fraud stress test to assess exposure and controls User access system to improve access restrictions
Failure of systemically important supplier or counter-party	Preparation for central clearing
Staff capability shortfall	Capability Development Framework deployed to focus staff development to more effectively contribute to achieving strategic objectives
Failure of value-adding strategies or opportunities caused by ill-thought out or poorly researched investment strategies	Review of risk budgeting approach and implementation New Opportunities Assessment Group underway and developing
Insufficient liquidity due to crisis or failure in markets or institutions	Assessment of new system for improved calculation and reporting on liquidity
IT systems or infrastructure not fit for purpose of Guardians' business needs	Investigation into cloud-based infrastructure Risk system to reduce operational risk and improve independence and stress-testing ability Data management pilot project to improve access to data
Key investment beliefs are wrong	The Reference Portfolio and Total Active Risk Budget are reviewed at least every five years
Significant breach of legislation or regulation	Regular reviews of our legislative compliance framework

DERIVATIVE RISK MANAGEMENT

Where we use derivatives as part of our investment strategy, we have robust control frameworks in place to ensure their judicious and efficient use. Controls include a strong focus on the risks relating to the use of counter-parties, liquidity and operational matters, including compliance with investment mandates. See pages 47 and 82 for more information on the Fund's use of derivatives.

RISK COMMITTEE

The Risk Committee, a management committee, is the Guardians' key risk oversight body. The Risk Committee has three main roles:

- as a risk leadership body;
- to provide leadership on the effectiveness of frameworks and processes at the Guardians; and
- to add value.

The Risk Committee focuses on:

- taking an enterprise-wide holistic and governance view of the organisation;
- assessing potential risk profile changes and selecting key areas to be reviewed;
- undertaking specific reviews on behalf of management to confirm risks are appropriately managed;
- assessing the effectiveness of risk and control frameworks;
- obtaining confirmation from the business that specific processes are robust, used consistently and any exceptions are handled appropriately; and
- smoothing and simplifying processes to facilitate scalability, while ensuring effective risk management.

In 2016/17, the Risk Committee's activities included:

- a review of top risks for the Guardians and the Fund;
- a review of risks for each individual business unit;
- performing stress tests on various enterprise activities to test business resilience;
- a review of our master custodian, Northern Trust;
- considering our approach to fraud data analytics;
- reviewing cloud computing infrastructure options;
- reviewing the Manager Conviction process;
- reviewing mandatory leave; and
- leading the Guardians' response to cyber-security risks through an internal cyber-security project.

THE RISK COMMITTEE'S KEY OBJECTIVES FOR 2017/18 ARE TO:

- continue its focus on adding value to the business by being innovative, connected and commercial;
- pivot its governance budget from the traditional role of risk oversight towards leadership on frameworks, processes and tools across the organisation (in order to encourage forward thinking);
- in relation to the business, reduce downside risk for the same outcome and increase outcomes for the same risk; and
- build peer relationships.

MONITORING

Staff compliance with the relevant policies and procedures is monitored actively, as is compliance by external managers with the investment mandates we give them.

The following table sets out performance against key Fund risk measures relating to rebalancing (designed to keep the Fund's overall volatility in line with the Reference Portfolio), strategic tilting active risk, active manager risk limits and target levels of liquidity. It refers to potential rather than actual risk and is designed to encourage continuous disclosure and improvement (lessons learned).

Performance Against Key Fund Risk Measures						
	Target	2016/17	2015/16	2014/15	2013/14	2012/13
INVESTMENT RISK MEASURES						
Rebalancing						
Breaches of absolute risk limit (overall acceptable level of risk in the Fund) post-portfolio rebalancing	0	0	0	0	0	0
Breaches of relative risk limit (rebalancing limits) post-portfolio rebalancing	0	0	0	0	0	0
Breaches of active manager limit	0	0	0	0	0	0
Tilting						
Breaches of strategic tilting active risk limit post-portfolio rebalancing	0	0	0	0	0	0
Breaches of strategic tilting absolute risk limit post-portfolio rebalancing	0	0	0	0	0	0
Breaches of target liquidity level	0	0	0	0	0	0
BUSINESS RISK MEASURES						
Active breaches of compliance with investment mandates*	0	1	1	0	3	5
Loss of data/IT services of more than 30 minutes	0	0	0	1	0	0
Regulatory non-compliance	0	0	0	0	0	0
Processes and Profit and Loss impacts of more than $10m	0	0	Not Reported	Not Reported	Not Reported	Not Reported
Loss of key personnel**	0	0	Not Reported	Not Reported	Not Reported	Not Reported
Operational incidents or errors rated as potentially high risk***	N/A	1	3	4	3	0

* Our custodian reports any breaches of compliance with the Fund's segregated listed investment mandates to us for investigation and discussion with the manager involved (e.g., failing to sell a stock that had dropped out of an index within an agreed time period). All breaches, passive and active, are factored into our monitoring and reviews of our external and internal investment managers. In the case of serious incidents, a claims process may be available to the Fund.

** 'Loss of key personnel' is defined as: loss of personnel that would result in an investment strategy or activity having to stop.

*** The Guardians has a structured process for reporting, investigating and rectifying operational incidents and errors (e.g. a data entry error or a failure to correctly follow a process/instruction). Incidents or errors with potentially medium or high impacts are reported to the Board's Audit Committee as soon as practicable. As our objective is to capture as much information as possible with a view to improving our processes and controls, we do not set a target for reducing the number of errors reported.

As a result of a Board review the Guardians' risk assessment framework and risk appetite statement have been restructured. A new section has been added to provide improved focus on business risks. New risk limits have also been added for Cyber-Risk and Loss of Key Personnel, and the Reputational Risks section has been streamlined. There have been no changes to the Investment Risk section.

Our mandate requires us to manage the Fund in line with global best practice. Achieving our mandate requires us to provide remuneration packages that will attract, motivate and retain a world-class team.

The employment market for professionals in the investment sector is highly competitive. We aim to build and maintain a team of talented people who can deliver value in terms of Fund performance. The Guardians is made up of people with significant expertise and experience in investment management and research, portfolio design, risk management and investment operations, along with highly skilled specialists in finance, law, IT, communications and HR.

Remuneration consists of salary, participation in a discretionary bonus programme, KiwiSaver and participation in a discretionary benefits scheme.

Unlike other public sector organisations in New Zealand, staff salaries at the Guardians are not funded through Parliamentary appropriation. Instead, they are paid for by the Fund.

KEY FACTORS

In structuring remuneration at the Guardians appropriately, we are conscious of the need to:

- reinforce the long-term objectives of the Fund;
- reinforce our investment strategy, which is based on a whole-of-Fund approach, rather than individual asset classes or investment portfolios;
- ensure remuneration encourages appropriate, but not excessive, risk-taking; and
- be realistic about the periods for which staff are likely to remain with the Guardians and can reasonably expect to be rewarded for performance.

We aim to be clear about what people are paid for and why, and to be consistent, systematic and transparent in applying our remuneration policies. Our intent is to remunerate and reward people for their knowledge, skills, alignment to behavioural expectations and contribution in the roles they are performing.

Equal Pay

Our Human Resources Policy makes a specific commitment to achieving the principle of equal pay for equal work.

Based on a 2016 report from EY, we are confident that we are paying equally for work of equal value. The overall pay gap at the Guardians reflects the predominance of males in senior and investment professional roles. See page 91 for further details.

BASE SALARIES

Employees receive a base salary, which is fixed, and which reflects their role, contribution and level of experience. Base salaries are based on:

- independently determined job sizes;
- employees' competence in roles; and
- current, independent remuneration market data, based on upper quartile, New Zealand financial services sector rates.

Salaries are reviewed annually with any increases subject to meeting minimum performance expectations.

SUPERANNUATION

The Guardians makes compulsory employer contributions to KiwiSaver at the minimum level (3%).

DISCRETIONARY BENEFITS SCHEME

A range of other benefits is also offered to permanent staff on a discretionary, non-contractual basis. These benefits include income protection insurance, life insurance and health insurance. The total cost to the Guardians of providing these benefits was NZD229,000 in 2016/17.

DISCRETIONARY BONUS SCHEME

As is normal within the financial services sector, staff are eligible for performance pay on top of base salaries.

The Guardians' discretionary bonus scheme is designed to incentivise employees and create a culture of good performance. All bonuses are at the discretion of the Board. There is no contractual requirement with employees requiring the payment of any bonus in any given year.

There are two components to the bonus scheme:

1) an individual performance component for which all permanent employees are eligible; and

2) a two-part Fund performance component, which applies to members of the Leadership Team, Investments Group and Portfolio Completion Group.

Bonuses are calculated as a percentage of average base remuneration and vary up to a maximum percentage. The maximum available is:

	Total	Individual Component	Fund Component
Leadership Team, Investments Group and Portfolio Completion Group	60%	20%	40%, comprised of: • Excess Return – 13.33% • Value Added – 26.67%
Other employees	20%	20%	N/A

REMUNERATION SUMMARY

Benefit	Purpose and link to strategy	Operation
Base salary	Building and maintaining a 'great team' To reflect the responsibilities of the individual role and the individual's level of experience and competence in the role Set at appropriate level to mitigate risks of over-reliance on discretionary income	Reviewed annually Each individual has a job size and base salary associated with their position. Positions are re-evaluated at least 5 yearly Base salaries are determined by positions being evaluated by remuneration specialists using market evaluation systems General approach is to benchmark against upper quartile, New Zealand financial services sector rates Individual performance is reviewed bi-annually, and salaries are reviewed annually. Eligibility for a salary review is subject to meeting minimum performance expectations. Employees with a performance rating outcome equivalent to below target are not eligible for a salary review
Individual objectives and performance bonus	Promotes commitment to a positive, constructive workplace culture Linked to employee behaviour consistent with the Guardians' desired workplace culture	Bonus payments are at the Board's discretion Employees with a performance rating outcome equivalent to below target are not eligible for a bonus
Fund component	Based on Fund financial performance outperforming Treasury Bill return and Reference Portfolio Incentivises whole of Fund approach and aligns with statutory mandate of maximising returns without undue risk Based on Fund performance over rolling four year periods to encourage sustainable performance	Bonus payments are at the Board's discretion Based on audited performance results Employees with a performance rating outcome equivalent to below target are not eligible for a bonus Available to the Leadership Team, Investments and Portfolio Completion employees
Other benefits	Building and maintaining a 'great team' Good employer	Discretionary life insurance, income continuance insurance and medical insurance

Further information about the bonus scheme is set out below.

INDIVIDUAL PERFORMANCE COMPONENT (ALL STAFF)

All permanent staff are eligible for a discretionary bonus payment in respect of achievement relating to their individual performance (a maximum of 20% of base remuneration). All discretionary bonus payments are contingent upon staff having achieved their objectives. This is captured in an assessment of performance against a set of expectations agreed in writing between the employee and their manager.

Individual performance is measured with reference to:

- the individual's performance against behavioural criteria consistent with the Guardians' desired workplace culture (this is determined by the individual's manager, based on feedback from 360 degree performance reviews and in consultation with the Leadership Team).

The involvement of the Leadership Team in the process is designed to ensure fairness and consistency across the organisation.

The individual component of the bonus is payable annually.

FUND PERFORMANCE COMPONENT (LEADERSHIP TEAM, INVESTMENTS GROUP, PORTFOLIO COMPLETION GROUP)

Staff who are members of the Leadership Team, Investments Group and Portfolio Completion Group are eligible for a further bonus (a maximum of 40% of base remuneration), based on two Fund performance measures:

1) Excess Return (1/3 of the 40%); and

2) Value Added (2/3 of the 40%).

These measures are based on whole-of-Fund performance, consistent with our Reference Portfolio approach to investing the Fund. Under the Reference Portfolio approach, we work together to ensure our investment decisions improve the Fund's portfolio as a whole, rather than optimising performance within individual asset classes or sub-portfolios.

Payments against these measures are made over four years on a rolling average basis. This is intended to incentivise appropriate risk-taking and reflect the Fund's focus on long-term performance.

Payments made in any one year therefore reflect a four year moving history. A new four year 'Vintage' is initiated each financial year.

The Excess Return measure is calculated based on the Fund's actual return, less the 90-day Treasury Bill return, a proxy of the opportunity cost to the government of investing in the Fund instead of paying down debt. The maximum bonus payable under this portion is capped at 13.33% of base remuneration if the Fund exceeds the Treasury Bill return by 4% (i.e. outperformance of the Treasury Bill return is capped at 4%).

The Value Add measure is calculated based on the Fund's actual return, less the Reference Portfolio return. Payments based on this measure are capped at 26.67% of base remuneration if the Fund exceeds the Reference Portfolio return by 0.75% (i.e. outperformance of the Reference Portfolio is capped at 0.75%).

Interim payments for the Fund performance component are calculated based on actual average remuneration (excluding bonus payments) across the relevant period. The maximum percentage paid out is a quarter of the Vintage in Year 1 and increases by a quarter of the Vintage each year thereafter, in line with the percentage of services rendered by the employee.

Therefore, once a staff member has been employed for four years, they will have four separate Vintages running, paying out a maximum of 25% each, as summarised in the table below.

Max Out scenario	Vesting Level (% of services performed)	Less Previously Paid	Payable Current Year
1st Vintage	100%	75%	25%
2nd Vintage	75%	50%	25%
3rd Vintage	50%	25%	25%
4th Vintage	25%	0%	25%
Total			100%

INCENTIVE ACHIEVEMENT IN 2016/17

- For eligible staff who have been employed for the last four full years:
  - Payments made in respect of Treasury Bill return were 16.67% of average base remuneration for the equivalent period, compared with the maximum possible 13.33%.
  - Payments made in respect of the Reference Portfolio return were 28.71% of average base remuneration for the equivalent period, compared with the maximum possible 26.67%.
- Over the past four years the Fund has:
  - Exceeded the Treasury Bill return by an average of 11.55% p.a. (12.68% in 2016/17)
  - Exceeded the Reference Portfolio return by an average of 2.30% p.a. (3.05% in 2016/17).

The maximum possible refers to the maximum payable per vintage. At any given time we have four vintages running, and each of these will have cumulative achievement levels between 0% and 100% throughout their four year lives. The associated interim payments also vary year to year.

Strong performance will improve the status of previously underperforming vintages, and result in catch-up of interim payments. This year we have all four vintages at 100% achievement to date for the current year and one vintage that has made-up performance for previous underachievement. The combined effect is an additional 5% bonus payment to make up for a prior year underachievement. This occurs occasionally.

Further information about remuneration can be found in our Human Resources Policy, available at: **https://www.nzsuperfund.co.nz/publications/policies**. See also the Guardians' financial statements at page 192.

CHIEF EXECUTIVE OFFICER REMUNERATION

One of the Board's most important decisions is deciding on the appointment and remuneration of the CEO.

Process

The EPRC (see page 67), based on independent advice from external remuneration specialists, reviews the CEO's remuneration annually and makes recommendations to the Board. The Board then consults with the State Services Commission and, where relevant, the Minister of Finance, before making a final decision. In ensuring the final decision rests with the Board, this process reflects the design of the Fund and the importance placed on its commercial independence.

Factors Taken into Account

In the Board's view, the role of the CEO of the Guardians is unique in New Zealand, requires original strategic thinking and leadership and has grown in complexity and scope over time.

As is normal good practice, the Board aims to ensure alignment between the CEO's remuneration and the strategy and performance of the Guardians and Fund. For this reason, the CEO (along with other members of the Leadership, Investments and Portfolio Completion teams) is eligible for bonus payments up to a maximum of 60% of his base remuneration, under the Guardians' discretionary bonus scheme.

The Board also considers relativity between the CEO's remuneration and the staff of the Guardians.

The Board is confident that the CEO's pay is competitive and appropriate.

In public discussion about the CEO's remuneration over the course of the year, it was noted that the remuneration is high relative to other public sector CEOs in New Zealand. The public sector pay scale recommended by the State Services Commission is not, in the Board's view, appropriate for setting the CEO's remuneration. The Guardians operates in a highly competitive market, and its global mandate, highly specialised financial and investment focus and the potential of difficulty in replacing the CEO's skill set requires a directly meaningful and relevant market-based benchmark.

In setting the CEO's remuneration, the Board therefore considers remuneration paid by public and private sector organisations and comparable public funds. See page 81 for further information on the components of the bonus scheme and how they are measured.

Rationale for Increases

The Board approved a 2.7% increase to the CEO's base salary for the 2016/17 year. This increase to base salary, combined with strong individual performance and the Fund's ongoing out-performance of its benchmarks, resulted in an increase in the CEO's total remuneration of 14.7% in 2016/17.

In approving increases to the CEO's base salary over the last few years, the Board has been conscious of factors including:

- the increased complexity of the role;
- the growth in the size of the Fund;
- the CEO's continued strong performance, including achieving improvements in the Guardians' workplace culture.

Changes to the Guardians' bonus scheme became effective 1 July 2015. As described in previous annual reports, the effect of these changes was to make the CEO (and other Leadership Team members) eligible for the same bonus scheme as Guardians' investments staff: 60% of base remuneration compared with 40% previously. There was no change to the discretionary nature of the scheme; all bonuses are paid at the Board's discretion. The extension of the 60% scheme to the CEO and other members of the Leadership Team reflected the nature of their work and influence over investment strategy and performance. The Board also wished, given the need for succession planning, to maintain appropriate relativity between roles in the organisation.

The discretionary bonus scheme is designed to create strong alignment between the CEO's remuneration and the performance of the Guardians and the Fund. Consistent with the Guardians' long-term goals, bonus payments for Fund performance in any one year reflect a four-year rolling average. There are no trailing payments available once an employee ceases service with the Fund.

The alignment between performance and remuneration is illustrated by the large range in the CEO's potential remuneration. For 2016/17, the CEO's potential remuneration range was from a minimum of $728,843 to a maximum (based on a retrospective view of actual salary payments) of $1,249,199.

Annual CEO Remuneration 1 July 2012 – 30 June 2017

Financial Year	2016/17		2015/16	
	$	% achieved	$	% achieved
Contractual Base Remuneration	$700,400	–	$682,000	–
Actual Base Remuneration Payment (A number of factors can mean there is a difference between the contractual and actual base. See footnote* for more detail)	$740,476	–	$690,322	–
At Risk – Individual Component (max 20% of actual base remuneration)	$116,995	15.8%	$117,355	17.0%
At Risk – Fund Financial Performance Excess Return on a 4 year moving average	$116,647	13.3%	$61,829	10.0%
Cumulative Fund Performance can impact interim payments resulting in payments in a subsequent year. See page 81 for more detail.		3.3%		(3.3%)
At Risk – Fund Financial Performance Value Add on a 4 year moving average	$200,330	26.7%	$155,616	24.6%
Cumulative Fund Performance can impact interim payment resulting in payments in a subsequent year. See page 81 for more detail.		2.1%		(2.1%)
KiwiSaver	$35,233	–	$30,754	–
Benefits (Health, Life and Income Protection Insurance)**	$7,431	–	$4,879	–
Total Remuneration	**$1,217,112**	**–**	**$1,060,753**	**–**

The At Risk Financial Performance component was increased from 20% to 40% in FY 2015/16 when the Leadership Team's bonus structure was made consistent with the Investments and Portfolio Completion teams. From FY 2015/16, the maximum At Risk for the Fund's Financial Performance of Excess Return is 13.3%. The maximum At Risk for the Fund's Financial Performance of Value Add is 26.7%. The At Risk Fund Financial Performance components of the bonus scheme are explained fully at page 81.

Financial Year	2014/15		2013/14		2012/13	
	$	% achieved	$	% achieved	$	% achieved
Contractual Base Remuneration	$571,000	–	$566,000	–	$464,000	–
Actual Base Remuneration Payment (A number of factors can mean there is a difference between the contractual and actual base. See footnote* for more detail)	$596,078	–	$586,796	–	$477,685	–
At Risk – Individual Component (max 20% of actual base remuneration)	$101,333	17.0%	$117,359	20.0%	$83,595	17.6%
At Risk – Fund Financial Performance Excess Return on a 4 year moving average	$37,932	6.7%	$35,621	6.7%	$40,590	6.9%
Cumulative Fund Performance can impact interim payments resulting in payments in a subsequent year. See page 81 for more detail.		–		–		1.6%
At Risk – Fund Financial Performance Value Add on a 4 year moving average	$95,581	13.3%	$51,686	10.0%	$65,233	13.8%
Cumulative Fund Performance can impact interim payment resulting in payments in a subsequent year. See page 81 for more detail.		3.3%		(3.3%)		–
KiwiSaver	$24,928	–	$23,744	–	$20,013	–
Benefits (Health, Life and Income Protection Insurance)**	$4,276	–	$4,020	–	$3,582	–
Total Remuneration	**$860,128**	**–**	**$819,226**	**–**	**$690,698**	**–**

For FY 2013/14 and FY 2014/15, the maximum At Risk for the Fund's Financial Performance of Excess Return was 6.7%. For FY 2012/13 this maximum was 6.9%, due to a final payment from a prior bonus scheme. For FY2013/14 and FY 2014/15 the maximum At Risk for the Fund's Financial Performance of Value Add was 13.3%. For 2012/13, this maximum was 13.8%, due to a final payment from a prior bonus scheme.

* Actual base salary payments can be lower or higher than contractual base salary, depending on a number of factors; the difference is mostly attributable to the amount and value of leave taken.

** Benefits include FBT, exclude GST.

SECTION

04

Operational Highlights

Ngā Tīpakonga ā-Whakahaere

We look to leverage our unique endowments when investing locally. Our timber and rural assets make use of the Fund's long-term horizon and known liquidity profile.

86. HIGHLIGHTS FROM OPERATIONS AND IT

88. OUR PEOPLE

94. TEAM PROFILE – NZ DIRECT INVESTMENTS

96. REGULATORY UPDATE

97. ENVIRONMENTAL PERFORMANCE

Image courtesy of **Timberlands Limited**

HIGHLIGHTS FROM OPERATIONS AND IT

CYBER-SECURITY

The danger of potential exposure to cyber threats has continued to grow. We recognise this risk, and improving cyber-security defence, knowledge and preparation is an ongoing priority for the Guardians. In 2015, we underwent a cyber-security risk assessment carried out by an independent external provider. A cyber-security project was set up in response to the review. The project seeks to lift our maturity across all areas of cyber-security.

Since the project was established, we have undertaken a number of activities to ensure that we meet the cyber-security needs of the Fund. These have included:

- education of staff;
- external cyber-security training for IT staff;
- threat detection scanning;
- engaging with Microsoft and Datacom to investigate various tools and processes to increase our cyber-security defences; and
- ongoing discussions with local and global peers to discuss threats and compare approaches.

As at 30 June 2017, seven of the eight planned cyber-project workstreams had been completed, with the final workstream, threat monitoring, still to be completed.

RISK MANAGEMENT PLATFORM

See page 102 for a project summary.

DATA MANAGEMENT

A multi-year Data Management project was commenced in 2016, comprised of three separate workstreams:

1. SuperMART: Over the last year we have upgraded our central data management platform, known as SuperMART, to improve the speed and throughput of changes to it through improved solution design, development standards and supporting infrastructure.

2. Data Warehouse: This involves building a single multi-purpose data warehouse to implement our target information architecture and support end-user data queries and analytics. The data warehouse will assist investment decision making, increase trust in data, help automate standard reporting and enable faster processing. This workstream will be completed in 2017/18.

3. Data Governance: This aims to ensure our key portfolio and market data remains well-governed, defined and understood. Improving data governance will increase the accuracy and certification of investment data, giving users greater confidence when using data and enabling better investment decisions. This workstream will be completed in 2017/18.

CLOUD MIGRATION

An assessment is currently underway to replace the Guardians' IT infrastructure. This will involve moving in part to a public cloud-based infrastructure (the Microsoft Azure Cloud) located in Australia. Cloud computing refers to sharing resources, software and information via the Internet. The move to the cloud offers the Guardians a number of benefits, including a flexible and scalable infrastructure environment, high standards of security and advanced business continuity options. Our decision was also informed by the New Zealand government's cloud first policy (**www.ict.govt.nz/guidance-and-resources/using-cloud-services/why-agencies-must-use-cloud-services/**).

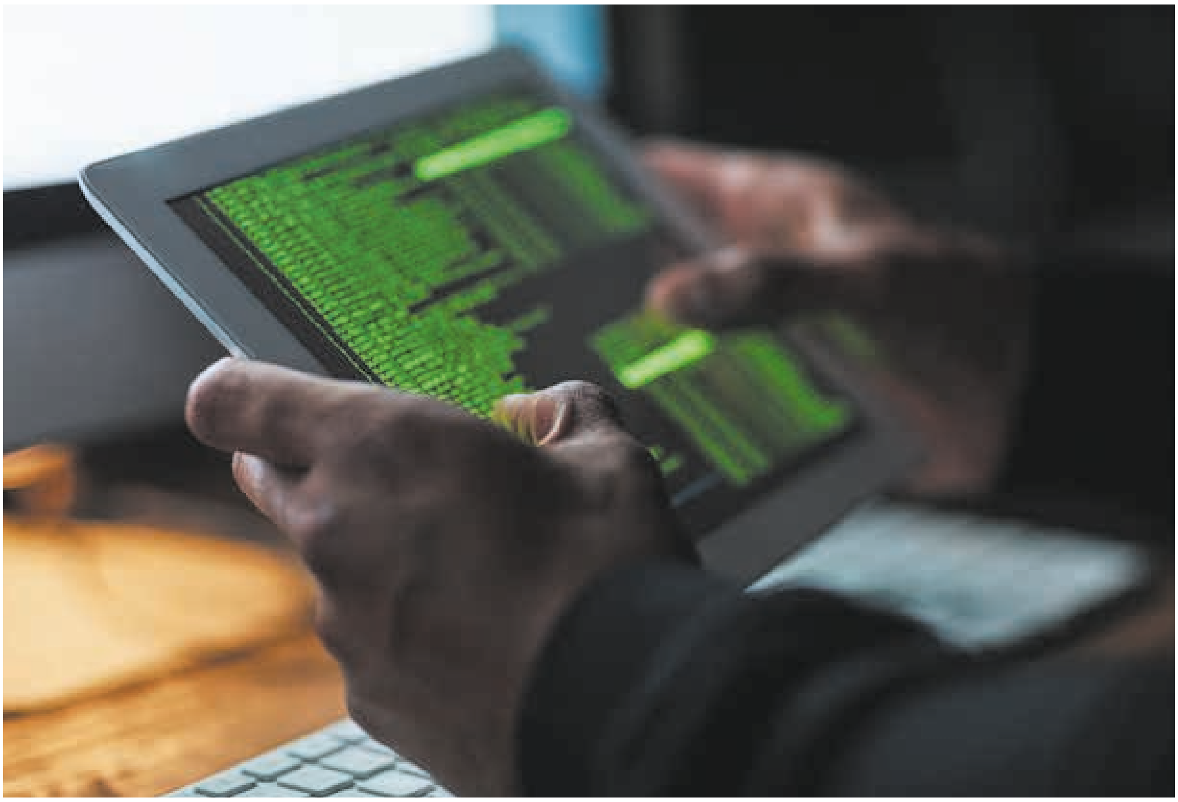
In December 2016, a high-level assessment of our business's critical systems confirmed that they would run in the Microsoft Azure Cloud.

We are now in the process of carrying out the design phase of the project, made up of three components:

- a technical design of our systems in the Microsoft Cloud;
- a risk assessment of the solution; and
- a business case documenting the benefits and costs of operating the model.

USER ACCESS MANAGEMENT

As we progressed with our cyber-security response, it became clear to us that it was time to improve the way we managed user access to our systems. Each job or role at the Fund now has a role profile which defines what system access is required (and at what level) to perform that role effectively. The role profiles have been defined by the heads of each team and ensure that each staff member has the right level of access for their role. To assist with the management of this process, we deployed Tika (Māori word for 'correct'), a tool that administers user access across the Fund's many systems in order to protect the integrity of our data and information.



VARIATION MARGIN PROJECT

In response to the global financial crisis of 2008/09, G20 countries introduced increased regulations on banking and non-banking entities in order to make banks more resolvable (in the event of a failure) and more resilient to shocks and to promote transparency in the financial markets.

One regulation recently introduced by the G20 countries requires the posting of variation margin and initial margin on most non-centrally cleared over-the-counter (OTC) derivatives transactions. In order to continue trading non-cleared OTC derivatives with our counter-parties we need to ensure that our documentation and collateral processes comply with the new regulations.

A project team with representatives from Operations, Legal, Portfolio Completion, Risk and IT was formed in September 2016 to ensure that we would be able to continue trading OTC derivatives after the new regulations had taken effect.

The focus so far has been on variation margin, given we are not subject to the initial margin requirements until September 2020.

The Operations Team worked with the Legal Team to interpret complex regulations, often lacking consistency across multiple jurisdictions. We negotiated the required regulatory compliant collateral documentation (called a Credit Support Annex, or CSA) with each counter-party and made the required changes both internally and with our outsourced collateral management provider (JP Morgan) by the first regulatory deadline of 1 March 2017.

See page 96 for an update on regulatory matters of relevance to the Guardians and the Fund.

In an industry that is highly competitive, our people are our biggest asset. We recognise that staff attraction, retention and development are critical to our success.

We place a high priority on attracting the best candidates, retaining our talent and building the capability of our team. We strive to be a good employer and are committed to offering equal employment opportunities to prospective and existing staff. Workplace flexibility, investing in professional development and offering staff career progression opportunities are central to our employment offering.

We aim to embed the Guardians' vision, values and culture into our day-to-day activity; translate business strategies into clear role requirements, accountabilities and competencies; and improve productivity and business performance through compensation, performance management and leadership and coaching programmes.

Achievements during 2016/17

- Equal Pay Review completed – see page 91.
- Launch of SuperSEED, our capability development framework, to promote development activities for the coming year.
- Performance Review process streamlined.

Priorities for 2017/18

- Leadership development – increasing leadership capability at all levels to increase communication and create a coaching culture.
- Review the Guardians' leave and employee benefit offerings.

OUR CULTURE

Our focus on developing and strengthening our workplace culture continued into 2016/17. We place a strong emphasis on creating a high-performing and constructive environment conducive to attaining our organisational vision: a great team building the best portfolio. We will continue to coach staff about the behaviour and values to maintain and progress our common culture.

CULTURE SURVEY

In April 2017, 98% of permanent staff at the Guardians completed the Organisational Culture Inventory (OCI) and Organisational Effectiveness Inventory (OEI), together, the Culture Survey. The Culture Survey is undertaken on a two-year cycle, with the last survey taken in March 2015.

The OCI is the most widely used and thoroughly researched tool for measuring organisational culture in the world. It examines staff experience of the operating culture. The OEI measures staff experience of the organisation's structures, systems, technology and skills/qualities. The OEI also measures key culture outcomes at the individual member, group and organisational levels. Together the tools provide insight into how close we are to our desired culture.

Overall, the results of the surveys showed positive gains on 2015. Most notably, we recorded drops in all aggressive defensive cultural styles, and maintained our predominantly constructive culture with all four constructive styles above, or close to, the constructive benchmark.*

Continuing to develop and maintain our constructive culture gives us a significant point of difference in the market. Increased ability to attract, develop and retain key talent brings with it many benefits, ultimately improving the organisational effectiveness of the Fund.

The OCI/OEI surveys will be run again in 2019, and our interim engagement survey will be repeated in 2018.

INTERNAL PROMOTIONS

During the 2016/17 year, we confirmed three permanent internal transfers and 11 promotions. The Guardians has highly skilled staff, and it is important to us to be able to offer opportunities in different teams to help our staff to grow and develop. Being able to offer staff career progression opportunities and the ability to gain new skills helps us retain valuable institutional knowledge.

STAFF DEVELOPMENT

This year we implemented SuperSEED, a new Capability Development Framework to promote intended learning and development activities for the coming year.

The Guardians continued to invest in the organisation-wide Personal Efficiency Programme in 2016/17, designing and running group training as part of our wider effort to maximise efficiency, increase productivity and reduce cost.

We also ran a series of weekly Te Reo language classes, with 50 Guardians staff members participating. The classes enabled staff members to improve their cultural understanding, help in their interactions with Māori stakeholders and further reinforce our humanistic working culture.

To meet an identified need, 24 staff members completed communication and presentation training.

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* The constructive benchmark is a score of 75th percentile or better in the OCI survey results.

To support the development of staff members' personal working styles, the Guardians supported 58 staff members through the Life Styles Inventory programme.

Two staff members participated in external secondments with managers, peers and partners, and six staff members were able to experience internal/cross team secondments.

TUPUTOA PARTNERSHIP

The Guardians partnered with the TupuToa Programme (https://www.tuputoa.org.nz/) to offer positions to three summer interns in 2016/17. TupuToa is an organisation set up to help pave the way for Māori and Pasifika tertiary students to establish careers in the corporate sector. The partnership aligns with our desire to build up the capability of our team by attracting candidates from a range of different backgrounds and disciplines. It is also consistent with our long-term goal to support the development of our talent pipeline. This year, the interns undertook roles with the NZ Direct Investments, External Investments and Partnerships, Tax and Legal teams.

All three of our interns have been retained in some capacity. One of the interns accepted a permanent position as an analyst in the External Investments and Partnerships team, while the remaining two have continued in casual part-time positions while completing university study. We have also hired another former TupuToa intern to undertake research for the Corporate Strategy team.

HEALTH AND SAFETY

Our Human Resources Policy, available on www.nzsuperfund.co.nz, sets out our commitment to provide a safe and healthy working environment for all employees and for visitors. We strive to:

- reduce and, where possible, eliminate any hazards;
- educate employees on health and safety issues;
- prevent injury to people at work; and
- comply with the requirements of the Health and Safety at Work Act 2015.

Under the policy, responsibility for maintaining a safe and healthy work environment is the responsibility of all staff.

Being mainly office-based, the Guardians is a relatively low-risk environment from a physical safety point of view. Identified potential hazards include overseas travel, gradual process injury and stress.

We are managing our key risk areas constantly and provide a substantial programme of support services to staff.

The Health, Safety, Security and Environment (HSSE) Committee comprises staff from various business units and leads the response to, and prevention of, HSSE related risks across the organisation. The Committee aims to promote a culture that identifies unsafe situations and behaviours before they have an impact on people, the environment and the Guardians' reputation.

The Committee meets once a quarter and reports to the Leadership Team on a yearly basis. In 2015/16, the Committee's mandate was expanded to include security and environmental issues.

This year, we were pleased to achieve a tertiary-level standard in the Accident Compensation Corporation's (ACC) Workplace Safety Management Practices Programme. Previously we had received primary-level standard.

Under this programme, the Guardians receives a discount on the standard ACC Workplace Cover levy in recognition of our establishment of health and safety systems and good practices in injury prevention.

In 2016/17, the Committee's core focus was on improving the fire evacuation process, which included working with Precinct and the other Zurich House tenants to reduce risk in this area. Other health and safety activities included:

- annual health and safety training, including first-aid, CPR and defibrillator training;
- subsidised health insurance;
- workstation assessments for all employees;
- access to height adjustable desks, including those in full stand-up mode;
- advice on safe travel practices and international travel support including wallet size travel safety booklets;
- free healthy heart checks and influenza injections;
- provision of emergency kits to comply with Civil Defence and Emergency Management recommendations;
- access to independent Employee Assistance Programme providers; and
- regular occupational health nurse visits.

GOOD EMPLOYER

The Guardians is committed to being a good employer. This includes offering equal employment opportunities (EEO) to prospective and existing staff and recognising the employment aims of Maori, ethnic minorities, women and people with disabilities. All staff are employed on individual contracts and are involved in the development of our good employer and EEO programmes. They also have the opportunity to provide input on our Human Resources Policy and approach.

We believe that being a good employer will help us achieve our long-term business goals. To us, being a good employer means that our people enjoy and feel safe in their workplace; trust the processes and procedures around their development, recognition, promotion and exit; and are enthused and professionally satisfied by their roles.

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GOOD EMPLOYER REPORTING

The Human Rights Commission gave the Guardians a compliance rating of 100% for its 'good employer' reporting in their review of the annual reports of 91 Crown Entities.

Our activities against seven key elements of being a good employer are summarised below:

Element	Guardians Activity
Leadership, accountability and culture	Alignment between Strategic Plan objectives, individual objectives and performance measures Organisational Culture Survey and Organisational Effectiveness Surveys completed in April 2017
Employee development, promotion and exit	Programme in place to identify and develop talent Vacancies advertised internally Secondment programme established Exit interview process
Recruitment, selection and induction	Robust recruitment and selection processes Orientation and induction for all staff Summer internship programme
Remuneration, recognition and conditions	Transparent, equitable and gender-neutral job evaluation practices Remuneration benchmarked against third-party New Zealand data Current incentive programme into its sixth year
Flexibility and work design	IT systems facilitate working from home Flexible working arrangements supported 100% return rates from parental leave
Harassment and bullying prevention	Employee Code of Conduct and relevant policies available at all times Performance management process rewards positive and constructive behaviour
Safe and healthy environment	Strong focus on employee health, safety and well-being through provision of support services (see page 89) Achieved tertiary-level standard in ACC's Workplace Safety Management Practices Programme

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EQUAL PAY AWARD

In November 2016 we were delighted to win a Bronze Award in the YWCA New Zealand Equal Pay Awards. The awards programme recognises best practice employers who create progressive working environments for women in New Zealand.

In making the Bronze Award, the judges said the Guardians:

> "…has made public its commitment and intent to Diversity & Inclusion (D&I), with a board-approved strategy that sees a strong role for equal pay. Supported by an HR Policy …that ensures the principle of equal pay for equal work achieved, there is no shying away from the ambitious stake this organisation has made to achieve a gender-inclusive culture"

Specific measures the Guardians has put in place include:

- flexible workplace practices;
- unconscious bias training; and
- gender neutral recruitment policies.

EY REPORT ON EQUAL PAY AT THE GUARDIANS

In 2016, we commissioned EY to undertake an analysis on equal pay at the Guardians. Their work, which formed part of our YWCA award entry, showed that:

- we are equal payers for equal work, with no evidence of deliberate underpayment of roles of a similar 'size'; and
- we are treating males and females equitably during performance reviews, pay reviews and in the award of incentives.

However, EY estimated an overall average pay gap between all males vs all females at the Guardians of 37%. This figure is based on median hourly earnings. It is calculated by subtracting median female pay from median male pay, dividing the result by median male pay, then multiplying by 100. If males and females received exactly the same pay, the gender pay gap would be 0. If males received twice as much pay as females, the gender pay gap would be 50%.

While this gap was larger than we expected, it is explained by females being under-represented in the senior or higher paying roles in the organisation and over-represented in lower paying roles. Females are also under-represented in the organisation as a whole.

While EY's report was a one-off, we will continue to report on equal pay metrics, as recommended by the Human Rights Commission, in the Workforce Profile section of our annual reports.

Reducing the overall gender pay gap at the Guardians is an ongoing focus for us.

DIVERSITY AND INCLUSIVENESS

In 2015/16 we introduced a Diversity and Inclusiveness Policy. The objective of the Policy is to ensure that we have a workforce profile that delivers a competitive advantage by leveraging diversity of thought, supporting our ability to make the best investment decisions. It also seeks to foster an inclusive workplace environment where every individual is engaged and able to add value regardless of gender, cultural identity, sexual orientation or age.

As part of our commitment to diversity and inclusion we aim to support staff in balancing their work and personal lives. Our flexible work practices provide a process by which any employee may apply for a variation in their work arrangements, whether it be flexi-place, flexi-time, part-time hours, condensed work weeks or a job-share arrangement.

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Components	2017	2016	2015	2014	2013
OUR WORKFORCE					
Full Time Equivalent (FTE) employees	124.4	112.2	111.0	96.6	86.4
People	127	115	113	98	89
Full time (FTE)	93%	93%	94%	96%	92%
Part time (FTE)	7%	7%	6%	4%	8%
Staff members with disabilities	1%	1%	1%	1%	1%
FEMALE REPRESENTATION					
Female staff members	47 (37%)	44 (38%)	40 (35%)	32 (33%)	32 (36%)
Female Board members	3 (43%)	3 (43%)	3 (43%)	3 (43%)	3 (43%)
Female Leadership Team members and direct reports to CEO	2 (29%)	2 (29%)	2 (22%)	2 (22%)	2 (25%)
Female heads of teams	6 (33%)	4 (22%)	4 (25%)	4 (25%)	4 (26%)
Female investment professionals	12 (25%)	13 (28%)	11 (23%)	9 (22%)	8 (28%)
Gender pay gap*	37%	Not Reported	Not Reported	Not Reported	Not Reported
TURNOVER**					
Turnover – all staff	13.8%	10.7%	4.4%	5%	12%
Turnover – male	7.6%	11.4%	2.7%	5.20%	13%
Turnover – female	17.3%	9.6%	8.3%	4.60%	9%
EDUCATIONAL QUALIFICATIONS					
% of staff with a postgraduate tertiary qualification	51%	50%	53%	57%	52%
% of staff with an undergraduate tertiary qualification	88%	90%	92%	91%	91%
Staff training investment as a % of total Guardians operating expenditure	1.30%	1.14%	1.44%	1.38%	0.76%
RETURN TO WORK AND RETENTION AFTER PARENTAL LEAVE (AS PRIMARY CARE-GIVER)					
Return to work – male	None Taken	None Taken	None Taken	None Taken	None Taken
Return to work – female	100%	50%	100%	50%	100%
Retention as at 30 June 2016 after returning during the year – male	None Taken	None Taken	None Taken	None Taken	None Taken
Retention as at 30 June 2016 after returning during the year – female	100%	100%	100%	100%	100%
HEALTH AND SAFETY					
Lost-time work injuries	0	0	0	0	0
Absenteeism as measured by days of sick leave per FTE	4.1	4.1	3.1	3.2	2.4

* This year, in line with new reporting guidance from the Human Rights Commission, we report on the gender pay gap at the Guardians for the first time.
** We define turnover as voluntary turnover.

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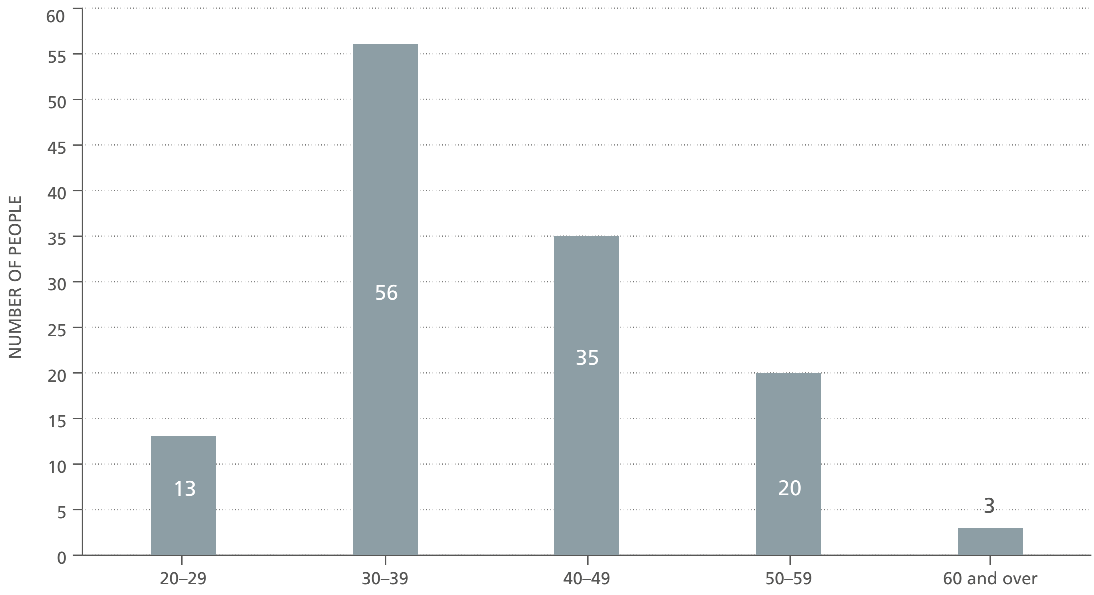
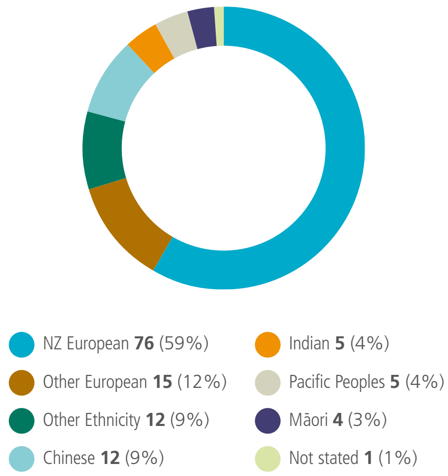
WORKFORCE AGE
AS AT JUNE 30 2017

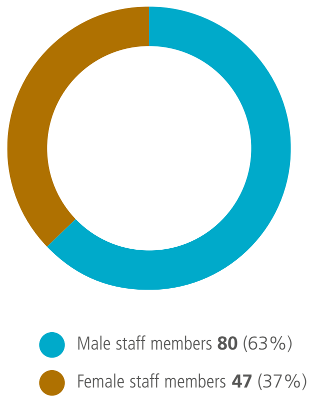


ETHNIC PROFILE
AS AT 30 JUNE 2017*



* 130 total count as three staff identify with two different ethnic groups.

GENDER BALANCE
AS AT 30 JUNE 2017



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TEAM PROFILE – NZ DIRECT INVESTMENTS

WILL GOODWIN — JOHN BARTLEY — RAEANA CONNELL — ANDREW SMITH — NEIL WOODS — JESSICA GILBERT — TAMA POTAKA

ABSENT: BRENDON JONES, MEGAN GLEN (SEE PAGE 95).

The Fund is one of the largest institutional investors in New Zealand and a significant player in domestic capital markets. Our NZD4.9 billion New Zealand investment portfolio includes NZD1.7 billion invested in the local share market, alongside substantial investments in Datacom, Kaingaroa Timberlands, and Kiwibank. Investments have also been made in residential property in Hobsonville and rural land across the country.

The Fund's New Zealand-based active investments are overseen by the NZ Direct Investments team.

NZ Direct Investments is organised into two separate teams: Active NZ and NZ Direct. They manage several different kinds of opportunities. The Active NZ team manages active positions in NZ listed equities (the Fund also has two external managers, Devon Funds Management and Mint Asset Management, actively managing NZ equities). The NZ Direct team, shown here, oversees the Fund's Timber and Rural Portfolios (see page 41 for case study), as well as opportunistic investments that arise in New Zealand.

When investing opportunistically, the team looks for large private market transactions where they are best able to leverage the Fund's unique endowments: its long-term horizon, sovereign status and certain liquidity profile. Under its founding legislation, the Fund is unable to take a controlling interest in an operating company. The team therefore targets large scale transactions of over NZD100 million, for typically a 20%-50% stake.

The team devotes significant time and resource to developing best-in-class governance and responsible investment frameworks across all of their investments. Strong and comprehensive shareholders' agreements are formulated to govern and formalise interactions and expectations between shareholders. Building and leveraging relationships is another key focus; becoming more involved and visible in the New Zealand market to increase the understanding of the Fund and to help originate transactions and build team profile.

The team is headed by Will Goodwin, who joined the Guardians in 2016. Before then, Will was based in Sydney, where he held various senior executive roles across the Todd Corporation in finance, corporate development and private equity.

Will is joined by Managers Megan Glen and Brian Bourdôt and Portfolio Managers Neil Woods, John Bartley and Brendon Jones. Each provides direct oversight of the Fund's existing investments, while working to originate, assess and execute new investment opportunities and initiatives across a variety of sectors. As Managers, Brian and Megan have additional responsibilities around the development and management of the team's analysts: Greg Slusarski, Linda Van, Raeana Connell, Jessica Gilbert, and Andrew Smith. The analysts support the team's function by undertaking company and industry sector research, and identifying opportunities to drive the superior performance of the NZ Direct portfolio.

The team also includes Tama Potaka, who joined early this year as a senior advisor to lead the development of the New Zealand Investment Hub. Tama is of Ngāti Hauiti, Mōkai Patea, Ngāruahine Taranaki, Whanganui/Ngāti Rangi, Ngāti Toarangatira and Ngāti Raukawa iwi.

Before joining the Guardians, Tama was a senior leader at Tainui Group Holdings and prior to that a lawyer at Bell Gully.

STAFF PROFILE:
Megan Glen

Megan Glen, Manager, NZ Direct Investments, joined the Guardians in 2016. She was formerly a director in Credit Suisse's Investment Banking and Capital Markets group based in New York, advising North American private equity funds on acquisitions, financings and divestitures. Megan has extensive experience in leveraged finance, publicly registered offerings and M&A transactions across a variety of industry sectors. Megan previously spent seven years at First NZ Capital in their investment banking team in Auckland. She has a BCom(Finance)/BSc from the University of Auckland.

Since joining the Guardians, Megan has taken on responsibility for managing the Fund's recent investment in Kiwibank and exploring new investment opportunities. Megan enjoys applying the Fund's unique attributes and developing her team's investment skills to drive successful New Zealand businesses for the benefit of all New Zealanders.

As a global investor, we are subject to a wide range of legal requirements. Ensuring that we comply with these requirements is an important task.

In this section, we provide examples of areas of regulatory change relevant to our activities or to the business of our investment managers, counter-parties and service providers.

US FINANCIAL REGULATION REFORMS AND BREXIT

There will be substantial regulatory changes in the US and Europe over the next few years.

In the US, President Trump's Republican party is pursuing a wide-ranging programme of reform, including to the US financial system. The US Department of the Treasury published a number of recommendations in June, including amendments to matters such as US capital, stress testing and liquidity requirements.

Across the Atlantic, the UK and EU are beginning to negotiate the UK's exit from the EU, which is required to take effect no later than the end of March 2019.

There is a lot of uncertainty with these processes, including the final shape of any regulatory changes. We continue to monitor developments to assess the impact on the Fund.

OTC DERIVATIVES REGULATION

As noted on page 87, one of the many reforms to over-the-counter (OTC) derivatives that will affect the Fund over the coming years is the rules on the margining requirements for non-cleared derivatives.

Regulators in each of the key G20 countries have finalised their own rules in order to meet the globally agreed timetable for implementation of the new margining requirements.

The Fund is exempt from the relevant margin requirements in the US and Australia but is required to comply when entering into non-cleared OTC derivatives with banks in certain other jurisdictions.

The original compliance date applicable to the Fund for posting variation margin in each of the relevant jurisdictions was extended by six months to 1 September 2017. The compliance date for posting initial margin remains at 1 September 2020.

SUBMISSIONS

- Submission to the Financial Markets Authority on Substantial Product Holder Disclosures
- Submission to the Australian Treasury in relation to their consultation on Stapled Structures
- Joint Submission to the Organisation for Economic Co-Operation and Development on its Public Discussions Draft "BEPS Action 6 – Discussion Draft on non-CIV examples"
- Submission to the revision of the NZX Corporate Governance Code
- Submission to the US Department of Treasury and the US Internal Revenue Service regarding the Qualified Foreign Pension Fund exemption
- Joint Submission to the Organisation for Economic Co-Operation and Development on BEPS Action 6 – Discussion draft on non-CIV examples
- Joint Submission to the Organisation for Economic Co-Operation and Development on the discussion draft re the treaty residence of pension funds – definition of recognised pension fund
- Submission to the 2016 Retirement Policy Review: The NZ Super Fund and the partial pre-funding of universal superannuation. Prepared at the request of the Commission for Financial Capability.
- Joint Submission on the Reserve Bank consultation on New Zealand's response to foreign margin requirements.
- Joint Submission to the Reserve Bank's issue paper: Review of the Capital Adequacy Framework for Locally Incorporated Banks.

Copies of the Fund's submissions can be viewed at https://www.nzsuperfund.co.nz/publications/submissions.

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The Guardians' environmental performance falls under the remit of the HSSE Committee. The Committee aims to improve staff awareness about the environmental impact of our activities and set achievable targets for minimising this impact.

As a responsible investor, we strive to integrate environmental concerns into our wider activities as an investment manager and hold ourselves accountable to the same guidelines. The biggest potential impact we can make is on our investment portfolio through our engagement with the organisations we invest in. See the Responsible Investment Report on pages 48–57 for more information.

The measures detailed below are the greenhouse gas emissions for the corporate operations of the Guardians. They have been calculated in accordance with the guidance provided in ISO 14064-1:2006 and have been verified by Enviro-Mark Solutions. A verification report is available on: **https://ar2017.nzsuperfund.co.nz/sites/default/files/documents/Assurance_1617_NZSuperannuationFund_Org.pdf**

		2016/17		2015/16		2014/15	
ENERGY SOURCE	MEASURE	QUANTITY	CO_2	QUANTITY	CO_2	QUANTITY	CO_2
Electricity	Kwh	141,121	16.86t	140,932	19.82t	147,845	20.47t
International air travel (long haul)	Km	3,947,104	756.34t	3,489,400	733.41t	3,737,408	785.54t
International air travel (short haul)	Km	950,715	160.14t	685,707	113.97t	911,188	151.45t
Domestic air travel	Km	223,342	62.24t	226,499	66.39t	203,374	59.61t
Mileage (medium car) 1.6 – 2.0L	Km	7,102	1.48t	5,628	1.29t	3,589	0.82t
Taxi – cost	$	87,413	5.81	66,967	7.21t	90,223	9.71t
Waste to landfill	Kg	2,339	2.63	2,609	3.10t	Not Reported	Not Reported
TOTAL			**1,005.51t**		**947.20t**		**1027.6t**

SECTION 04 OPERATIONAL REPORT

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We've been able to find numerous high-quality, world-class investments in New Zealand.

SECTION

05

Statement of Performance

Te Pūrongo Whakahaere Pūtea

100. STATEMENT OF PERFORMANCE

104. MANAGERS AND CUSTODIANS

Image courtesy of **Rockit Apple**

This Statement of Performance measures the Guardians' progress against objectives and measurements set out in the Guardians' 2012-2017 and 2016–2021 Statements of Intent and the 2017–2018 Statement of Performance Expectations.

As explained in our Statement of Intent, the single output of the Guardians is managing the Fund. That output comprises five work streams covering:

- investment;
- risk management;
- cost control;
- governance; and
- organisational capability.

For each work stream, we have set performance measures which, collectively, are performance measures for our output.

Note: while government cash contributions to the Fund are suspended, we receive no Crown funding other than an appropriation to meet Board costs and audit fees (this appropriation, NZD597,000 compared with a budget of NZD528,000 in 2016/17, is required by our legislation). All other costs (e.g., manager fees, staff salaries, research costs) are met by the Fund, and it is these costs that are the subject of our cost control work programme. The NZD597,000 appropriation for 2016/17 was higher than the NZD428,000 spent in 2015/16 in order to cater for the appointment of an additional overseas-based Board member.

OUTCOME MEASURES

The Fund's ultimate outcome is to help reduce the tax burden of future New Zealand taxpayers arising from the cost of New Zealand superannuation.

This long-term outcome will begin to be achieved only when the government starts withdrawals from the Fund. Our legislation prescribes the level of annual capital contributions to the Fund required from the government and only permits capital withdrawals once all the required contributions have been made and, in any event, only after 30 June 2020. Treasury is currently forecasting that withdrawals will begin in 2029/30.

The table below shows the Fund's performance compared to expectations over one and five year periods using the measures set out in our 2016 – 2021 Statement of Intent. The third measure is a portfolio volatility measure. It shows the amount of value the Reference Portfolio could lose in a 1-in-100 year event (or, to put it another way, there is a 1% chance of the Reference Portfolio losing this amount of value or more within the specified time period). If losses of this magnitude were to happen more often than is expected, then either a rarer-than-expected event has occurred or we have taken more risk than we assumed we had. For a fuller description of this measure, please refer to page 9 of our 2016–2021 Statement of Intent, which is available on **www.nzsuperfund.co.nz**.

Measure	Expected Outcome – 1 Year	Actual Outcome – 1 Year	Expected Outcome – 5 Years	Actual Outcome – 5 Years
Reference Portfolio returns relative to Treasury Bills (per annum)	+2.7%*	+14.5%	+2.7% p.a.*	+10.4% p.a.
Actual Portfolio returns relative to Reference Portfolio (after costs)	+1.0%	+4.4%	+1.2% p.a.**	+3.2% p.a.
In a 1-in-100 year event, potential Reference Portfolio loss is equal to or worse than:	-25.2%	+16.3%	-5.0% p.a.	+13.0% p.a.

* In 2014/15, the Guardians conducted a review of the Fund's Reference Portfolio, resulting in the Reference Portfolio benchmark being increased from +2.5% to +2.7%. The new benchmark came into effect in July 2015. Further information on the Reference Portfolio and Treasury Bill measures are available on our website at **www.nzsuperfund.co.nz/how-we-invest/reference-portfolio.**

** This figure reflects our expected outcome five years ago, in 2012. Our current five year expectation for this measure is +1.0%p.a.

OUTPUT MEASURES 2016/17

The table below outlines our performance in delivering on the five work streams through which we manage the Fund using the measures set out in our 2016–2021 Statement of Intent.

Work Programme	Measure	Expected Outcome	Actual Result	Further information
INVESTMENT	Reference Portfolio returns above Treasury Bills (per annum) over any 20-year moving average period	2.7% p.a.	Achieved. Refer to table on page 100.	Pages 26–31 and **www.nzsuperfund.co.nz.**
INVESTMENT	Actual Fund returns above Reference Portfolio (per annum, net of costs)	1.0% p.a.	Achieved. Refer to table on page 100.	Pages 26–31 and **www.nzsuperfund.co.nz.**
COST CONTROL	Costs relative to peers in CEM survey	Achieve a rating of 'median cost, value adding' or better over a 5-year rolling period.	Cost (5 year) – Achieved Value-Add (5 year) – Achieved.	See page 113 for a full discussion and more information on the CEM survey and cost control. An executive summary of the survey results is also available at **www.nzsuperfund.co.nz/performance/cost**.
RISK MANAGEMENT	In a 1-in-100 year event, potential Reference Portfolio loss	≤-25.2 p.a.	Achieved. Refer to table on page 100.	See page 9 in our 2016–2021 Statement of Intent.
RISK MANAGEMENT	Transparency ratings	10/10 in the Sovereign Wealth Fund Institute's Transparency Index; top quartile or higher ratings in other surveys.	Achieved 10/10 in the SWFI's Q2 2017 Transparency Index. No other surveys noted.	Refer to **www.nzsuperfund.co.nztransparency-reporting** and **www.swfinstitute.org** for more information.
RISK MANAGEMENT	Annual updating of response to Santiago Principles	A self-assessment of the adherence to the Santiago Principles is completed and assured by an independent third party.	Completed. Our responses to the Santiago Principles were also assured by EY.	See **www.nzsuperfund.co.nz/performance/best-practice** and the website of the International Forum of Sovereign Wealth Funds at **www.ifswf.org**.
RISK MANAGEMENT	UNPRI Assessment over time	A or A+ rating for Strategy and Governance*.	Achieved an A+ rating for Strategy and Governance in the 2016/17 UNPRI assessment.	See page 53; **www.unpri.org** and **www.nzsuperfund.co.nz** for more information.
RISK MANAGEMENT	Published records of voting, Responsible Investment in Practice Report	Voting reports for both periods and the Responsible Investment in Practice are completed and published.	Six-monthly voting reports to 31/12/16 and 30/6/17 published. Responsible Investment Report published.	See **www.nzsuperfund.co.nz/performance-esg-management/votingreports** and the Responsible Investment Report at pages 48–57.
GOVERNANCE	Outcome of independent reviews	Ongoing good reviews with the review and our response published. There were no material concerns of the effective and efficient performance of the Guardians' functions.	N/A for 2016/17. The last independent review was completed in 2014/15.	Refer page 43 of the 2014/15 annual report.
ORGANISATIONAL CAPABILITY	Result of organisational culture survey	Achieve the constructive benchmark in at least two of the four constructive styles in the biennial Human Synergistics OEI/OCI surveys.**	Achieved.	See pages 88–89.
	Result of organisational engagement survey	Achieve an overall staff engagement score in the upper quartile of the global benchmark in the biennial CEB Engagement Survey.**	Achieved.	See pages 88–89.

* The expected outcome for the Guardians' performance in the UNPRI assessments was updated to reflect measures put in place after the 2014/15 pilot assessment.

** Or equivalent ratings in equivalent surveys, bearing in mind that over 10 or 20 year periods our preferred survey methodology may change.

For detailed explanations of these performance measures see our 2016-2021 Statement of Intent and the Performance section of **www.nzsuperfund.co.nz.**

KEY 2016/17 STRATEGIC PLAN ACTIVITIES

In this section, we report on the Guardians' progress against the three activities that were highlighted in our 2016–2017 Statement of Performance Expectations and which were key to our Strategic Plan for the 2016/17 year.

1.

RISK SYSTEMS

ACHIEVED	**20%**
WORK PROGRAMME	**INVESTMENT, RISK**
STRATEGIC PLAN OBJECTIVE	**BEST PORTFOLIO, EFFICIENCY, SCALABILITY AND INNOVATION**

In 2014, we commenced work on a project to consider the best way of supporting the Fund's current and future requirements for portfolio and risk management. Having identified and assessed a range of options, we decided to investigate and select an investment risk management platform to allow us to better monitor our investment risks, particularly around liquidity and counter-party risk.

Following a rigorous selection process and due diligence, a preferred product was selected and an implementation project commenced in August 2016. Unfortunately in December 2016, the owner of this product advised that they were exiting the business, and as we were not sufficiently confident that the new owners were a suitable long-term partner for the Guardians, we terminated the contract.

The opportunity was taken to confirm that the project objectives remained appropriate, and we then restarted the project with a new system, Quantifi. Implementation commenced in June 2017, however, a significant amount of time had been lost due to the change in product and supplier, hence the 20% achievement rating. This project will now be completed during the 2017/18 financial year.

Quantifi's platform will replace existing risk models across a range of investment risk areas. We are confident its implementation will produce long-term tangible benefits to the Fund. The platform will:

- Reduce the significant operational risk of having key processes using multiple application functions;
- Increase the frequency of risk reporting. The effort required to run our models at present means they are run on a weekly or monthly basis. We expect the new system to report daily;
- Significantly improve liquidity stress test capability. At present out models are not integrated, making it difficult to apply a stress test across different areas;
- Improve the independent monitoring of risk;
- Improve user access to the outputs of risk monitoring with drill-down capability; and
- Enable pre-trade analysis for trading, as well as daily PnL attributions, to improve risk capture and monitoring for the Portfolio Completion team.

The project draws on significant IT resources, as well as key business resources across the Portfolio Risk, Portfolio Completion and Asset Allocation teams.

2.

CONCENTRATED PORTFOLIO

ACHIEVED	**100%**
WORK PROGRAMME	**INVESTMENT, COST CONTROL**
STRATEGIC PLAN OBJECTIVE	**EFFICIENCY, SCALABILITY AND INNOVATION**

This project involved investigating the use of a concentrated portfolio to implement the Fund's passive global equities allocation.

In 2016/17, a project team was assembled to undertake the investigation. In May 2017, a summary of the project team's findings was presented for discussion at the Investment Committee.

The project team recommended against the use of a concentrated portfolio, and the Investment Committee accepted this recommendation. Potential benefits in operating cost savings and in executing the Fund's Responsible Investment Framework were assessed against the ability of a concentrated portfolio to replicate the Fund's passive equity exposures. Overall the cost savings were not material enough to mitigate the costs due to the higher tracking error, increased rebalancing and transaction costs and increased volatility associated with concentrated portfolios. Moving to a concentrated portfolio would also reduce revenue from securities lending, derived mainly from holding a large number of passive stocks.

3.

COLLATERAL OPTIMISATION

ACHIEVED	**100%**
WORK PROGRAMME	**INVESTMENT, COST CONTROL**
STRATEGIC PLAN OBJECTIVE	**BEST PORTFOLIO, EFFICIENCY, SCALABILITY AND INNOVATION**

Collateralisation is the primary means of managing credit exposure amongst the Fund's counter-parties. It represents the monies or securities that are posted between the Fund and its counter-parties to mirror unrealised profit and loss on the Fund's open derivatives positions.

Collateral optimisation is the process of delivering collateral to each counter-party in the cheapest way possible and in a way that makes best use of the inventory of securities across the Fund.

The project is a multi-year activity that commenced in 2016/17. There are three parts to the project, the first of which was to implement a securities lending programme.

In June 2016, the Board approved the re-establishment of a securities lending programme, and we commenced lending in June 2017. See page 43 for more information.

The remaining two initiatives will be undertaken in 2017/18:

- Research vendor solutions for optimisation and implementation;
- Arrange asset delivery to minimise financing costs in meeting collateral obligations.

This table sets out a complete list of the Fund's asset and investment managers and custodians during the financial year.

It includes both those managers appointed by us and those who manage funds in which the Fund is invested. It identifies where new managers or custodians have been appointed or terminated over the last 12 months. It also identifies whether managers invest primarily in listed (or highly traded) or unlisted securities.

We disclose the value of the assets each manager manages on behalf of the Fund, as at 30 June 2017. We also disclose the value of each investment as a percentage of the total Fund. Our internal investment mandates are managed by the Guardians' in-house team of investment professionals.

Managers appointed since 1 July 2016	Year appointed	Fund name and focus areas	Type	Value of amount invested NZDM	% of Total NZSF (pre-tax)
AQR Capital Management, LLC	2016	Segregated mandate - factor investing (low volatility and value)	Listed	772	2.2%
BlackRock Financial Management	2016	Global Merger Partners LLC – merger arbitrage	Listed	298	0.8%
Canyon Capital Advisors	2016	Canyon NZ DOF Investing L.P. – distressed credit	Unlisted	149	0.4%
Northern Trust	2016	Segregated mandate - factor investing (low volatility and value)	Listed	650	1.8%
Direct Capital	2016	Direct Capital Partners Fund V – New Zealand expansion capital	Unlisted	0	0.0%
Movac	2016	Movac Fund 4 LP – New Zealand expansion capital	Unlisted	4	0.0%
Pioneer Capital Partners III	2016	Pioneer Capital Partners Fund III – New Zealand expansion capital	Unlisted	10	0.0%

Mandates closed since 1 July 2016*	Year appointed	Fund name and focus areas	Type	Value of amount invested NZDM	% of Total NZSF (pre-tax)
GMO Renewable Resources	2005	Timber assets in New Zealand	Unlisted		
Hancock Natural Resource Group	2005	Timber assets in New Zealand	Unlisted		
Secured Capital	2010	SCJREP IV Loan Fund – non-performing and sub-performing commercial property loans in Japan	Unlisted		

*Refer to page 44 for more information.

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Incumbent managers as at 1 July 2016	Year appointed	Fund name and focus areas	Type	Value of amount invested NZDM	% of Total NZSF (pre-tax)
Adams Street Partners	2007	Adams Street Partnership Fund – 2007 Non-US Fund – buyout, funds of funds	Unlisted	8	0.0%
AMP Capital Investors	2005	AMP Property Portfolio (APP) – New Zealand Property	Unlisted	0	0.0%
Apollo Global Management LLC	2012	Financial Credit Investment – US life settlements	Unlisted	63	0.2%
	2014	Financial Credit Investment II – US life settlements	Unlisted	203	0.6%
AQR Capital Management LLC	2009	CNH Convertible Arbitrage Fund – a diverse convertible arbitrage fund	Listed	27	0.1%
Ascribe Capital (formerly American Securities)	2010	American Securities Opportunity Fund II – distressed credit	Unlisted	30	0.1%
Bain Capital (formerly Sankaty Advisors)	2013	Sankaty Credit Opportunities V Europe – distressed credit	Unlisted	95	0.3%
BlackRock Investment Management UK	2013	Segregated mandate – passive global equities	Listed	2,865	8.3%
	2010	Segregated mandate – passive global fixed income	Listed	2,744	8.0%
Bridgewater Associates	2006	Bridgewater Pure Alpha Fund II, Limited – global macro	Listed	301	0.9%
Canyon Capital Advisors	2010	Canyon Distressed Opportunities Fund (Delaware) – distressed credit	Unlisted	12	0.0%
CITP	2011	China Infrastructure Partners – Chinese infrastructure and related investments	Unlisted	114	0.3%
Coller Investment Management	2007	Coller International Partners V Fund – global private equity secondaries	Unlisted	0*	0.0%
Devon Funds Management	2011	Segregated mandate - New Zealand active equities	Listed	365	1.1%
D.E. Shaw & Co	2012	D.E. Shaw Heliant International Fund – global macro	Listed	237	0.7%
Direct Capital	2014	George H Limited co-investment	Listed and Unlisted	7	0.0%
	2009	Direct Capital Partners IV – New Zealand expansion capital	Unlisted	13	0.0%
	2005	Direct Capital Partners III – New Zealand expansion capital	Unlisted	0	0.0%
Elementum Advisers	2010	Segregated mandate – natural catastrophe reinsurance	Unlisted	75	0.2%
FarmRight	2010	Rural land in New Zealand	Unlisted	305	0.9%

* The investment in CIP V is held at cost, which is less than the net asset value reported by Coller. The cost of the investment is NZD0 because the value of the capital returned from CIP V is greater than the amount that was invested.

MANAGERS AND CUSTODIANS (CONTINUED)

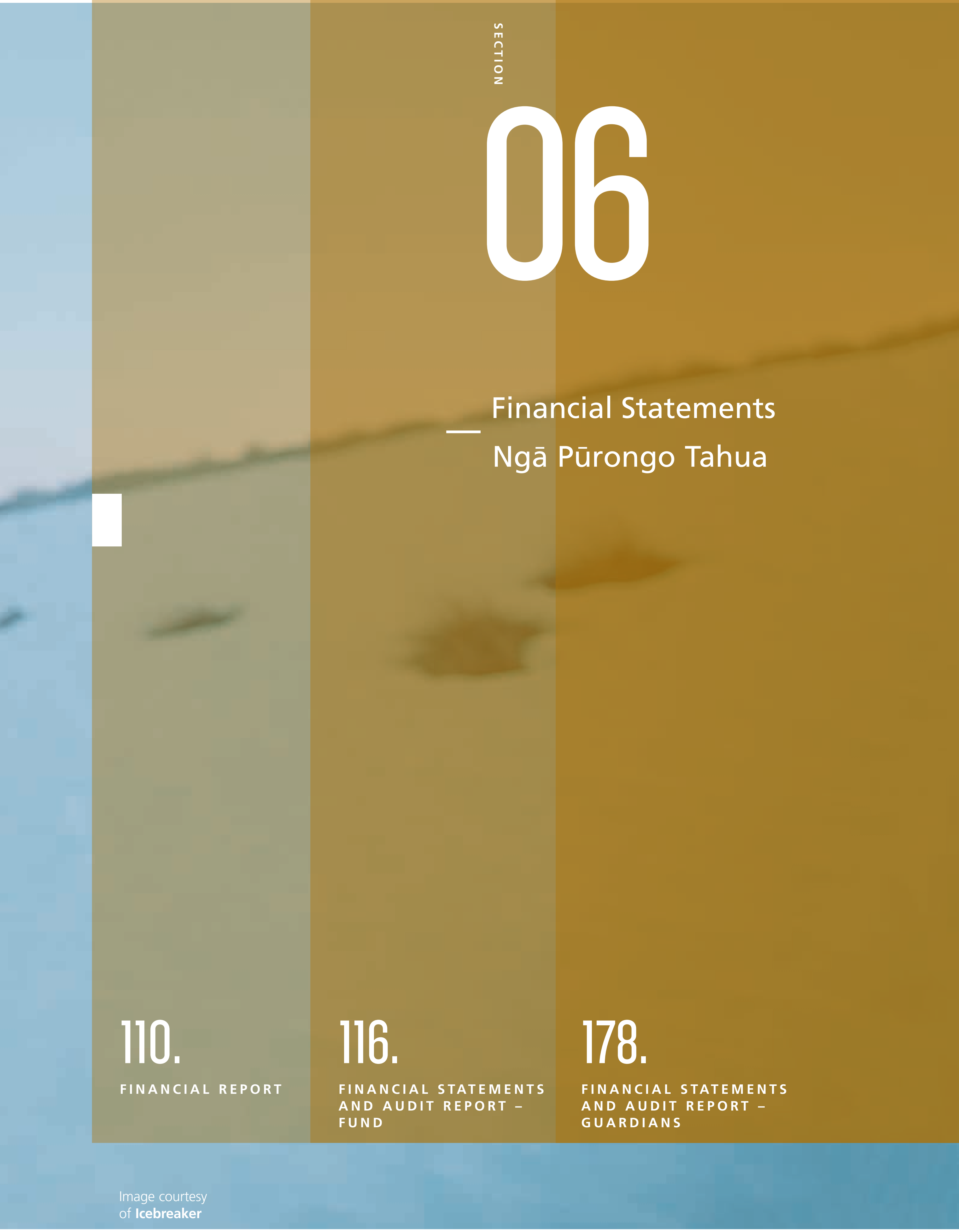
Incumbent managers as at 1 July 2016	Year appointed	Fund name and focus areas	Type	Value of amount invested NZDM	% of Total NZSF (pre-tax)
Global Forest Partners	2009 & 2012	AIF Properties – Australian timber	Unlisted	122	0.4%
	2010	Global Timber Investors 9 – timber assets in New Zealand, Australia, Asia, Africa and South America	Unlisted	31	0.1%
	2007	Global Timber Investors 8 – timber assets in Australia, New Zealand and South America	Unlisted	99	0.3%
Hancock Natural Resource Group	2005	Timber assets in the United States	Unlisted	32	0.1%
HarbourVest Partners	2006	HarbourVest International Private Equity Partnership V Fund – buyout, funds of funds	Unlisted	22	0.1%
H.R.L. Morrison & Co	2006	Global infrastructure mandate, which includes our investment in Retire Australia and LongRoad	Listed and Unlisted	478	1.4%
	2009	Public Infrastructure Partners Fund – social infrastructure such as educational and health-care facilities, and student accommodation	Unlisted	88	0.3%
Kohlberg Kravis Roberts (KKR)	2007	KKR Asia Fund – Asian private equity	Unlisted	9	0.0%
	2008	KKR 2006 Fund – global private equity	Unlisted	41	0.1%
	2014	KKR Energy Income and Growth Fund (EIGF) and private equity investments in North American natural gas exploration and production, mid-stream, downstream and/or energy infrastructure and services	Unlisted	110	0.3%
Leadenhall Capital Partners	2013	Natural catastrophe reinsurance	Unlisted	203	0.6%
LSV Asset Management	2005	Segregated mandate – emerging markets equities	Listed	410	1.2%
Mint Asset Management	2015	Segregated mandate – New Zealand active equities	Listed	278	0.8%
Northern Trust	2013	Segregated mandate – passive global equities	Listed	5,065	14.3%
	2015	Segregated mandate – passive global fixed income	Listed	1,056	3.0%
Pencarrow Private Equity	2011	Pencarrow IV Investment Fund – small and mid-market New Zealand businesses	Unlisted	32	0.1%
Pioneer Capital Partners	2013	New Zealand expansion capital	Unlisted	31	0.1%
Ramius Advisors, LLC	2016	Ramius Merger Fund LLC – merger arbitrage mandate	Listed	284	0.8%
Savanna Real Estate	2010	Savanna Real Estate (PIV) Fund II – private equity real estate in the major markets surrounding New York City, Washington, D.C. and Boston	Unlisted	0	0.0%
Sveafastigheter	2011	Sveafastigheter Fund III – real estate assets primarily in Sweden and Finland	Unlisted	2	0.0%

Incumbent managers as at 1 July 2016	Year appointed	Fund name and focus areas	Type	Value of amount invested NZDM	% of Total NZSF (pre-tax)
State Street Global Advisors	2009	Segregated mandate – passive global listed equities	Listed	5,947	16.8%
Waterman Capital	2010	Waterman Fund II – small and mid-market New Zealand businesses	Unlisted	16	0.0%
Willis Bond & Co	2010	Willis Bond Institutional Partners – private real estate in New Zealand	Unlisted	8	0.0%

Custodian	Role
CUSTODIANS DURING THE FINANCIAL YEAR	
Northern Trust	Global master custodian for the Fund's assets
CUSTODIANS APPOINTED FOR A SPECIFIC PURPOSE DURING THE FINANCIAL YEAR	
Wells Fargo and Bank of New York Mellon	Holding collateral associated with our investment in catastrophe-linked securities (including catastrophe bonds)
Euroclear Bank NA/SV	Holding collateral required under sale and repurchase (repo) transactions
The New Zealand Guardian Trust Company of New Zealand, the Public Trust and Foundation Corporate Trust	Trustees for holding money relevant to tax pooling arrangements
State Street Bank and Trust Company	Appointed custodian for the Fund's securities lending programme

Investment mandates managed by the Guardians' in-house team of investment professionals include:

- Active Collateral
- Active NZ Equities
- Cash
- Currency Management
- Direct Arbitrage
- Dividend Derivatives
- Event Driven Opportunity
- Infrastructure Transition Assets
- Life Settlements
- Passive NZ Equities
- Beta Implementation and Completion
- Securities Lending
- Strategic Tilting
- U.S. Transition Assets
- Volatility Strategy



SECTION

06

Financial Statements
Ngā Pūrongo Tahua

110. FINANCIAL REPORT

116. FINANCIAL STATEMENTS AND AUDIT REPORT – FUND

178. FINANCIAL STATEMENTS AND AUDIT REPORT – GUARDIANS

Image courtesy of **Icebreaker**

Explaining our financial statements

STEWART BROOKS
GENERAL MANAGER FINANCE AND RISK

This Annual Report includes financial statements for both the Fund and for the Guardians, the Crown entity that manages the Fund. All Guardians' costs are paid for out of the Fund, except for a small appropriation, funded by parliament, for Board fees and expenses.

The financial statements for the Fund are among the largest and most complex for a New Zealand reporting entity. The Fund accounts have been prepared under International Financial Reporting Standards (IFRS), while the Guardians' accounts are prepared under Public Benefit Entity (PBE) accounting standards.

In this section, we explain the key elements of the Fund's financial statements and discuss the main financial features of the 2016/17 year.

A five-year financial summary can be found at page 111. The financial statements for the Guardians are at page 178 and the financial statements for the Fund at page 116.

Other specific points of interest within the financial statements include:

- Remuneration information at pages 191-193 (Note 3(b)). This information should be read alongside the explanation of our remuneration framework on pages 79-83.
- As mentioned above, the Guardians' costs are recovered either from the Fund or funded by parliament, resulting in a 'zero' net profit/loss for the year.

Fund Five-Year Financial Summary

	2013* (Restated)	2014	2015	2016	2017	
	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000	
Balance Sheet						
Cash and cash equivalents	6,141,822	3,352,901	1,355,384	2,135,442	2,167,742	
Investments	17,349,231	23,487,130	27,998,775	27,973,626	34,403,663	Increased investments reflects the Fund's investment performance (refer to pages 26-27)
Other assets	229,265	392,527	791,447	310,302	1,184,490	Rebalancing activity has resulted in high levels of pending sales and purchases
Other liabilities	(728,683)	(795,446)	(603,685)	(314,880)	(2,382,830)	
Net assets excluding NZ income tax	**22,991,635**	**26,437,112**	**29,541,921**	**30,104,490**	**35,373,065**	
Current NZ income tax	(248,741)	(409,162)	278,223	(247,016)	(504,696)	
Deferred NZ income tax	(179,733)	(203,242)	(278,887)	(305,613)	(364,723)	
Net assets including NZ income tax	**22,563,161**	**25,824,708**	**29,541,257**	**29,551,861**	**34,503,646**	
Contributed capital	14,882,079	14,882,079	14,882,079	14,882,079	14,882,079	Crown contributions to the Fund – suspended in 2009
Other reserves	7,681,082	10,942,629	14,659,178	14,669,782	19,621,567	Predominantly cumulative net profit after New Zealand tax
Total equity	**22,563,161**	**25,824,708**	**29,541,257**	**29,551,861**	**34,503,646**	
Income statement						
Investment income	602,714	731,929	723,842	708,141	756,432	Interest and dividend income, both of which vary in line with the amount invested and market returns
Investment gains and losses	4,394,553	3,748,874	3,219,531	(50,103)	5,566,624	Changes in the value of our investments – fluctuates in line with market movements
Net operating income	**4,997,267**	**4,480,803**	**3,943,373**	**658,038**	**6,323,056**	
Expenses	(168,264)	(134,352)	(115,045)	(98,959)	(121,333)	Our biggest expense is external manager and performance fees. These costs vary from year to year in line with investment returns
Profit before NZ income tax	**4,829,003**	**4,346,451**	**3,828,328**	**559,079**	**6,201,723**	
Tax (expense) / credit	(1,006,280)	(1,094,556)	(122,652)	(537,798)	(1,255,031)	The Fund makes returns to the Crown in the form of tax payments. See pages 114–115 for further discussion
Profit after NZ income tax	**3,822,723**	**3,251,895**	**3,705,676**	**21,281**	**4,946,692**	

* Restatements are the result of the adoption of New Zealand International Financial Reporting Standards changes. There have been no past misstatements.

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201-1

Understanding the Fund's Financial Statements

BALANCE SHEET

The overall size of the Fund's balance sheet is an important measure: it shows how much value is in the Fund at a particular date. This is the money that will ultimately be deployed to help pre-fund New Zealand Superannuation. The key components of the balance sheet are:

1) **Cash and cash equivalents** – this includes cash used for collateral against derivative exposures and operating cash used for the day-to-day activities of the Fund;

2) **Investments** – this includes our holdings of equities, bonds and other financial instruments held by the Fund;

3) **Other assets and liabilities** – predominantly amounts due or owed for the settlement of recent transactions; and

4) **Tax** – New Zealand tax amounts owed by the Fund.

As at 30 June 2017, the Fund's balance sheet totalled NZD34.5 billion, made up of NZD14.9 billion contributed by the Crown with a further NZD19.6 billion added (after tax) by the Guardians from investing those contributions. In addition, the Fund has also paid NZD5.6 billion to the Crown via tax payments since investing began.

One of the more complex items within the Fund's financial statements is the use of derivatives, which is outlined on pages 154–159 (Note 4(e)). There are three broad concepts that matter when considering derivatives: gross notionals, fair value and net economic exposures.

The **gross notional** value of a derivative is the total exposure of a derivative position in dollar terms at the time of investing. The gross notional derivative values are disclosed in absolute terms in the notes to the financial statements irrespective of whether the Guardians are 'long' or 'short' a particular derivative position. As a result, the gross notional derivative values do not represent the actual derivative exposure risk of the Fund.

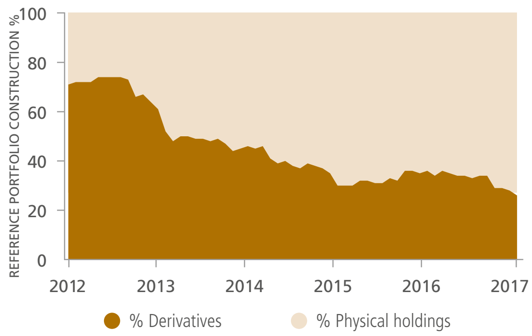
The **fair value** of a derivative is the marked-to-market value of the derivative position at a point in time (i.e. the gain or loss made on a trade since its inception) based on its market price. The fair value may fluctuate considerably through time as a result of market price movements and does not reflect the realised value of the derivative (as it has not been sold), nor the trading activity of the Guardians during the year (i.e. the buying and selling of derivative positions). Importantly the fair value of a position determines the quantity of collateral (cash equivalent assets) we hold for or receive from our derivative counter-parties as security.

The **net economic exposure** is the difference between the 'long' and 'short' gross notional positions, thus outlining the 'net exposure' to a particular financial position. The net economic exposure to derivatives is considerably smaller than the gross notional exposures. The majority of our net economic exposure via derivatives is made up of the Fund's foreign exchange currency exposure being hedged back to NZ dollars.

102-45

The graph below shows the proportion of the Reference Portfolio that was accessed through derivatives from 1 July 2012 to 30 June 2017.

USE OF DERIVATIVES



INCOME STATEMENT

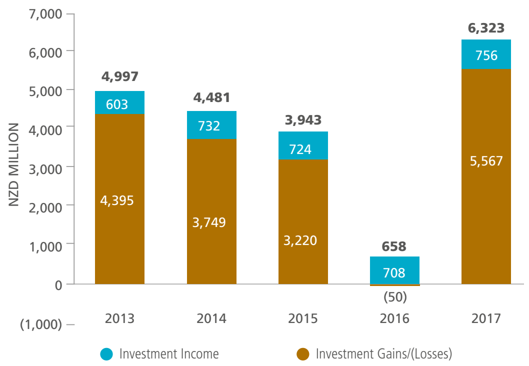
NET OPERATING INCOME

Net operating income is the annual income generated by the Fund before expenses have been deducted. There are two key components to net operating income:

1) **Investment income** – primarily the income from interest and dividends; and

2) **Investment gains and losses** – changes in the value of the Fund's investments, along with the impact of changes in the value of the New Zealand dollar on investments held in other currencies.

NET OPERATING INCOME



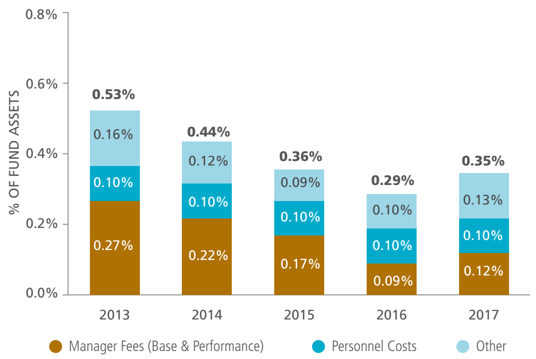
In 2017, the Fund's net operating income was NZD6,323 million. Investment income (interest and dividends) increased slightly although remained broadly in line with prior years. The Fund reported its largest ever marked-to-market gains on the value of its investments. See the Investment Report on pages 25–57 for more information.

EXPENSES

The net expected return of an investment (return after taking account of all expenses) is central to all our investment decisions. We therefore seek to:

- ensure that any fees paid to external managers are in line with market standards and the complexity of the investment;
- include the cost of due diligence in our assessment of whether an investment opportunity is worth pursuing, relative to the potential risk-adjusted value;
- choose cost-effective access points for all investment opportunities; and
- benchmark our costs against those of our peers.

COST OF MANAGING THE FUND AS A PERCENTAGE OF NET ASSETS



In 2016/17, the cost of managing the Fund's investments was NZD113.1 million (excluding farm and timber operating costs). As a percentage of net assets, total costs were 0.35%. The key components were:

- **External Manager Fees of NZD40.6 million**. These fees can vary considerably year-on-year due to performance fees, which are only earned by a small number of external managers if they out-perform specified benchmarks. This year base manager fees remained flat (0.08%) while performance fees increased to 0.04%;
- **Guardians personnel costs of NZD33.0 million**, which remained steady as a proportion of net assets; and
- **Other costs of NZD39.4 million** including (in order of significance) trading fees paid on investment activity, custodian fees, IT costs and other professional fees paid to external parties.

In terms of reporting costs in our financial statements, the legal structure through which we invest and the way in which we incur costs can have a significant impact. Where the Fund incurs costs directly e.g. external manager fees billed directly, these are separately reported as part of the Fund's expenses. Indirect costs that are incurred by investment vehicles in which the Fund holds an interest, e.g. manager fees incurred within managed fund structures or the operating costs of our farms, are however netted off against returns within 'Investment gains and losses'.

The impact of costs on the Fund's performance remains a key consideration when assessing new and existing mandates and the allocation of funds. Cost control activities in 2016/17 included:

- developing new quarterly reporting focused on cost analysis and identifying savings opportunities;
- streamlining our policy review process to make this more efficient; and
- implementing a new credit card management system

As well as monitoring costs internally, the Fund is also benchmarked against other global peers via the annual CEM Cost-Effectiveness survey. This survey covers both value-add (returns) and cost, relative to the global and peer medians.

The most recent survey, of 252 funds representing over USD14 trillion in assets, estimated the Fund's value-add for the five years to 31 December 2016 to be 3.0%, comparing favourably to a peer median of 0.6% and a global median of 0.4%.

The Fund's five-year net total return of 15.5% was among the highest in its peer group and in the global universe of funds surveyed. The Fund also performed well in the 2016 calendar year. CEM estimated the Fund's net value-add as 3.2% compared with a peer median of 0.5%.

To assess whether the Fund's costs are high or low given its unique asset mix and size, CEM calculates a benchmark cost each year. This benchmark is an estimate of what it would cost to operate the Fund's asset mix using the median costs incurred by peers for similar services.

The Fund's total cost of 33.8 basis points was below the benchmark cost of 37.6 basis points for 2016. CEM describes this as a 'cost saving' of 3.8 basis points in 2016.

For the past five years, the Fund had an average cost savings of 2.0 basis points. The CEM report is available at: **www.nzsuperfund.co.nz/performance/cost.**

INCOME TAX

The Fund pays income tax in New Zealand to the New Zealand government and is also subject to foreign tax depending on the source of its offshore income. Since inception, the Fund has paid NZD5.56 billion in tax to the New Zealand government. We include New Zealand tax paid in measurements of the Fund's performance because it is a return to the Crown.

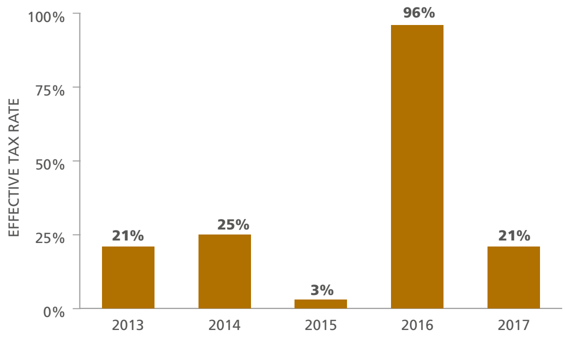
The Fund is one of the largest taxpayers in New Zealand, and its income tax expense can be highly volatile. This is largely driven by the New Zealand tax rules for physical equity investments. Generally only dividends in relation to physical equity investments are subject to tax. Gains on these investments are not subject to any further tax, and any losses are not tax deductible. New Zealand tax on dividends from foreign equities (excluding most listed Australian equity investments) is calculated notionally under New Zealand's 'Fair Dividend Rate' (FDR) regime. A deemed dividend of 5% per annum of the market value of the foreign equity investment is taxable while actual dividends received are not subject to tax.

Tax is paid on actual dividends received from New Zealand and most listed Australian equity investments.

Income or losses arising from the Fund's other investments, e.g. equity derivatives, bonds and cash deposits, are generally subject to 28% New Zealand tax.

The graph below illustrates the tax volatility the Fund has experienced over the past five years.

FUND TAX EXPENSE AS A PERCENTAGE OF NET INCOME



NEW ZEALAND
INCOME TAX PAID

$676m

on 2016/17 returns. An additional NZD494m owing for this year was paid in July 2017.

OFFSHORE
WITHHOLDING TAXES

$14m

(excludes underlying taxes paid by the Fund's investments).

TAX RATE VOLATILITY IN A NUTSHELL

The Fund's tax rate is very volatile. Our tax affairs are complex, and there are many contributors to this volatility, but the main driver is how our physical global equities are taxed under the FDR regime. This regime taxes these assets at the rate of 5% of market value, rather than being taxed based on actual market movements.

In simple terms, this means that in any given year if our return on global equities exceeds 5%, then our tax rate will be lower than 28%, and if our returns are less than 5% then our tax rate will be higher than 28%. This financial year and the previous year illustrates both of these outcomes.

In 2016/17, the Fund had an effective tax rate of 21% compared to 96% in 2015/16.

TAX GOVERNANCE

The Guardians' Risk Management Policy sets out the Fund's tax management framework.

We also:

- endorse and operate in accordance with the OECD's Business and Industry Advisory Committee (BIAC) Statement of Tax Principles for International Business (available at www.nzsuperfund.co.nz/publications/disclosures/tax); and
- have a co-operative compliance agreement with the New Zealand Inland Revenue (IRD).

Under our agreement with the IRD, tax positions taken by the Fund on its activities, including the tax treatment of new investments, are disclosed to the IRD before our New Zealand tax return is filed. This provides us with real-time engagement with the IRD and enhanced certainty around our tax position before we file our return. As one of New Zealand's largest taxpayers, it is important for the Guardians to be involved in tax policy thought leadership. The Guardians is a member of the Corporate Taxpayer Group in New Zealand and makes submissions, in conjunction with peer funds, to the OECD and foreign Governments in relation to changes to the international tax framework. The Risk Management Policy is available at www.nzsuperfund.co.nz/publications/policies.

STATEMENT OF RESPONSIBILITY

For the year ended 30 June 2017

The Board and management of the Guardians of New Zealand Superannuation accept responsibility for the preparation of the annual financial statements of the New Zealand Superannuation Fund and the judgements used in them.

The Board and management of the Guardians of New Zealand Superannuation accept responsibility for establishing and maintaining a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of financial and non-financial reporting of the New Zealand Superannuation Fund.

In the opinion of the Board and management of the Guardians of New Zealand Superannuation, the annual financial statements for the year ended 30 June 2017 fairly reflect the financial position, operations and cash flows of the New Zealand Superannuation Fund.

CATHERINE SAVAGE, CHAIR
27 September 2017

ADRIAN ORR, CHIEF EXECUTIVE OFFICER
27 September 2017

As at 30 June 2017		FUND ACTUAL		BUDGET (UNAUDITED)
		2017	2016	2017
	NOTE	NZD'000	NZD'000	NZD'000
ASSETS				
Cash and cash equivalents	2(a), 4(a), 4(b)	2,744,837	2,237,847	2,175,704
Cash pledged as collateral	2(a), 4(a), 4(c)	288,540	758,811	1,318,473
Trade and other receivables	2(a), 4(a), 4(d)	1,169,311	133,101	1,727,859
Other current assets	2(a)	–	924	–
Investments				
Investments – derivative financial instrument assets	2(a), 4(a), 4(e)	1,327,336	1,566,708	–
Investments – other financial assets	2(a), 4(a), 4(e)	31,821,965	26,475,845	26,520,993
Other financial assets pledged as collateral	2(a), 4(a), 4(e)	55,456	56,164	60,365
Investments in unconsolidated subsidiaries	2(a), 4(a), 4(e)	1,531,424	386,599	600,678
Agricultural assets	2(a)	–	19,040	–
Total investments		34,736,181	28,504,356	27,182,036
Assets held for sale	2(a)	–	4,072	–
Property, plant and equipment	2(a), 5(a)	2,018	158,070	1,226
Intangible assets	2(a)	13,161	14,135	722
Total assets		**38,954,048**	**31,811,316**	**32,406,020**
LIABILITIES				
Cash collateral received	2(a), 4(a), 4(c)	865,635	861,216	390,723
Trade and other payables	2(a), 4(a), 4(g)	2,367,188	298,666	548,414
Investments – derivative financial instrument liabilities	2(a), 4(a), 4(e)	332,518	530,730	–
Income tax payable	2(a)	504,696	247,016	122,082
Provision for performance-based fees	2(a), 5(b)	15,642	16,214	21,526
Deferred tax liability	2(a), 7(e)	364,723	305,613	317,023
Total liabilities		**4,450,402**	**2,259,455**	**1,399,768**
Net assets		**34,503,646**	**29,551,861**	**31,006,252**
PUBLIC EQUITY				
Retained surplus		19,597,494	14,631,074	16,054,303
Available-for-sale reserve	6(b)	16,285	16,305	34,134
Asset revaluation reserve	6(b)	7,788	22,403	35,736
Contributed capital	6(a)	14,882,079	14,882,079	14,882,079
Total public equity		**34,503,646**	**29,551,861**	**31,006,252**

The attached notes form part of, and should be read in conjunction with, these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2017		FUND ACTUAL		BUDGET (UNAUDITED)
		2017	2016	2017
	NOTE	NZD'000	NZD'000	NZD'000
Net operating income	7(a)	6,323,056	658,038	2,710,664
Operating expenditure	7(c)	121,333	98,959	143,098
Profit for the year before income tax expense		**6,201,723**	**559,079**	**2,567,566**
Income tax expense	7(e)	1,255,031	537,798	620,903
Profit for the year after income tax expense		**4,946,692**	**21,281**	**1,946,663**
Other comprehensive income – reclassifiable to profit or loss in subsequent periods				
Net fair value gains/(losses) on available-for-sale financial assets		3,660	(11,377)	7,369
Other comprehensive income – not reclassifiable to profit or loss in subsequent periods				
Gains/(losses) on revaluation of assets		(661)	867	9,994
Tax expense on items of other comprehensive income	7(e)	2,094	(167)	–
Other comprehensive income for the year, net of tax		**5,093**	**(10,677)**	**17,363**
Total comprehensive income for the year		**4,951,785**	**10,604**	**1,964,026**

The attached notes form part of, and should be read in conjunction with, these financial statements.

For the year ended 30 June 2017		FUND ACTUAL				
	NOTE	ASSET REVALUATION RESERVE NZD'000	AVAILABLE-FOR-SALE RESERVE NZD'000	CONTRIBUTED CAPITAL NZD'000	RETAINED SURPLUS NZD'000	TOTAL NZD'000
Balance at 1 July 2015		**21,703**	**27,682**	**14,882,079**	**14,609,793**	**29,541,257**
Profit for the year					21,281	21,281
Other comprehensive income		867	(11,377)			(10,510)
Tax expense on items of other comprehensive income		(167)	–			(167)
Total comprehensive income for the year		700	(11,377)	–	21,281	10,604
Capital contributions from the Crown in respect of funding the net cost of New Zealand superannuation entitlements	6(a)			12,267,000		12,267,000
Capital withdrawals by the Crown in respect of funding the net cost of New Zealand superannuation entitlements	6(a)			(12,267,000)		(12,267,000)
Balance at 30 June 2016		**22,403**	**16,305**	**14,882,079**	**14,631,074**	**29,551,861**
Profit for the year					4,946,692	4,946,692
Other comprehensive income		(661)	3,660			2,999
Tax expense on items of other comprehensive income		2,094	–			2,094
Transfer between reserves	9(a)	(16,048)	(3,680)		19,728	–
Total comprehensive income for the year		(14,615)	(20)	–	4,966,420	4,951,785
Capital contributions from the Crown in respect of funding the net cost of New Zealand superannuation entitlements	6(a)			13,043,000		13,043,000
Capital withdrawals by the Crown in respect of funding the net cost of New Zealand superannuation entitlements	6(a)			(13,043,000)		(13,043,000)
Balance at 30 June 2017		**7,788**	**16,285**	**14,882,079**	**19,597,494**	**34,503,646**

The attached notes form part of, and should be read in conjunction with, these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 30 June 2017	NOTE	FUND ACTUAL 2017 NZD'000	FUND ACTUAL 2016 NZD'000	BUDGET (UNAUDITED) 2017 NZD'000
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash was provided from:				
Proceeds from sale of investments		18,267,474	18,418,840	32,500,855
Cash collateral received		9,986,412	14,026,919	–
Dividends received		445,579	427,550	421,782
Interest received		285,966	278,881	309,364
Income tax received		–	13,550	–
Other income		8,500	11,030	–
Total cash inflow from operating activities		**28,993,931**	**33,176,770**	**33,232,001**
Cash was applied to:				
Purchases of investments		(17,632,534)	(18,515,432)	(32,999,625)
Cash collateral paid		(9,864,620)	(13,542,159)	–
Managers' fees		(45,338)	(38,009)	(29,906)
Payments to suppliers		(61,962)	(63,374)	(129,694)
Income tax paid		(936,147)	–	(402,992)
Goods and Services Tax		(2,794)	(3,153)	–
Total cash outflow from operating activities		**(28,543,395)**	**(32,162,127)**	**(33,562,217)**
Net cash provided by/(used in) operating activities	7(f)	**450,536**	**1,014,643**	**(330,216)**
CASH FLOWS FROM INVESTING ACTIVITIES				
Cash was provided from:				
Proceeds from sale of property, plant and equipment		–	26	–
Proceeds from sale of intangible assets		144	–	–
Total cash inflow from investing activities		**144**	**26**	**–**
Cash was applied to:				
Purchases of property, plant and equipment		(1,069)	(40,961)	(273)
Purchases of intangible assets		(60)	(141)	(865)
Total cash outflow from investing activities		**(1,129)**	**(41,102)**	**(1,138)**
Net cash provided by/(used in) investing activities		**(985)**	**(41,076)**	**(1,138)**
Net increase/(decrease) in cash and cash equivalents		**449,551**	**973,567**	**(331,354)**
Cash and cash equivalents at the beginning of the financial year		2,237,847	1,257,420	2,507,058
Effects of exchange rate changes on the balance of cash held in foreign currencies		57,439	6,860	–
Cash and cash equivalents at the end of the financial year	4(a), 4(b)	**2,744,837**	**2,237,847**	**2,175,704**

The attached notes form part of, and should be read in conjunction with, these financial statements.

SECTION 1: GENERAL INFORMATION AND BASIS OF PREPARATION

(a) General information

These are the financial statements of the New Zealand Superannuation Fund (Fund), a fund established under Section 37 of the New Zealand Superannuation and Retirement Income Act 2001 (Act) on 11 October 2001.

The Fund is a long-term, growth-oriented, sovereign wealth fund that was established to help reduce the tax burden on future taxpayers of the rising cost of New Zealand superannuation. The Fund is managed and administered by the Guardians of New Zealand Superannuation (Guardians). The Guardians was established as a Crown entity by Section 48 of the Act and became operative from 30 August 2002. The Guardians is expected to invest the Fund in a commercial, prudent manner consistent with:

- best-practice portfolio management;
- maximising return without undue risk to the Fund as a whole; and
- avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

The Fund's master custodian is the Northern Trust Corporation.

The Fund is domiciled in New Zealand and the address of its principal place of business is set out in the Corporate Directory on page 213.

The financial statements of the Fund for the year ended 30 June 2017 were authorised for issue in accordance with a resolution of the Board of the Guardians of New Zealand Superannuation on 27 September 2017.

(b) Basis of preparation

The Fund is a profit-oriented entity. The financial statements of the Fund have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP). They comply with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other authoritative pronouncements of the External Reporting Board, as appropriate for profit-oriented entities. The financial statements also comply with International Financial Reporting Standards (IFRS).

The financial statements have been prepared on a fair value basis, except for certain items as detailed in the notes to the financial statements.

The financial statements are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars (NZD'000) unless stated otherwise.

Accounting policies are selected and applied in a manner that ensures the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring the substance of the underlying transactions or other events is reported. Accounting policies relating to specific financial statement items are set out in the relevant notes to the financial statements. Accounting policies that materially affect the financial statements as a whole are set out below.

The Fund meets the definition of an investment entity and has applied the exemption from preparing consolidated financial statements available under NZ IFRS 10 Consolidated Financial Statements. As a result, its investments in subsidiaries are not consolidated, but are measured at fair value through profit or loss in the Statement of Financial Position. These separate financial statements are the only financial statements presented by the Fund.

The budget was approved by the Board of the Guardians of New Zealand Superannuation for the year ended 30 June 2017. The budget figures are unaudited.

(c) Significant judgements and estimates

The preparation of the Fund's financial statements requires the Board and management to make judgements and use estimates that affect the reported amounts of income, expenditure, assets, liabilities and the accompanying disclosures. Uncertainty about these judgements and estimates could result in outcomes that require a material adjustment to the carrying amounts of assets and liabilities in future periods. The judgements and estimates used in respect of the Fund are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the Fund and that are believed to be reasonable under the circumstances. The judgements and estimates that the Board and management have assessed to have the most significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are as follows:

- Assessment as an investment entity (Note 1(d));
- Assessment of control, joint control or significant influence (Notes 1(e) – (g));
- Assessment of investments in structured entities (Note 1(h)); and
- Determination of fair value (Note 2(b)).

SECTION 1: GENERAL INFORMATION AND BASIS OF PREPARATION (continued)

(d) Investment entity

The Fund meets the definition of an investment entity as the following conditions exist:

- The Fund obtains and manages funds for the purpose of providing its investor with investment management services;
- The Fund has committed to its investor that its business purpose is to invest funds solely for returns from capital appreciation and investment income;
- The Fund measures and evaluates the performance of substantially all of its investments on a fair value basis;
- The Fund has more than one investment; and
- The Fund has documented exit strategies for its investments.

Although the Fund does not meet all of the typical characteristics of an investment entity (namely, the Fund does not have multiple investors, its investor is a related party and it does not have ownership interests in the form of equity), the Board and management believe the Fund is an investment entity because it has been specifically established as an investment vehicle, it has a diversified investment portfolio with best practice investment policies and procedures in place, it invests funds for the purpose of maximising returns and it has elected to fair value the majority of its investments where feasible for the purposes of its financial statements.

Key judgement – assessment as an investment entity

The Board and management reassess the Fund's investment entity status on an annual basis, if any of the criteria or characteristics change.

(e) Subsidiaries

Subsidiaries are those entities (including structured entities and other holding vehicles) that are controlled by the Fund under the provisions of NZ IFRS 10 Consolidated Financial Statements. The Fund controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. The Fund reassesses whether or not it controls an entity if facts and circumstances indicate that there are changes to one or more of the elements of control.

Under Section 59 of the New Zealand Superannuation and Retirement Income Act 2001 (Act), the Guardians must use their best endeavours to ensure the Fund does not control any other entity.

On 23 October 2015, Section 59 of the Act was amended to specifically exclude Fund Investment Vehicles (FIVs). A FIV is defined as an entity that is formed or controlled by the Guardians for the purpose of holding, facilitating or managing the investments of the Fund. A FIV that is controlled by the Guardians is a subsidiary of the Fund for accounting purposes.

All investment opportunities are diligently evaluated to ensure compliance with all relevant laws.

As above, the Board and management have applied the exemption available under NZ IFRS 10 from preparing consolidated financial statements for the Fund. As a result, its investments in subsidiaries are not consolidated, but are measured at fair value through profit or loss and are classified as 'unconsolidated subsidiaries' in the Statement of Financial Position.

The Fund has interests in the following unconsolidated subsidiaries:

NAME	NOTE	BALANCE DATE	COUNTRY OF INCORPORATION	OWNERSHIP INTEREST 2017 %	2016 %
CNI Timber Operating Company Limited	(i)	30 June	New Zealand	0.0	0.0
Bain Capital Credit Managed Account (NZSF) Limited Partnership	(ii), (v)	31 March	Cayman Islands	99.9	99.9
KKR NZSF Energy Investor Limited Partnership	(ii)	31 December	Cayman Islands	100.0	100.0
NZSF Land Holdings Limited	(iii)	30 June	New Zealand	100.0	100.0
NZSF Hobsonville Investments Limited	(iii)	30 June	New Zealand	100.0	100.0
Global Merger Partners LLC	(iii)	31 December	Delaware, US	98.1	0.0
Global Merger Partners Master Limited	(iii)	31 December	Cayman Islands	98.1	0.0
Canyon NZ-DOF Investing Limited Partnership	(iii)	30 June	Delaware, US	100.0	0.0
NZSF Rural Holdings Limited	(iii)	30 June	New Zealand	100.0	0.0
NZSF Southland Farms Limited	(iii)	30 June	New Zealand	100.0	0.0
NZSF Canterbury Farms Limited	(iii)	30 June	New Zealand	100.0	0.0
NZSF Waikato Farms Limited	(iii)	30 June	New Zealand	100.0	0.0
NZSF Tui Investments Limited	(iii)	30 June	New Zealand	100.0	0.0
NZSF US Renewables, Inc.	(iii)	31 December	Delaware, US	100.0	0.0
NZSF Side Car (Movac) Limited Partnership	(iii)	31 March	New Zealand	100.0	0.0
NZSF Side Car (Pioneer) Limited Partnership	(iii)	31 March	New Zealand	100.0	0.0
NZSF Variable Co-Investment (Direct Capital) Limited Partnership	(iii)	31 December	New Zealand	100.0	0.0

In addition, the Fund has 100% ownership interest in 1 Segregated Account of Bermudan-domiciled Segregated Account Company Horseshoe Re Limited (2016: 1 Segregated Account) and 100% ownership interest in 10 Segregated Accounts of Bermudan-domiciled Segregated Account Company Horseshoe Re II Limited (2016: 8 Segregated Accounts) (Note (iv) below). All Segregated Accounts have a balance date of 31 December.

(i) CNI Timber Operating Company Limited was wound up during the year and removed from the companies register on 8 November 2016.

(ii) Cayman Islands limited partnerships are treated as unconsolidated subsidiaries of the Fund for accounting purposes. They are not entities under Section 59 of the Act and accordingly the interests held in these partnerships do not constitute a breach of that section.

(iii) Fund Investment Vehicles (FIVs).

During the year the Fund established or invested in a number of FIVs, as follows:

The Fund subscribed for an interest in Global Merger Partners LLC and Global Merger Partners Master Limited which are externally managed FIVs established for the purpose of holding, facilitating and managing the Fund's investment in a new merger arbitrage commingled fund, managed by BlackRock Financial Management, Inc.

The Fund subscribed for a limited partner interest in Canyon NZ-DOF Investing Limited Partnership which is an externally managed FIV established for the purpose of holding, facilitating and managing the Fund's distressed credit investments alongside Canyon Distressed Opportunities Fund II and other Canyon-managed accounts as determined by Canyon Capital Advisors, LLC.

NZSF Rural Holdings Limited and its wholly owned subsidiaries, NZSF Southland Farms Limited, NZSF Canterbury Farms Limited and NZSF Waikato Farms Limited, were established during the year for the purpose of holding, facilitating and managing the Fund's investments in certain farming and other rural assets. These assets were previously reported separately in the Fund's Statement of Financial Position (primarily within property, plant and equipment; livestock; and various working capital balances) and were transferred into these subsidiaries during the year. Refer to Note 9(a) for further detail on these asset transfers.

SECTION 1: GENERAL INFORMATION AND BASIS OF PREPARATION (continued)

NZSF Southland Farms Limited was established on 11 July 2016 under the name NZSF Rural Holdings Limited. It was renamed on 20 October 2016. NZSF Canterbury Farms Limited, NZSF Waikato Farms Limited and NZSF Rural Holdings Limited were all established on 21 October 2016.

NZSF Tui Investments Limited was established on 5 October 2016 for the purpose of purchasing the Fund's investment in Kiwi Group Holdings Limited (the holding company for Kiwibank).

NZSF US Renewables, Inc. was established on 3 October 2016 for the purpose of acquiring and holding the Fund's investment in Longroad Energy Holdings, LLC., a US-based company investing in renewable energy solutions.

NZSF Side Car (Movac) Limited Partnership, NZSF Side Car (Pioneer) Limited Partnership and NZSF Variable Co-Investment (Direct Capital) Limited Partnership were established on 28 November 2016, 2 December 2016 and 16 December 2016 respectively for the purpose of co-investing alongside other limited partners in certain private equity opportunities.

(iv) Horseshoe Re Limited and Horseshoe Re II Limited, acting for, and for the benefit of, the Segregated Accounts, enter into agreements relating to the Fund's investments in insurance-linked products. These companies are domiciled in Bermuda as Bermuda is a large, well regulated centre for reinsurance business. As a matter of Bermudan law, a Segregated Account is not a 'legal person' and has no existence separate from the Segregated Account company. In addition, the Fund does not control the Segregated Account company. Therefore, even though the Segregated Accounts are treated as unconsolidated subsidiaries for accounting purposes, they are not entities under Section 59 of the Act and accordingly the interests held do not constitute a breach of that section.

(v) Bain Capital Credit Managed Account (NZSF) Limited Partnership changed its name from Sankaty Managed Account (NZSF) Limited Partnership during the year.

As at 30 June 2017, there are no significant restrictions on the ability of unconsolidated subsidiaries to transfer funds, including dividends, to the Fund.

Further disclosures on unconsolidated subsidiaries are contained in Note 9(a).

Key judgement – assessment of control

The Board and management have assessed the Fund's investments in subsidiaries in light of the control model established under NZ IFRS 10 Consolidated Financial Statements to ensure the correct classification and disclosure of investments in subsidiaries. The Fund holds investments in a number of entities that are not considered subsidiaries even though its ownership interest exceeds 50%. The Board and management have concluded that the Fund has no unilateral power to direct the relevant activities of these entities and therefore it does not have control of these entities.

(f) Associates

Associates are those entities over which the Fund has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the entity, but is not control or joint control over those policies.

The Fund has interests in the following associates that are measured at fair value through profit or loss and classified as private equity in the Statement of Financial Position:

NAME	BALANCE DATE	COUNTRY OF INCORPORATION	OWNERSHIP INTEREST 2017 %	OWNERSHIP INTEREST 2016 %
Kaingaroa Timberlands Partnership	30 June	New Zealand	42.0	42.0
Kiwi Group Holdings Limited	30 June	New Zealand	25.0	0.0

Kaingaroa Timberlands Partnership is a major North Island forestry business. It is valued in United States dollars and translated into New Zealand dollars for financial reporting purposes.

On 31 October 2016, NZSF Tui Investments Limited, an unconsolidated subsidiary of the Fund, acquired a 25% interest in Kiwi Group Holdings Limited. Kiwi Group Holdings Limited is the sole shareholder of Kiwibank, a registered New Zealand bank, whose principal activity is the provision of retail and banking products and services to individuals and small to medium-sized businesses.

As at 30 June 2017, there are no significant restrictions on the ability of any associate to transfer funds to the Fund.

Key judgement – assessment of significant influence

The Board and management have assessed the Fund's investments in associates in light of the definition of significant influence included in NZ IAS 28 Investments in Associates and Joint Ventures. The Fund holds investments in a number of entities that are not considered associates even though its ownership interest exceeds 20%. The Board and management have concluded that the Fund has no power to participate in the financial and operating policy decisions of these entities and therefore it does not have significant influence over these entities.

(g) Joint ventures

A joint venture is a type of joint arrangement whereby the parties that have joint control have rights to the net assets of the arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

The Fund has interests in the following joint ventures that are measured at fair value through profit or loss and classified as private equity in the Statement of Financial Position:

			OWNERSHIP INTEREST	
NAME	BALANCE DATE	COUNTRY OF INCORPORATION	2017 %	2016 %
Datacom Group Limited	31 March	New Zealand	38.8	37.6
RA (Holdings) 2014 Pty Limited	31 March	Australia	50.0	50.0
Hobsonville Development Limited Partnership	31 March	New Zealand	49.0	49.0
Hobsonville Development GP Limited	31 March	New Zealand	49.0	49.0
New Ground Living (Hobsonville Point) Limited	31 March	New Zealand	45.0	45.0
Longroad Energy Holdings, LLC	31 December	Delaware, US	45.0	0.0

Datacom Group Limited is an information technology services company with operations in New Zealand, Australia and the Asia Pacific.

RA (Holdings) 2014 Pty Limited is the holding company for the Fund's investment in RetireAustralia, a leading Australian retirement village operator.

NZSF Hobsonville Investments Limited, an unconsolidated subsidiary of the Fund, holds a 49% interest in Hobsonville Development Limited Partnership, a partnership established for the purpose of developing, then selling property at Hobsonville Point in Auckland, and its management company, Hobsonville Development GP Limited.

NZSF Land Holdings Limited, an unconsolidated subsidiary of the Fund, holds a 45% interest in New Ground Living (Hobsonville Point) Limited a company established for the purpose of developing, then renting property at Hobsonville Point in Auckland.

On 4 October 2016, NZSF US Renewables Inc., an unconsolidated subsidiary of the Fund, acquired a 45% interest in Longroad Energy Holdings, LLC. Longroad Energy Holdings, LLC is a Delaware limited liability company formed on 13 July 2016 for the purpose of developing utility-scale renewable energy facilities throughout North America.

As at 30 June 2017, there are no restrictions on the ability of any joint venture to transfer funds, including dividends, to the Fund.

SECTION 1: GENERAL INFORMATION AND BASIS OF PREPARATION (continued)

Key judgement – assessment of joint control

The considerations made in determining joint control are similar to those necessary to determine control over subsidiaries. The Fund's joint arrangements are classified as joint ventures because certain key operating and financial activities require the approval of the Fund as well as at least one other investor and the contractual arrangements provide the parties with rights to the net assets of the joint arrangements.

(h) Structured entities

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. A structured entity often has some or all of the following features or attributes:

- restricted activities;
- a narrow and well-defined objective, such as to provide investment opportunities for investors by passing on risks and rewards associated with the assets of the structured entity to investors;
- insufficient equity to permit the structured entity to finance its activities without subordinated financial support; and
- financing in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks.

The Fund is principally involved with structured entities through investments in private equity investment funds, unconsolidated subsidiaries, collective investment funds, unlisted unit trusts, insurance-linked investments, shareholder loans, agency mortgage-backed securities and asset-backed securities that are issued by structured entities. The Fund invests in structured entities to assist with the implementation of its overall investment strategy. The Fund does not sponsor any structured entities.

Structured entities have the following business activities:

PRIVATE EQUITY INVESTMENT FUNDS AND UNCONSOLIDATED SUBSIDIARIES

Private equity investment funds and unconsolidated subsidiaries provide a mechanism to share exposure with other investors and may take various legal forms (e.g. limited liability companies, limited partnerships, trusts). The Fund makes commitments to, and investments in, these legal structures and in return is issued with rights to a proportional stake in their net assets. They have a broad range of investment objectives and are managed by unrelated asset managers who apply various investment strategies to accomplish their respective investment objectives.

COLLECTIVE INVESTMENT FUNDS AND UNLISTED UNIT TRUSTS

Collective investment funds and unlisted unit trusts finance their operations by way of subscription, in which case, the Fund subscribes and is issued with redeemable shares that entitle it to a proportional stake in the net assets of the investment.

INSURANCE-LINKED INVESTMENTS

The Fund invests in catastrophe bonds which are issued by structured entities. Each bond is linked to an insurance event such as a natural disaster. The bonds transfer particular risks from the insurer to the bond holder.

SHAREHOLDER LOANS

The Fund may make investments in private equity investment funds, or other private equity investments via shareholder loans. The borrower in the arrangement may be a structured entity. Shareholder loans are classified as fixed income securities in the Statement of Financial Position.

AGENCY MORTGAGE-BACKED SECURITIES

Agency mortgage-backed securities are pass-through securities issued by the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal National Mortgage Association (Fannie Mae), both US-government sponsored enterprises, and the Government National Mortgage Association (Ginnie Mae), a US-government corporation. These securities are traded in the TBA (To Be Announced) market and are mortgage-backed forward, or 'delayed delivery' securities. The securities have standardised 15-year or 30-year maturity dates, however, whilst the terms of the security are agreed up front, the specific mortgages to be delivered to fulfil the security obligation are only allocated just prior to settlement. Agency mortgage-backed securities are classified as fixed income securities in the Statement of Financial Position.

ASSET-BACKED SECURITIES

The Fund invests in a variety of asset-backed securities, the majority of which have been senior tranches of debt issued by a structured entity. The debt is usually collateralised by an underlying pool of assets. The asset-backed securities take the form of mortgage-backed securities (collateralised by both commercial and residential mortgages), asset-backed securities (collateralised by consumer loans, small business loans and auto loans), collateralised debt obligations (CDO) and collateralised loan obligations (CLO). Asset-backed securities are classified as fixed income securities in the Statement of Financial Position.

Key judgement – assessment of investments in structured entities

The Board and management have assessed which of the Fund's investments are investments in structured entities. In doing so, the Board and management have considered voting rights and other similar rights afforded to investors as well as any contractual arrangements in place with these investments.

The Board and management have concluded that certain of the Fund's investments meet the definition of a structured entity because:

- the voting rights in the investments are not the dominant factor in deciding who controls the investment; and
- the investments have narrow and well-defined objectives to provide investment opportunities to investors.

Further disclosures on structured entities are contained in Notes 3(e) and 7(b).

(i) Other significant accounting policies

FOREIGN CURRENCY TRANSLATION

Transactions denominated in foreign currencies are converted to New Zealand dollars using the exchange rates prevailing at the dates of the transactions. Foreign currency monetary assets and liabilities are translated at the exchange rate prevailing at balance date. Where there is a movement in the exchange rate between the date of a foreign currency transaction and balance date, the resulting exchange differences are recognised in the Statement of Comprehensive Income.

GOODS AND SERVICES TAX (GST)

Income, expenditure, assets and liabilities are recognised in the financial statements exclusive of GST, with the exception of receivables and payables which are stated inclusive of GST. Where GST is irrecoverable as an input tax, it is recognised as part of the related asset or expenditure.

STATEMENT OF CASH FLOWS

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

Operating activities include all activities other than investing or financing activities.

Investing activities are those activities relating to the acquisition, holding and disposal of property, plant and equipment and intangible assets.

Financing activities are those activities relating to capital contributions and to payments of superannuation entitlements. As the current funding by the Crown of superannuation entitlements flows directly from the Treasury to the Ministry of Social Development, it is not considered cash flow of the Fund and accordingly, is not recorded in the Statement of Cash Flows.

Cash flows are included in the Statement of Cash Flows on a gross basis. The GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority, is classified as operating cash flows.

(j) Changes in accounting policies

There have been no changes in accounting policies during the year. All accounting policies have been applied consistently throughout these financial statements.

Certain prior year comparatives have been restated to conform with current year presentation. These reclassifications have no impact on the overall financial performance or financial position of the Fund for the comparable year.

SECTION 1: GENERAL INFORMATION AND BASIS OF PREPARATION (continued)

(k) Standards issued but not yet effective

The following standards and interpretations that have been issued or amended but are not yet effective, have not been adopted for the year ended 30 June 2017.

REFERENCE	TITLE	SUMMARY	APPLICATION DATE OF STANDARD*	IMPACT ON FINANCIAL STATEMENTS	APPLICATION DATE FOR FUND*
NZ IFRS 9 (2014)	Financial Instruments	The final version of NZ IFRS 9 Financial Instruments brings together the classification and measurement, impairment and hedge accounting phases of the International Accounting Standards Board's project. The standard will replace NZ IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of NZ IFRS 9. An entity may elect to apply earlier versions of NZ IFRS 9 if, and only if, the entity's relevant date of initial application is before 1 February 2015. Otherwise, early application is only permitted if the complete version of NZ IFRS 9 is adopted in its entirety for reporting periods beginning after 4 September 2014. The transition to NZ IFRS 9 differs by requirements and is partly retrospective and partly prospective. Despite the requirement to apply NZ IFRS 9 in its entirety, entities may elect to early apply only the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss without applying the other requirements in the standard. An entity that elects to do so is required to disclose that fact and provide the related disclosures set out in paragraphs 10–11 of NZ IFRS 7 Financial Instruments: Disclosures.	1 January 2018	The new standard will affect the classification and measurement of the Fund's financial assets and disclosures in the financial statements.	1 July 2018
NZ IFRS 15	Revenue from Contracts with Customers	NZ IFRS 15 establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. NZ IFRS 15 supersedes: (a) NZ IAS 11 Construction Contracts (b) NZ IAS 18 Revenue (c) NZ IFRIC 13 Customer Loyalty Programmes (d) NZ IFRIC 15 Agreements for the Construction of Real Estate (e) NZ IFRIC 18 Transfers of Assets from Customers (f) NZ SIC-31 Revenue – Barter transactions Involving Advertising Services The core principle of NZ IFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity recognises revenue in accordance with that core principle by applying the following steps: (a) Step 1: Identify the contract(s) with a customer (b) Step 2: Identify the performance obligations in the contract (c) Step 3: Determine the transaction price (d) Step 4: Allocate the transaction price to the performance obligations in the contract (e) Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation	1 January 2018	The new standard may impact disclosures in the financial statements.	1 July 2018

REFERENCE	TITLE	SUMMARY	APPLICATION DATE OF STANDARD*	IMPACT ON FINANCIAL STATEMENTS	APPLICATION DATE FOR FUND*
NZ IFRS 16	Leases	NZ IFRS 16 is the new standard on the recognition, measurement, presentation and disclosure of leases. The standard will replace: (a) NZ IAS 17 Leases (b) NZ IFRIC 4 Determining whether an Arrangement contains a Lease (c) NZ SIC – 15 Operating Leases – Incentives (d) NZ SIC – 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease The scope of the new standard includes leases of all assets, with certain exceptions. A lease is defined as a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration. NZ IFRS 16 requires lessees to account for all leases under a single on-balance sheet model (subject to certain exemptions) in a similar way to finance leases under NZ IAS 17. Lessees recognise a liability to pay rentals with a corresponding asset and recognise interest expense and depreciation separately. Reassessment of certain key considerations (e.g. lease term, variable rents based on an index or rate, discount rate) by the lessee is required upon certain events. Lessor accounting is substantially the same as today's lessor accounting, using NZ IAS 17's dual classification approach. Application of NZ IFRS 16 is required for annual periods beginning on or after 1 January 2019. Early application is permitted, but not before an entity applies NZ IFRS 15.	1 January 2019	The new standard will affect the measurement of the Fund's financial assets and financial liabilities and disclosures in the financial statements.	1 July 2019

* Designates the beginning of the applicable annual reporting period.

SECTION 2: FAIR VALUE

(a) Fair value measurement

Accounting Policy

The majority of the assets and liabilities of the Fund are measured at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Management uses valuation techniques for the Fund that are appropriate in the circumstances and for which sufficient data is available to measure fair value, maximising the use of relevant observable inputs. All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within a fair value hierarchy as follows:

Level 1 – Quoted (unadjusted) market prices in active markets for identical assets and liabilities. An active market is one where prices are readily available and those prices represent actual and regularly occurring market transactions on an arm's length basis. The fair value of Level 1 assets and liabilities requires little or no judgement.

Level 2 – Valuation techniques that use observable market data. Such techniques include the use of market standard discounting methodologies, option pricing models and other valuation techniques widely used and accepted by market participants.

Level 3 – Valuation techniques that use inputs not based on observable market data. Unobservable inputs are those not readily available in an active market due to illiquidity or complexity of the product. These inputs are generally derived and extrapolated from other relevant market data and calibrated against current market trends and historic transactions. These valuations are calculated using a high degree of management judgement.

The level within which an asset or liability is categorised in the fair value hierarchy is determined based on the lowest level input that is significant to the fair value measurement as a whole.

The fair value of the Fund's assets and liabilities are categorised as follows:

		FUND ACTUAL					
2017	NOTE	QUOTED MARKET PRICE (LEVEL 1)	VALUATION TECHNIQUE: MARKET-OBSERVABLE INPUTS (LEVEL 2)	VALUATION TECHNIQUE: NON-MARKET OBSERVABLE INPUTS (LEVEL 3)	TOTAL ASSETS AND LIABILITIES MEASURED AT FAIR VALUE	ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE*	TOTAL
		NZD'000	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000
ASSETS							
Cash and cash equivalents	4(a), 4(b)				–	2,744,837	2,744,837
Cash pledged as collateral	4(a), 4(c)				–	288,540	288,540
Trade and other receivables	4(a), 4(d)				–	1,169,311	1,169,311
Other current assets					–	–	–
Investments							
Derivative financial instrument assets:							
Forward foreign exchange contracts	4(e)		1,001,800		1,001,800		1,001,800
Cross currency swaps	4(e)		14,009		14,009		14,009
Asset swaps	4(e)		3,648		3,648		3,648
Longevity contingent swaps	4(e)			67,087	67,087		67,087
Futures contracts	4(e)				–		–
Total return swaps - equity	4(e)		111,738		111,738		111,738
Credit default swaps	4(e)		44,502		44,502		44,502
Interest rate swaps	4(e)		68,436		68,436		68,436
Other over-the-counter swaps	4(e)			20	20		20
Warrants	4(e)			16,096	16,096		16,096
Total derivative financial instrument assets		**–**	**1,244,133**	**83,203**	**1,327,336**	**–**	**1,327,336**
Other financial assets:							
Listed New Zealand equities	4(a), 4(e)	1,665,403			1,665,403		1,665,403
Listed global equities	4(a), 4(e)	16,579,391		7,732	16,587,123		16,587,123
Fixed income securities	4(a), 4(e)		6,701,251	110,305	6,811,556	1,721,782	8,533,338
Collective investment funds	4(a), 4(e)	230,566	848,447	11,897	1,090,910		1,090,910
Securities lending and similar agreements	4(a), 4(e)	90,973			90,973		90,973
Insurance-linked investments	4(a), 4(e)		74,664		74,664		74,664
Private equity	4(a), 4(e)			3,779,554	3,779,554		3,779,554
Unlisted unit trusts	4(a), 4(e)				–		–
Total other financial assets		**18,566,333**	**7,624,362**	**3,909,488**	**30,100,183**	**1,721,782**	**31,821,965**

*Assets and liabilities not measured at fair value are carried at amortised cost but their carrying values are a reasonable approximation of fair value.

For the year ended 30 June 2017

SECTION 2: FAIR VALUE (continued)

(a) Fair value measurement (continued)

		FUND ACTUAL					
2017	NOTE	QUOTED MARKET PRICE (LEVEL 1)	VALUATION TECHNIQUE: MARKET-OBSERVABLE INPUTS (LEVEL 2)	VALUATION TECHNIQUE: NON-MARKET OBSERVABLE INPUTS (LEVEL 3)	TOTAL ASSETS AND LIABILITIES MEASURED AT FAIR VALUE	ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE*	TOTAL
		NZD'000	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000
Other financial assets pledged as collateral	4(a), 4(e)		55,456		55,456		55,456
Investments in unconsolidated subsidiaries	4(a), 4(e)		304,344	1,227,080	1,531,424		1,531,424
Agricultural assets:							
Forests					–		–
Livestock					–		–
Crops					–		–
Total agricultural assets		**–**	**–**	**–**	**–**	**–**	**–**
Total investments		**18,566,333**	**9,228,295**	**5,219,771**	**33,014,399**	**1,721,782**	**34,736,181**
Assets held for sale					–		–
Property, plant and equipment	5(a)				–	2,018	2,018
Intangible assets		13,038			13,038	123	13,161
Total assets		**18,579,371**	**9,228,295**	**5,219,771**	**33,027,437**	**5,926,611**	**38,954,048**
LIABILITIES							
Cash collateral received	4(a), 4(c)				–	865,635	865,635
Trade and other payables	4(a), 4(g)				–	2,367,188	2,367,188
Derivative financial instrument liabilities:							
Forward foreign exchange contracts	4(e)		227,881		227,881		227,881
Cross currency swaps	4(e)		1,712		1,712		1,712
Asset swaps	4(e)		12,442		12,442		12,442
Futures contracts	4(e)		–		–		–
Total return swaps - equity	4(e)		2,354		2,354		2,354
Total return swaps - bonds	4(e)		2,308		2,308		2,308
Credit default swaps	4(e)		54,979		54,979		54,979
Interest rate swaps	4(e)		30,840		30,840		30,840
Options	4(e)		2		2		2
Total derivative financial instrument liabilities		**–**	**332,518**	**–**	**332,518**	**–**	**332,518**
Income tax payable					–	504,696	504,696
Provision for performance-based fees	5(b)				–	15,642	15,642
Deferred tax liability	7(e)				–	364,723	364,723
Total liabilities		**–**	**332,518**	**–**	**332,518**	**4,117,884**	**4,450,402**

*Assets and liabilities not measured at fair value are carried at amortised cost but their carrying values are a reasonable approximation of fair value.

		FUND ACTUAL					
2016	NOTE	QUOTED MARKET PRICE (LEVEL 1)	VALUATION TECHNIQUE: MARKET-OBSERVABLE INPUTS (LEVEL 2)	VALUATION TECHNIQUE: NON-MARKET OBSERVABLE INPUTS (LEVEL 3)	TOTAL ASSETS AND LIABILITIES MEASURED AT FAIR VALUE	ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE*	TOTAL
		NZD'000	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000
ASSETS							
Cash and cash equivalents	4(a), 4(b)				–	2,237,847	2,237,847
Cash pledged as collateral	4(a), 4(c)				–	758,811	758,811
Trade and other receivables	4(a), 4(d)				–	133,101	133,101
Other current assets					–	924	924
Investments							
Derivative financial instrument assets:							
Forward foreign exchange contracts	4(e)		1,186,753		1,186,753		1,186,753
Cross currency swaps	4(e)		42,538		42,538		42,538
Asset swaps	4(e)				–		–
Longevity contingent swaps	4(e)			78,802	78,802		78,802
Futures contracts	4(e)				–		–
Total return swaps – equity	4(e)		109,605		109,605		109,605
Credit default swaps	4(e)		125,429		125,429		125,429
Interest rate swaps	4(e)		9,562		9,562		9,562
Other over-the-counter swaps	4(e)			20	20		20
Warrants	4(e)			13,999	13,999		13,999
Total derivative financial instrument assets		**–**	**1,473,887**	**92,821**	**1,566,708**	**–**	**1,566,708**
Other financial assets:							
Listed New Zealand equities	4(a), 4(e)	1,492,275		5,955	1,498,230		1,498,230
Listed global equities	4(a), 4(e)	10,915,456		5,243	10,920,699		10,920,699
Fixed income securities	4(a), 4(e)		7,240,570	101,070	7,341,640	2,135,389	9,477,029
Collective investment funds	4(a), 4(e)	159,976	887,888	13,347	1,061,211		1,061,211
Securities lending and similar agreements	4(a), 4(e)				–		–
Insurance-linked investments	4(a), 4(e)		72,953		72,953		72,953
Private equity	4(a), 4(e)		19,094	3,425,975	3,445,069		3,445,069
Unlisted unit trusts	4(a), 4(e)			654	654		654
Total other financial assets		**12,567,707**	**8,220,505**	**3,552,244**	**24,340,456**	**2,135,389**	**26,475,845**

*Assets and liabilities not measured at fair value are carried at amortised cost but their carrying values are a reasonable approximation of fair value.

SECTION 2: FAIR VALUE (continued)

(a) Fair value measurement (continued)

		FUND ACTUAL					
2016	NOTE	QUOTED MARKET PRICE (LEVEL 1)	VALUATION TECHNIQUE: MARKET-OBSERVABLE INPUTS (LEVEL 2)	VALUATION TECHNIQUE: NON-MARKET OBSERVABLE INPUTS (LEVEL 3)	TOTAL ASSETS AND LIABILITIES MEASURED AT FAIR VALUE	ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE*	TOTAL
		NZD'000	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000
Other financial assets pledged as collateral	4(a), 4(e)		56,164		56,164		56,164
Investments in unconsolidated subsidiaries	4(a), 4(e)			386,599	386,599		386,599
Agricultural assets:							
Forests				410	410		410
Livestock			18,216		18,216		18,216
Crops					–	414	414
Total agricultural assets		**–**	**18,216**	**410**	**18,626**	**414**	**19,040**
Total investments		**12,567,707**	**9,768,772**	**4,032,074**	**26,368,553**	**2,135,803**	**28,504,356**
Assets held for sale					–	4,072	4,072
Property, plant and equipment	5(a)			151,173	151,173	6,897	158,070
Intangible assets			13,678		13,678	457	14,135
Total assets		**12,567,707**	**9,782,450**	**4,183,247**	**26,533,404**	**5,277,912**	**31,811,316**
LIABILITIES							
Cash collateral received	4(a), 4(c)				–	861,216	861,216
Trade and other payables	4(a), 4(g)				–	298,666	298,666
Derivative financial instrument liabilities:							
Forward foreign exchange contracts	4(e)		206,522		206,522		206,522
Cross currency swaps	4(e)		2,696		2,696		2,696
Asset swaps	4(e)		94,685		94,685		94,685
Futures contracts	4(e)		–		–		–
Total return swaps – equity	4(e)		74,064		74,064		74,064
Total return swaps – bonds	4(e)		–		–		–
Credit default swaps	4(e)		74,130		74,130		74,130
Interest rate swaps	4(e)		78,633		78,633		78,633
Total derivative financial instrument liabilities		**–**	**530,730**	**–**	**530,730**	**–**	**530,730**
Income tax payable						247,016	247,016
Provision for performance-based fees	5(b)				–	16,214	16,214
Deferred tax liability	7(e)				–	305,613	305,613
Total liabilities		**–**	**530,730**	**–**	**530,730**	**1,728,725**	**2,259,455**

*Assets and liabilities not measured at fair value are carried at amortised cost but their carrying values are a reasonable approximation of fair value.

Assets and liabilities not measured at fair value but for which fair value is disclosed are categorised as follows:

Level 1 – Cash and cash equivalents, cash pledged as collateral and cash collateral received.

Level 2 – Trade and other receivables, fixed income securities, crops, trade and other payables, income tax payable and deferred tax liability.

Level 3 – Other current assets, property, plant and equipment, intangible assets and provision for performance-based fees.

(b) Determination of fair value

The specific valuation techniques and the observability of the inputs used in valuation models for significant product categories are outlined below:

DERIVATIVE FINANCIAL INSTRUMENTS

The fair values of derivative financial instruments are principally determined using valuation techniques with market observable inputs. The most frequently applied valuation techniques include forward pricing and swap models using present value calculations. The models incorporate various inputs including foreign exchange spot and forward rates, interest rates, futures prices, default rates, credit spreads, volatility curves and discount rates.

In some instances, the fair values of derivative financial instruments are determined using valuation techniques with non-market observable inputs. These instruments are classified within Level 3 of the fair value hierarchy and include longevity contingent swaps, warrants and other over-the-counter swaps. The fair value of longevity contingent swaps is provided by the counterparty at balance date. The price is a non-binding bid price based on the fair value of the underlying basket of contracts. The fair value of other over-the-counter swaps is determined using an internally-generated discounted cash flow model, with the key input being interest rates.

LISTED EQUITIES

The fair value of listed equities, including those on loan under securities lending or similar agreements, is determined based on the last quoted bid price on the relevant exchange at balance date and have been classified within Level 1 of the fair value hierarchy. In some instances, where the market on which the security is traded is not highly liquid (e.g. the security may be listed on an emerging market stock exchange or trading of the security may be temporarily suspended), the price can also be determined using non-binding broker quotes. These securities have been classified within Level 3 of the fair value hierarchy.

FIXED INCOME SECURITIES

The fair value of highly liquid fixed income securities, including those on loan under securities lending or similar agreements, is determined based on the last quoted bid price provided by a reputable pricing vendor (being a financial data provider such as Bloomberg or Thomson Reuters) or broker at balance date and have been classified within Level 2 of the fair value hierarchy. Where the market for fixed income securities is illiquid, fair value is determined by a reputable pricing vendor who uses models to value the securities. The models incorporate various inputs including loan level data, repayment and default assumptions and benchmark prices for similar securities. These securities have been classified within Level 2 of the fair value hierarchy. For illiquid securities, because of the inherent uncertainty of valuation, it is possible that the fair values estimated may differ from those that would have been determined had a ready market for those securities existed and those differences may be significant. These securities have been classified within Level 3 of the fair value hierarchy.

The fair value of unlisted debt instruments, including fixed and floating rate instruments, that form part of an investment into a private equity investment, are valued by a suitably qualified independent valuer who ascribes an enterprise value to the entire private equity investment then apportions that value across the instruments held, including the debt instruments. These securities have been classified within Level 3 of the fair value hierarchy.

COLLECTIVE INVESTMENT FUNDS

The fair value of collective investment funds is provided by the investment managers or administrators at balance date. The price is based on the fair value of the underlying net assets or securities of the collective investment fund. Their classification within the fair value hierarchy is determined by the lowest level classification of the underlying instruments.

INSURANCE-LINKED INVESTMENTS

Insurance-linked investments which are catastrophe bonds are valued using prices provided by reputable pricing vendors or brokers at balance date and have been classified within Level 2 of the fair value hierarchy.

PRIVATE EQUITY

The fair value of private equity investment funds is provided by the investment managers or administrators at balance date. The price is based on the fair value of the underlying net assets of the private equity investment fund which is determined using a variety of methods, including independent valuations, valuation models based on the price of recent transactions, earnings multiples or discounted cash flows and have been classified within Level 3 of the fair value hierarchy. Private equity investments (not invested via a managed fund structure) are valued by reference to either an independent valuation or the price of recent investments and have been classified within Level 3 of the fair value hierarchy.

SECTION 2: FAIR VALUE (continued)

(b) Determination of fair value (continued)

UNLISTED UNIT TRUSTS

The fair value of unlisted unit trusts is determined based on the last bid price of the unit or security provided by the administrators at balance date. The bid price is based on the fair value of the underlying net assets or securities of the unlisted unit trust. Unlisted unit trusts have been classified within Level 3 of the fair value hierarchy.

UNCONSOLIDATED SUBSIDIARIES

The fair value of unconsolidated subsidiaries is based on the fair value of the underlying net assets of the specific investment which can be determined using a variety of methods, including being based on the last quoted bid price provided by a reputable pricing vendor, independent valuations, valuation models based on the price of recent transactions, earnings multiples or discounted cash flows. Unconsolidated subsidiaries have been classified accordingly within Levels 2 and 3 of the fair value hierarchy.

INTANGIBLE ASSETS

Allocations of New Zealand Units (NZUs) and/or other carbon credits that the Fund owns are recognised at net realisable value where they have been received, or where the Board and management are reasonably certain they will be received, and a price can be reliably ascertained either through the existence of an observable active market or through pricing obtained from reputable brokers.

Key judgement – determination of fair value

Where the fair value of assets and liabilities cannot be measured based on quoted prices in active markets, fair value is determined using valuation techniques with market observable inputs from third parties such as brokers or pricing vendors. For assets that have no quoted price (which principally consist of investments in private equity investment funds, collective investment funds, unlisted unit trusts, fixed income securities and certain derivative financial instruments) the determination of fair value requires significant judgement. Fair value for these assets is determined as follows:

PRIVATE EQUITY INVESTMENT FUNDS, COLLECTIVE INVESTMENT FUNDS AND UNLISTED UNIT TRUSTS WHERE FAIR VALUE IS PROVIDED BY INVESTMENT MANAGERS OR ADMINISTRATORS

The fair value of private equity investment funds, collective investment funds and unlisted unit trusts is provided by the investment managers or administrators at balance date. Depending on the nature of the underlying instruments, investment managers and administrators may use observable market prices, their own models or they may engage independent valuers who use models to obtain the fair value of investments. The Board and management may also directly appoint independent valuers to obtain the fair value of certain investments where this information is unable to be provided by an investment manager or administrator or where an investment is directly managed by the Fund.

FIXED INCOME SECURITIES WHERE FAIR VALUE IS DETERMINED BY A PRICING VENDOR

Where the market for fixed income securities is illiquid, fair value is determined by a pricing vendor who uses models to value the securities. The Board and management mitigate the risk of pricing errors by only selecting reputable pricing vendors and by periodically calibrating prices against observable market data.

DERIVATIVE FINANCIAL INSTRUMENTS WHERE FAIR VALUE IS DETERMINED BY A PRICING VENDOR, BROKER OR COUNTERPARTY

Pricing vendors, brokers or counterparties may use valuation models to price certain derivative financial instruments for which the inputs may include current and forward exchange rates, estimates of cash flows, interest rates, futures prices, default rates, credit spreads, volatility curves, indicative prices for similar assets and discount rates. The Board and management mitigate the risk of pricing errors by only selecting reputable pricing vendors, brokers or counterparties and by periodically calibrating prices against observable market data.

(c) Fair value sensitivity

The following table shows the Fund's sensitivity of fair value measurement to likely changes in non-market observable inputs (where appropriate, equivalent to one standard deviation) for financial assets categorised within Level 3 of the fair value hierarchy:

	FUND ACTUAL			
	NON-MARKET OBSERVABLE INPUT	MOVEMENT (%)	IMPACT ON FAIR VALUE MEASUREMENT	
			INCREASE	DECREASE
			NZD'000	NZD'000
2017				
Longevity contingent swaps	Discount rate	2	7,291	(3,378)
Listed New Zealand equities	Share price	18	–	–
Listed global equities	Share price	20	1,852	(1,852)
Fixed income securities	Yield	12	13,051	(13,051)
Collective investment funds	Unit price	13	1,524	(1,524)
Private equity	(i)	(i)	509,708	(509,708)
Unlisted unit trusts	Unit price	12	–	–
Unconsolidated subsidiaries	Share price	20	166,886	(166,886)
Property, plant and equipment	(ii)	(ii)	–	–
2016				
Longevity contingent swaps	Discount rate	2	4,059	(4,330)
Listed New Zealand equities	Share price	18	1,072	(1,072)
Listed global equities	Share price	20	1,085	(1,085)
Fixed income securities	Yield	12	8,732	(8,732)
Collective investment funds	Unit price	13	1,711	(1,711)
Private equity	(i)	(i)	457,482	(457,482)
Unlisted unit trusts	Unit price	12	105	(105)
Unconsolidated subsidiaries	Share price	20	31,375	(31,375)
Property, plant and equipment	Price per hectare	5	7,492	(7,492)

(i) The fair value of private equity investments is provided by the investment managers or administrators or by independent valuers at balance date. The Fund does not have access to the underlying valuation models to disclose sensitivities to assumptions. The Board and management has assessed that the reasonably likely movement in fair value in a one-year period is 20% for private equity investment funds and other private equity investments, 16% for private timber funds, 12% for private infrastructure investments and 6% for life settlements investments based on internal risk modelling.

(ii) During the year, property, plant and equipment relating to the Fund's rural investments was transferred into newly-formed unconsolidated subsidiaries. Refer to Notes 1(e) and 9(a) for further detail on these asset transfers.

(d) Transfers between levels in the fair value hierarchy

For assets and liabilities that are recognised in the financial statements at fair value on a recurring basis, the Board and management determine whether transfers have occurred between levels in the hierarchy by reassessing categorisation at the end of each reporting period.

SECTION 2: FAIR VALUE (continued)

(d) Transfers between levels in the fair value hierarchy (continued)

The following table presents the transfers between fair value hierarchy levels for the year:

	FUND ACTUAL		
	LEVEL 1	LEVEL 2	LEVEL 3
2017	NZD'000	NZD'000	NZD'000
Transfers between Levels 1 and 3:			
Listed New Zealand equities	3,124	–	(3,124)
Listed global equities	(3,496)	–	3,496

Listed New Zealand equities transferred into Level 1 relate to a position whose trading was suspended as at 30 June 2016 but was actively traded in the current year.

Listed global equities transferred out of Level 1 relate to positions whose trading was suspended as at 30 June 2017 but were actively traded in the prior year.

	FUND ACTUAL		
	LEVEL 1	LEVEL 2	LEVEL 3
2016	NZD'000	NZD'000	NZD'000
Transfers between Levels 1 and 3:			
Listed New Zealand equities	(6,124)	–	6,124
Listed global equities	7,681	–	(7,681)

Listed New Zealand equities transferred out of Level 1 relate to a position whose trading was suspended as at 30 June 2016 but was actively traded in the prior year.

Listed global equities transferred into Level 1 relate to positions whose trading was suspended in the prior year but were actively traded as at 30 June 2016.

Key judgement – transfers between levels of the fair value hierarchy

The classification of investments within the fair value hierarchy is reviewed annually. Transfers between the different levels of the hierarchy generally occur when there is a change in the trading status of a financial instrument (such as listing on a recognised exchange, suspension of trading or de-listing).

(e) Reconciliation of fair value measurement under Level 3 hierarchy

The following table provides a reconciliation of movements in the fair value of financial assets categorised within Level 3 of the fair value hierarchy:

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
Opening balance	4,183,247	4,339,855
Unrealised gains and losses recognised in net fair value gains on financial instruments held at fair value through profit or loss	502,337	(68,229)
Realised gains and losses recognised in net fair value gains on financial instruments held at fair value through profit or loss	45,408	197,071
Total gains and losses recognised in net fair value gains/(losses) on available-for-sale financial assets	1,993	–
Purchases	1,003,994	596,042
Sales	(267)	(71,333)
Settlements	(517,313)	(808,602)
Transfers to other categories	372	(1,557)
Closing balance	**5,219,771**	**4,183,247**

SECTION 3: RISK MANAGEMENT

(a) Risk management

Understanding and managing risk is considered a fundamental activity that is central to the management of the Fund. While risk is a necessary part of the Fund's activities, it must be understood to ensure the risk profile adopted is commensurate with the return objective and time horizon of the Fund. Effective risk management is critical to maintaining public and stakeholder confidence in the Guardians as manager of the Fund.

The Fund's investment activities expose it to various types of risk including investment, strategic, legal, operational and reputational risk. The Board and management of the Guardians are responsible for the management of these risks. Separate Investment and Risk Committees have been established as risk oversight bodies to provide support for the management of these risks.

The Guardians has risk management policies, procedures and other internal controls for application by staff, external investment managers and other service providers to manage the Fund's exposure to risk. The framework for managing this risk is set out in its Statement of Investment Policies, Standards and Procedures including its Risk Management Policy.

The Board has developed a risk-appetite statement outlining its expectations of the level of risk that is appropriate for the Fund to take on. This statement can be found at Schedule 2 of the Risk Management Policy which is available on www.nzsuperfund.co.nz. Performance against this statement is measured and reported to the Board on a regular basis, with any major breaches being notified on an exception basis.

(b) Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as equity prices, interest rates, foreign exchange rates and credit default swap spreads.

The market risks that the Fund is primarily exposed to are:

- Equity price risk, both globally and in New Zealand;
- Foreign currency risk, primarily due to changes in the New Zealand dollar versus the United States dollar; and
- Interest rate risk, primarily due to changes in New Zealand and United States interest rates.

The Fund is also exposed to commodity price risk in relation to its forestry and farming investments.

EQUITY PRICE RISK

Equity price risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in equity prices. The Fund is exposed to changes in the price of equities listed on both New Zealand and international stock exchanges, as well as derivative financial instruments or unlisted equities where fair value is determined with reference to an equity market index or comparable transactions in a listed equity market.

Equity price risk is managed by imposing investment constraints at a total Fund level and within individual investment mandates. Limits imposed on external investment managers are detailed within individual investment management agreements. Compliance with investment constraints is reported to the Board and management of the Guardians on a regular basis.

SECTION 3: RISK MANAGEMENT (continued)

(b) Market risk (continued)

The following table shows the Fund's sensitivity to a change in equity prices with all other variables held constant. The percentages used represent the Board's and management's assessment of a reasonably possible change in equity prices, equivalent to one standard deviation, based on internal risk modelling.

	FUND ACTUAL				
	ONE STANDARD DEVIATION (%)	PROFIT AFTER INCOME TAX EXPENSE		OTHER COMPREHENSIVE INCOME NET OF TAX	
		INCREASE NZD'000	DECREASE NZD'000	INCREASE NZD'000	DECREASE NZD'000
2017					
New Zealand equities	18	264,678	(264,678)	–	–
Global large cap equities	16	2,920,899	(2,920,899)	–	–
Global small cap equities	20	386,610	(386,610)	–	–
Infrastructure equities	12	125,182	(125,182)	–	–
Emerging markets equities	26	919,479	(919,479)	–	–
Private equity	20	566,134	(566,134)	13,429	(13,429)
2016					
New Zealand equities	18	232,829	(232,829)	–	–
Global large cap equities	16	2,401,289	(2,401,289)	–	–
Global small cap equities	20	334,708	(334,708)	–	–
Infrastructure equities	12	109,279	(109,279)	–	–
Emerging markets equities	26	815,408	(815,408)	–	–
Private equity	20	434,017	(434,017)	11,642	(11,642)

FOREIGN CURRENCY RISK

Foreign currency risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in foreign exchange rates. The Fund is exposed to foreign currency risk through its investments in offshore assets.

Foreign currency risk is managed by establishing a target hedge ratio for all foreign currency exposures at a total Fund level and by specifying bounds within which external investment managers may take on foreign currency exposures within individual investment management agreements. The financial instruments that external investment managers may use, and the creditworthiness of the counterparties, are detailed within those investment management agreements.

Foreign currency exposures are hedged with forward foreign exchange contracts and cross currency swaps with counterparties that have an appropriate minimum credit rating as determined by an international credit rating agency, and appropriate contractual arrangements must be in place between the Fund and the counterparty.

The table below shows effective foreign currency exposure after forward foreign exchange contracts and cross currency swaps have been taken into account.

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
Australian Dollars	595,255	968,282
Brazilian Real	195,848	125,116
British Pounds	684,826	1,462,424
Canadian Dollars	1,332,441	1,101,951
Chilean Pesos	44,575	28,601
Colombian Pesos	17,293	11,352
Czech Koruny	10,566	7,506
Danish Kroner	112	5,556
Egyptian Pounds	5,128	3,798
European Union Euros	(1,617,088)	(1,087,636)
Hong Kong Dollars	223,841	31,337
Hungarian Forints	15,896	6,378
Indian Rupees	70,447	128,099
Indonesian Rupiahs	36,662	63,404
Israeli New Shekels	233,011	45,319
Japanese Yen	(54,652)	(827,705)
Malaysian Ringgits	79,340	84,321
Mexican Pesos	137,498	89,994
Norwegian Krone	3,916	431
Pakistan Rupee	5,172	–
Philippines Pesos	44,718	36,903
Polish Zloty	60,414	32,581
Qatari Rial	26,387	20,860
Russian Rubles	106,576	73,867
Singaporean Dollars	379	3,571
South African Rand	195,614	133,158
South Korean Won	158,681	–
Swedish Kronor	(16,657)	–
Swiss Francs	(748,147)	(657,496)
Taiwanese New Dollars	129,120	8,977
Thai Baht	41,647	61,581
Turkish New Lira	44,794	36,810
United Arab Emirates Dirham	26,357	18,750
United States of America Dollars	1,651,871	1,302,849
	3,741,842	**3,320,939**

SECTION 3: RISK MANAGEMENT (continued)

(b) Market risk (continued)

The following table shows the Fund's sensitivity to a change in the New Zealand dollar against the major foreign currencies with all other variables remaining constant. The analysis has been performed only on the effective foreign currency exposure after allowing for the impact of forward foreign exchange contracts and cross currency swaps. The percentages used represent the Board's and management's assessment of a reasonably possible change in foreign currency rates, equivalent to one standard deviation.

	FUND ACTUAL				
	ONE STANDARD DEVIATION (%)	PROFIT AFTER INCOME TAX EXPENSE		OTHER COMPREHENSIVE INCOME NET OF TAX	
		INCREASE	DECREASE	INCREASE	DECREASE
		NZD'000	NZD'000	NZD'000	NZD'000
2017					
NZD/USD	10	116,011	(116,011)	2,924	(2,924)
NZD/EUR	10	(116,430)	116,430	–	–
NZD/GBP	10	49,307	(49,307)	–	–
NZD/JPY	10	(3,935)	3,935	–	–
NZD/Others	10	222,354	(222,354)	–	–
2016					
NZD/USD	10	90,949	(90,949)	2,856	(2,856)
NZD/EUR	10	(78,310)	78,310	–	–
NZD/GBP	10	105,295	(105,295)	–	–
NZD/JPY	10	(59,595)	59,595	–	–
NZD/Others	10	178,713	(178,713)	–	–

INTEREST RATE RISK

Interest rate risk is the risk that the fair value or future cash flows of the Fund's investments in fixed interest securities and cash and cash equivalents will fluctuate due to changes in market interest rates. The Fund is primarily exposed to changes in New Zealand and United States short-term interest rates.

Interest rate risk is managed by diversification between asset classes and by imposing investment constraints on external investment managers. Interest rate swaps are used to manage exposure to movements in interest rates.

The following table shows the Fund's sensitivity to a change in interest rates with all other variables remaining constant. The basis point movement used represents the Board's and management's assessment of a reasonably possible change in interest rates, equivalent to one standard deviation.

	FUND ACTUAL				
	ONE STANDARD DEVIATION (BASIS POINTS)	PROFIT AFTER INCOME TAX EXPENSE		OTHER COMPREHENSIVE INCOME NET OF TAX	
		INCREASE	DECREASE	INCREASE	DECREASE
		NZD'000	NZD'000	NZD'000	NZD'000
2017					
Fixed income securities and other interest-sensitive financial instruments	50	(19,763)	19,763	–	–
2016					
Fixed income securities and other interest-sensitive financial instruments	50	18,567	(18,567)	–	–

COMMODITY PRICE RISK

The Fund is exposed to financial risk in respect of its forestry activities due to the global volatility of log prices, exchange rates and transportation costs. These exposures are managed through adjustments to harvest levels and marketing efforts in order to minimise the risk of financial loss.

The Fund is also exposed to financial risk in respect of its farming activities due to the global volatility of milk prices and the price of key inputs e.g. feed and fertiliser. Dairy prices relative to key inputs are continually monitored so that operations can adapt as required. There are procedures, systems and infrastructure in place to minimise and manage the risks to which the land and livestock assets are exposed that could lead to financial loss. Such measures include ongoing animal health management, detailed planning and cost control systems supported by regular visits by agricultural consultants, along with significant investment in farm infrastructure and technology to deal with risks associated with effluent disposal. All rural land investments, livestock and physical assets are inspected at least twice monthly to assess the condition of these assets, and to manage any identified risks.

(c) Credit risk

Credit risk is the risk that a third party will default on its obligation to the Fund, causing the Fund to incur a loss. The Fund is exposed to credit risk arising from its cash and cash equivalents, receivables and investments. The maximum amount of credit risk for each class of financial asset is the carrying amount included in the Statement of Financial Position.

Capital allocated to internally managed investments is governed by the Investment Risk Allocation Policy and relevant Internal Investment Mandates. The Board and management mitigate the Fund's exposure to credit risk through internally managed investments by applying specific prudential limits to any unhedged exposure to any single investment manager or asset. Additionally, investment strategy-specific constraints are imposed, limiting the Fund's net unhedged exposure to individual counterparties; collective unhedged exposure to counterparties with credit ratings of 'BBB' or less; and individual clearing houses.

The use of, and capital allocated to, external investment managers is governed by the Investment Risk Allocation Policy and Externally Managed Investments Policy. Each external investment manager relationship is governed by an investment management agreement which outlines the key terms and conditions of the appointment. Specific prudential limits for external investment managers are built into these agreements which restrict the credit risk the Fund is exposed to. External investment managers are monitored individually on an on-going basis as well as being considered in the Fund's overall financial risk management activities.

SECTION 3: RISK MANAGEMENT (continued)

(c) Credit risk (continued)

CONCENTRATIONS OF CREDIT RISK

Concentration of credit risk exists if a single counterparty, or group of counterparties, is engaged in similar activities, operate within similar industries, geographies, or have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions.

The following tables analyse the Fund's concentration of credit risk by geographical and industrial distribution. The analyses are based on the Fund's net financial assets at balance date, at the aggregate level of each individual investment, and covers both internally and externally managed investments.

	FUND ACTUAL	
	2017	2016
	%	%
By geography		
New Zealand	13	12
Australia	7	6
North America	43	36
Europe	21	24
Asia	12	13
Other	4	9
	100	**100**

	FUND ACTUAL	
	2017	2016
	%	%
By industry		
Basic materials	8	9
Communications	6	5
Consumer – cyclical	6	5
Consumer – non-cyclical	13	11
Energy	2	4
Financial	30	31
Funds	5	3
Government	6	6
Industrial	7	6
Technology	6	4
Utilities	2	3
Other	9	13
	100	**100**

COUNTERPARTY CREDIT RISK

It is the Fund's policy to enter into financial instruments with reputable counterparties. The Board and management closely monitor the creditworthiness of the Fund's counterparties by reviewing their credit ratings, credit default swap spreads, equity pricing, news flows and other indicators on a regular basis.

At balance date, the Fund has counterparty exposure in respect of its forward foreign exchange contracts, cross currency swaps, asset swaps, longevity contingent swaps, total return swaps, credit default swaps, interest rate swaps and other over-the-counter swaps. The table below sets out the net exposures, excluding collateral, by individual counterparty (and, where applicable, specific branch) where instruments have a net positive fair value:

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
ANZ Bank New Zealand Limited	55,910	263,345
ASB Bank	5,934	4,326
Bank of New Zealand	55,210	57,379
Barclays Bank PLC, New York Branch	11,362	551
BNP Paribas, London Branch	2,678	–
BNP Paribas, Paris Branch	1,669	7,273
BNP Paribas, New York Branch	3,566	5,980
Citibank Limited, Sydney Branch	–	625
Citibank N.A., London Branch	1,036	–
Citibank N.A., New York Branch	114,832	185,544
Commonwealth Bank of Australia, Sydney Branch	116,498	196,560
Credit Suisse Securities (Europe) Limited	79,759	92,989
Deutsche Bank AG, London Branch	1,406	4,576
Deutsche Bank AG, New York Branch	104,942	12,002
Goldman Sachs International	130,619	134,320
Her Majesty the Queen In Right of New Zealand (NZ DMO)	–	35,224
The Hong Kong and Shanghai Banking Corporation Limited	8,458	17,580
JP Morgan Chase, London Branch	238,518	154,855
Morgan Stanley & Co. International PLC	200,443	68,812
National Australia Bank	3	–
Nomura International PLC	34,116	27,822
Societe Generale	7,836	50,383
The Northern Trust Company	3	3
UBS AG, London Branch	49	–
UBS AG, Singapore Branch	118,016	76,215
Westpac Banking Corporation, Wellington Branch	18,406	156,345
	1,311,269	**1,552,709**

The Board and management restrict the Fund's exposure to loss from derivative financial instruments by entering into master-netting arrangements with major counterparties with whom a significant volume of transactions are undertaken. These arrangements provide for a single net settlement of all financial instruments covered by the agreement in the event of default on any one contract. Master-netting arrangements do not result in the offset of assets and liabilities in the Statement of Financial Position unless certain conditions for offsetting under NZ IAS 32 Financial Instruments: Presentation apply. Refer to Note 4(f) for further detail on the offsetting of financial assets and financial liabilities.

SECTION 3: RISK MANAGEMENT (continued)

(c) Credit risk (continued)

CREDIT QUALITY OF FIXED INCOME SECURITIES

A breakdown of the Fund's fixed income securities, both internally and externally managed, by credit rating is set out below. Ratings are obtained from Standard & Poor's, Moody's and Fitch depending on the availability of data.

	FUND ACTUAL % OF FIXED INCOME SECURITIES	
	2017	2016
AAA/Aaa	13	11
AA/aa	29	32
A/A	32	29
BBB/Baa	8	9
Other credit rating	2	5
Not rated	16	14
	100	**100**

(d) Liquidity risk

Liquidity risk is the risk that the Fund will encounter difficulty in meeting the obligations associated with its financial liabilities as they fall due. The Fund's liquidity framework is designed to ensure that the Fund has the ability to generate sufficient cash in a timely manner to meet its financial commitments.

Liquidity risk is managed by:

- forecasting liquidity requirements;
- maintaining a buffer of cash and highly liquid securities to meet short-term liquidity requirements;
- regular review of the liquidity available by senior management;
- periodic 'stress-tests' of the liquidity framework using theoretical scenarios.

MATURITY PROFILE OF FINANCIAL ASSETS

The following table shows the maturity profile of financial assets available to meet financial obligations. The maturity profile is based on the earlier of contractual repricing or maturity period and excludes accrued interest.

	FUND ACTUAL							
	WEIGHTED AVERAGE EFFECTIVE INTEREST RATE	FIXED MATURITY DATES						
		VARIABLE INTEREST RATE	LESS THAN 1 YEAR	1 – 2 YEARS	2 – 5 YEARS	5 – 10 YEARS	10+ YEARS	NON-INTEREST BEARING
	%	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000
2017								
Financial assets								
Cash and cash equivalents(i)	1.12	2,538,439	–	–	–	–	–	206,398
Cash pledged as collateral(ii)	0.00	288,540	–	–	–	–	–	–
Fixed income securities	2.95	–	1,765,803	770,913	1,785,457	1,752,662	2,458,503	–
Other financial assets pledged as collateral	1.00	–	55,456	–	–	–	–	–
		2,826,979	**1,821,259**	**770,913**	**1,785,457**	**1,752,662**	**2,458,503**	**206,398**
2016								
Financial assets								
Cash and cash equivalents(i)	1.58	2,210,142	–	–	–	–	–	27,705
Cash pledged as collateral(ii)	0.00	758,811	–	–	–	–	–	–
Fixed income securities	2.66	–	966,897	1,116,458	2,631,872	1,933,260	2,828,542	–
Other financial assets pledged as collateral	1.00	–	–	–	56,164	–	–	–
		2,968,953	**966,897**	**1,116,458**	**2,688,036**	**1,933,260**	**2,828,542**	**27,705**

(i) Non-interest bearing cash and cash equivalents is primarily comprised of non-NZD denominated currencies held in custody, the majority of which earn no interest.

(ii) Cash pledged as collateral is held under Credit Support Annexes to ISDA Master Agreements and with futures exchanges. The rate of interest earned on this cash, whilst variable, is minimal as a result of the current low interest rate environment, and consequently a weighted average effective interest rate of 0.00% has been applied.

The maturity profile of derivative financial instruments is disclosed in Note 4(e).

SECTION 3: RISK MANAGEMENT (continued)

(e) Risks associated with structured entities

The following table summarises the carrying values recognised in the Statement of Financial Position of the Fund's investments in structured entities, as well as the maximum exposure to loss. The maximum exposure to loss is contingent in nature and may arise as a result of the provision of funding commitments (which are common with private equity investment funds). The maximum exposure to loss does not take into account the effects of any hedging or collateralisation designed to reduce that exposure to loss.

The value of the assets of the structured entities themselves have been provided as an indicator of their size, relative to the size of the Fund's interest in these entities. These values represent the most current available information.

	FUND ACTUAL			
	MAXIMUM EXPOSURE TO LOSS			
STRUCTURED ENTITY TYPE	CARRYING VALUE OF INVESTMENTS	UNDRAWN COMMITMENTS	TOTAL INVESTMENTS AND UNDRAWN COMMITMENTS	NET ASSETS OF THE STRUCTURED ENTITY*
	NZD'000	NZD'000	NZD'000	NZD'000
2017				
Fixed income securities:				
Asset-backed securities	876,625	215,563	1,092,188	159,059,549
Collateralised debt obligations and collateralised loan obligations	1,726	–	1,726	150,000
Mortgage-backed securities	1,046,111	52,320	1,098,431	67,102,567
Agency mortgage-backed securities	440,330	–	440,330	N/A(i)
Shareholder loans	117,780	–	117,780	4,307,174
Collective investment funds	1,090,910	–	1,090,910	127,960,714
Insurance-linked investments – catastrophe bonds	74,664	–	74,664	11,745,573
Private equity investments	2,522,806	431,406	2,954,212	26,529,264
Unlisted unit trusts	–	–	–	–
Unconsolidated subsidiaries	1,531,424	772,739	2,304,163	1,607,678
	7,702,376	**1,472,028**	**9,174,404**	**398,462,519**
2016				
Fixed income securities:				
Asset-backed securities	773,719	2,883	776,602	148,628,701
Collateralised debt obligations and collateralised loan obligations	74,894	–	74,894	12,262,031
Mortgage-backed securities	1,737,258	63,419	1,800,677	72,246,544
Agency mortgage-backed securities	364,831	–	364,831	N/A(i)
Shareholder loans	130,297	–	130,297	1,380,887
Collective investment funds	1,061,211	–	1,061,211	78,103,071
Insurance-linked investments – catastrophe bonds	72,953	–	72,953	5,345,619
Private equity investments	2,367,541	255,024	2,622,565	33,441,727
Unlisted unit trusts	654	–	654	2,500
Unconsolidated subsidiaries	386,599	396,255	782,854	391,236
	6,969,957	**717,581**	**7,687,538**	**351,802,316**

* Including the value of the Fund's investment

(i) Information is not available as the securities have not yet been issued.

SECTION 4: FINANCIAL ASSETS AND LIABILITIES

(a) Financial instruments

2017	NOTE	FUND ACTUAL FAIR VALUE THROUGH PROFIT OR LOSS – HELD FOR TRADING	FAIR VALUE THROUGH PROFIT OR LOSS – DESIGNATED UPON INITIAL RECOGNITION	LOANS AND RECEIVABLES	AVAILABLE-FOR-SALE FINANCIAL ASSETS	FINANCIAL LIABILITIES AT AMORTISED COST	TOTAL
		NZD'000	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000
Financial assets							
Cash and cash equivalents	4(b)			2,744,837			2,744,837
Cash pledged as collateral	4(c)			288,540			288,540
Trade and other receivables	4(d)			1,169,311			1,169,311
Investments							
Derivative financial instrument assets	4(e)	1,327,336					1,327,336
Other financial assets:							
Listed New Zealand equities	4(e)		1,665,403				1,665,403
Listed global equities	4(e)		16,587,123				16,587,123
Fixed income securities	4(e)		6,811,556	1,721,782			8,533,338
Collective investment funds	4(e)		1,090,910				1,090,910
Securities lending and similar agreements	4(e)		90,973				90,973
Insurance-linked investments	4(e)		74,664				74,664
Private equity	4(e)		3,738,940		40,614		3,779,554
Unlisted unit trusts	4(e)		–				–
Total other financial assets		–	30,059,569	1,721,782	40,614	–	31,821,965
Other financial assets pledged as collateral	4(e)		55,456				55,456
Investments in unconsolidated subsidiaries	4(e)		1,531,424				1,531,424
Total financial assets		**1,327,336**	**31,646,449**	**5,924,470**	**40,614**	**–**	**38,938,869**
Financial liabilities							
Cash collateral received	4(c)					865,635	865,635
Trade and other payables	4(g)					2,367,188	2,367,188
Investments – derivative financial instrument liabilities	4(e)	332,518					332,518
Total financial liabilities		**332,518**	**–**	**–**	**–**	**3,232,823**	**3,565,341**

SECTION 4: FINANCIAL ASSETS AND LIABILITIES (continued)

(a) Financial instruments (continued)

2016	NOTE	FUND ACTUAL: FAIR VALUE THROUGH PROFIT OR LOSS – HELD FOR TRADING NZD'000	FAIR VALUE THROUGH PROFIT OR LOSS – DESIGNATED UPON INITIAL RECOGNITION NZD'000	LOANS AND RECEIVABLES NZD'000	AVAILABLE-FOR-SALE FINANCIAL ASSETS NZD'000	FINANCIAL LIABILITIES AT AMORTISED COST NZD'000	TOTAL NZD'000
Financial assets							
Cash and cash equivalents	4(b)			2,237,847			2,237,847
Cash pledged as collateral	4(c)			758,811			758,811
Trade and other receivables	4(d)			133,101			133,101
Investments							
Derivative financial instrument assets	4(e)	1,566,708					1,566,708
Other financial assets:							
Listed New Zealand equities	4(e)		1,498,230				1,498,230
Listed global equities	4(e)		10,920,699				10,920,699
Fixed income securities	4(e)		7,341,640	2,135,389			9,477,029
Collective investment funds	4(e)		1,061,211				1,061,211
Securities lending and similar agreements	4(e)		–				–
Insurance-linked investments	4(e)		72,953				72,953
Private equity	4(e)		3,386,302		58,767		3,445,069
Unlisted unit trusts	4(e)		654				654
Total other financial assets		–	24,281,689	2,135,389	58,767	–	26,475,845
Other financial assets pledged as collateral	4(e)		56,164				56,164
Investments in unconsolidated subsidiaries	4(e)		386,599				386,599
Total financial assets		**1,566,708**	**24,724,452**	**5,265,148**	**58,767**	**–**	**31,615,075**
Financial liabilities							
Cash collateral received	4(c)					861,216	861,216
Trade and other payables	4(g)					298,666	298,666
Investments – derivative financial instrument liabilities	4(e)	530,730					530,730
Total financial liabilities		**530,730**	**–**	**–**	**–**	**1,159,882**	**1,690,612**

Accounting Policy

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

The Fund is party to financial instruments as part of its normal operations. These financial instruments include cash and cash equivalents, derivative financial instruments, investments (excluding agricultural assets), receivables and payables. All financial instruments are recognised in the Statement of Financial Position and all income and expenditure in relation to financial instruments are recognised in the Statement of Comprehensive Income.

INITIAL RECOGNITION

Financial assets and financial liabilities are recognised in the Statement of Financial Position when the Fund becomes a party to the contractual provisions of the financial instrument. They are initially recognised at fair value plus, in the case of financial assets and financial liabilities not recorded at fair value through profit or loss, transaction costs e.g. trading commission, that are attributable to the acquisition of the financial asset or financial liability.

Purchases or sales of financial instruments that require delivery within a time frame established by regulation or convention in the market place are recognised on the trade date, i.e. the date on which the Fund commits to purchase or sell the financial instrument.

SUBSEQUENT MEASUREMENT

Subsequent to initial recognition, the Fund's financial assets and financial liabilities are classified into the following categories:

Financial assets and financial liabilities at fair value through profit or loss

FINANCIAL ASSETS AND FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS – HELD FOR TRADING

Financial assets and financial liabilities are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. All derivative financial instruments held by the Fund are classified as held for trading. The Fund does not designate any derivative financial instruments as hedges in a hedging relationship.

FINANCIAL ASSETS AND FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS – DESIGNATED UPON INITIAL RECOGNITION

Financial assets and financial liabilities designated at fair value through profit or loss upon initial recognition include equity and debt instruments. They are designated at fair value upon initial recognition on the basis that they are part of a group of financial instruments that are managed and have their performance evaluated on a fair value basis, in accordance with the financial risk management and investment objectives of the Fund.

Subsequent to initial recognition, financial assets and financial liabilities at fair value through profit or loss are recognised in the Statement of Financial Position at fair value with changes in fair value being recognised in the Statement of Comprehensive Income in the period in which they arise.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. This category includes cash and cash equivalents, cash pledged as collateral, trade and other receivables and some unlisted debt instruments. Unlisted debt instruments that are classified as loans and receivables include fixed and floating rate notes and redeemable preference shares.

Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less any allowance for impairment.

Available-for-sale financial assets

Available-for-sale financial assets include private equity investments that do not have a quoted market price in an active market or whose fair value cannot be reliably measured. The Board and management have determined that the fair value for certain private equity investments cannot be reliably measured where the entity's financial statements have not been prepared under either IFRS or a recognised and reliable accounting basis such as US GAAP.

Available-for-sale financial assets also include private equity investments in cooperative and processing companies. The Fund is required to hold these investments to facilitate farming investment operations. As such, the Fund is normally unable to sell these investments without disrupting farming investment operations.

After initial recognition, available-for-sale financial assets are subsequently measured at fair value, where fair value can be reliably measured, with unrealised gains or losses recognised in other comprehensive income and the available-for-sale reserve. Available-for-sale financial assets whose fair value cannot be reliably measured are measured at cost less impairment. Transaction costs are included in the cost of the investment.

Financial liabilities at amortised cost

Financial liabilities at amortised cost are non-derivative financial liabilities. This category includes cash collateral received and trade and other payables.

DERECOGNITION

Financial assets are derecognised when the rights to receive cash flows from the investments have expired or when the Fund has transferred substantially all of the risks and rewards of ownership. A financial liability is derecognised when the Fund's obligation under the liability is discharged, cancelled or has expired.

IMPAIRMENT

The Board and management assess, at each reporting date, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an 'incurred loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

SECTION 4: FINANCIAL ASSETS AND LIABILITIES (continued)

(b) Cash and cash equivalents

Accounting Policy

Cash and cash equivalents includes cash balances on hand, cash held in bank accounts, demand deposits and other highly liquid investments with an original maturity of three months or less, which have an insignificant risk of change in fair value.

At 30 June 2017, cash of $1,307,418,000 (2016: $181,486,000) had been allocated and was held in Northern Trust's (the Fund's Global master custodian) custody awaiting investment by investment managers.

(c) Collateral

In line with standard industry practice, collateral transactions are settled in line with the relevant Credit Support Agreements (CSAs) which may vary from counterparty to counterparty. Settlements of collateral transactions inherently lag behind real-time mark-to-market movements in the related derivative financial instruments; may only be settled once thresholds, as governed by the CSAs, in these mark-to-market movements are achieved; and may be required from one, both or neither of the counterparties involved with the transaction.

CASH PLEDGED AS COLLATERAL

The cash balance pledged as collateral to meet obligations under CSAs for derivative positions is $142,636,000 (2016: $424,989,000). The counterparties are not permitted to sell or re-pledge the collateral balances. The pledged assets will be returned to the Fund when the underlying transaction is terminated, but in the event of default the counterparty is entitled to apply the collateral in order to settle the liability.

Cash balances totalling $145,904,000 (2016: $333,822,000) are held in separate bank accounts lodged with the relevant futures exchange. Fixed income securities with a fair value of $55,456,000 (2016: $56,164,000) have been lodged with a clearing broker. These cash and fixed income securities have been pledged as collateral for potential margin calls on futures with a fair value of $nil (2016: $nil) held by the Fund.

CASH COLLATERAL RECEIVED

The cash balance received as collateral to meet obligations under CSAs for derivative positions is $865,635,000 (2016: $861,216,000). The Fund is not permitted to sell or re-pledge the collateral cash balances. The pledged assets will be returned to the counterparties when the underlying transaction is terminated, but in the event of default the Fund is entitled to apply the collateral in order to settle the liability.

The fair value of fixed income securities received as collateral to meet obligations under securities lending and similar agreements is $7,558,000 (2016: $nil). The fair value of equity securities received as collateral to meet obligations under securities lending and similar agreements is $83,895,000 (2016: $nil). The Fund is not permitted to sell or re-pledge the collateral. The assets will be returned to the counterparties when the underlying transaction is terminated, but in the event of default the Fund is entitled to apply the collateral in order to settle the liability.

(d) Trade and other receivables

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
Trade receivables	30,856	5,784
Allowance for impairment	–	–
Accrued interest	51,932	57,725
Dividends receivable	29,273	24,580
Unsettled sales	1,056,742	44,392
GST receivable	508	620
	1,169,311	**133,101**

Trade receivables are non-interest bearing and have standard 30-day credit terms. An allowance for impairment of trade receivables is recognised when there is objective evidence that the Fund may not be able to collect all amounts due according to the original terms of the receivables.

The timing and amount of expected cash flows for accrued interest, dividends receivable and unsettled sales are certain as they are based on contractual terms and corporate actions.

As a result of their short-term nature, the carrying value of trade and other receivables held at amortised cost approximates fair value.

(e) Investments

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
Derivative financial instrument assets:		
Forward foreign exchange contracts	1,001,800	1,186,753
Cross currency swaps	14,009	42,538
Asset swaps	3,648	–
Longevity contingent swaps	67,087	78,802
Futures contracts	–	–
Total return swaps – equity	111,738	109,605
Credit default swaps	44,502	125,429
Interest rate swaps	68,436	9,562
Other over-the-counter swaps	20	20
Warrants	16,096	13,999
Total derivative financial instrument assets	**1,327,336**	**1,566,708**
Other financial assets:		
Listed New Zealand equities	1,665,403	1,498,230
Listed global equities	16,587,123	10,920,699
Fixed income securities	8,533,338	9,477,029
Collective investment funds	1,090,910	1,061,211
Securities lending and similar agreements	90,973	–
Insurance-linked investments	74,664	72,953
Private equity (i)	3,779,554	3,445,069
Unlisted unit trusts	–	654
Total other financial assets	**31,821,965**	**26,475,845**
Other financial assets pledged as collateral (ii)	**55,456**	**56,164**
Investments in unconsolidated subsidiaries	**1,531,424**	**386,599**
Derivative financial instrument liabilities:		
Forward foreign exchange contracts	227,881	206,522
Cross currency swaps	1,712	2,696
Asset swaps	12,442	94,685
Futures contracts	–	–
Total return swaps – equity	2,354	74,064
Total return swaps – bonds	2,308	–
Credit default swaps	54,979	74,130
Interest rate swaps	30,840	78,633
Options	2	–
Total derivative financial instrument liabilities	**332,518**	**530,730**

(i) Includes unlisted investment funds; unlisted equity investments; investments in joint ventures; and investments in associates.

(ii) For restrictions on other financial assets pledged as collateral, refer to Note 4(c).

SECTION 4: FINANCIAL ASSETS AND LIABILITIES (continued)

(e) Investments (continued)

DERIVATIVE FINANCIAL INSTRUMENTS

Accounting Policy

The Fund enters into a variety of derivative financial instruments to manage its exposure to foreign currency risk, credit risk and interest rate risk and to achieve exposure to assets and asset classes. The use of derivative financial instruments is governed by the Statement of Investment Policies, Standards and Procedures, including the Derivatives Policy, which provide written principles on the use of derivative financial instruments by the Fund. Compliance with policies and exposure limits is monitored on a continuous basis.

At 30 June 2017, the Fund has positions in the following types of derivative financial instruments:

Forwards and futures

Forward and futures contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market. Futures contracts are transacted in standardised amounts on regulated exchanges and are subject to daily cash margin requirements.

The main differences in the risks associated with forward and futures contracts are credit risk and liquidity risk. The Fund has credit exposure to the counterparties of non-collateralised forward contracts. The credit risk related to futures contracts is considered minimal because the exchange reduces credit risk by daily margining. Forward contracts are settled gross and, therefore, considered to bear a higher liquidity risk than the futures contracts which are settled on a net basis. Both types of contracts result in market risk exposure.

Swaps

Swaps are contractual agreements between two parties to exchange streams of payments over time based on specified notional amounts. Where swap contracts are settled net, the payment flows are usually netted against each other, with the difference being paid by one party to the other. All swaps other than cross currency swaps are settled net. In a cross currency swap, the Fund pays a specified amount in one currency and receives a specified amount in another currency. Swap contracts expose the Fund to counterparty credit risk, market risk and liquidity risk.

Warrants

Warrants are contractual agreements that convey the right, but not the obligation, for the purchaser either to buy or sell a specific amount of a financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

The Funds holds warrants at fair value in respect of one of its private equity investments.

Options

Options are contractual agreements that convey the right, but not the obligation, for the purchaser either to buy or sell a specific amount of a financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

The Fund purchases and sells put and call options through regulated exchanges and over-the-counter markets. The Fund is exposed to credit risk on purchased options only to the extent of their carrying amount, which is their fair value. Options are generally settled on a net basis.

The contract maturities, notional and fair values for all derivative financial instruments are set out below. Fair values presented correspond in total to the net assets and liabilities for each class of derivative.

FORWARD FOREIGN EXCHANGE CONTRACTS

	FUND ACTUAL			
	NOTIONAL VALUE – BUY(SELL) FOREIGN CURRENCY	FAIR VALUE	NOTIONAL VALUE – BUY(SELL) FOREIGN CURRENCY	FAIR VALUE
	2017	2017	2016	2016
	NZD'000	NZD'000	NZD'000	NZD'000
Less than 3 months	(26,468,185)	350,059	(23,050,030)	781,135
3 to 12 months	(10,736,369)	423,860	(6,746,767)	199,096
	(37,204,554)	**773,919**	**(29,796,797)**	**980,231**

All forward foreign exchange contracts are settled gross.

CROSS CURRENCY SWAPS

	FUND ACTUAL		
2017	BUY/SELL	NOTIONAL VALUE	FAIR VALUE
		NZD'000	NZD'000
1 to 2 years	NZD/EUR	311,541	(1,728)
2 to 5 years	NZD/EUR	46,731	4,362
	NZD/USD	347,412	1,182
	USD/JPY	777,926	7,679
5 to 10 years	NZD/USD	194,209	802
		1,677,819	**12,297**
2016			
Less than 1 year	NZD/EUR	77,994	20,369
	NZD/JPY	117,880	14,856
	NZD/USD	153,047	(2,099)
1 to 2 years	NZD/EUR	496,821	(109)
	NZD/GBP	46,797	4,326
	NZD/USD	417,394	1,118
2 to 5 years	AUD/JPY	1,530,837	1,381
		2,840,770	**39,842**

All cross currency swaps are settled gross. Notional value is derived from the 'buy' leg of these contracts.

SECTION 4: FINANCIAL ASSETS AND LIABILITIES (continued)

(e) Investments (continued)

ASSET SWAPS

	FUND ACTUAL			
	NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
	2017	2017	2016	2016
	NZD'000	NZD'000	NZD'000	NZD'000
Less than 1 year	77,885	(12,422)	–	–
1 to 2 years	–	–	77,994	(13,160)
2 to 5 years	–	–	155,988	(63,185)
5 to 10 years	–	–	–	–
Later than 10 years	208,058	3,628	427,194	(18,340)
	285,943	**(8,794)**	**661,176**	**(94,685)**

All asset swaps are settled net.

LONGEVITY CONTINGENT SWAPS

	FUND ACTUAL			
	NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
	2017	2017	2016	2016
	NZD'000	NZD'000	NZD'000	NZD'000
Later than 10 years	301,830	67,087	335,580	78,802
	301,830	**67,087**	**335,580**	**78,802**

All longevity contingent swaps are settled net.

FUTURES CONTRACTS

	FUND ACTUAL			
	NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
	2017	2017	2016	2016
	NZD'000	NZD'000	NZD'000	NZD'000
Equity futures	1,760,152	–	2,127,494	–
Fixed interest futures	2,048,634	–	3,752,037	–
	3,808,786	**–**	**5,879,531**	**–**

The margin on futures contracts is settled daily.

TOTAL RETURN SWAPS – EQUITY

	FUND ACTUAL			
	NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
	2017	2017	2016	2016
	NZD'000	NZD'000	NZD'000	NZD'000
Less than 1 year	8,249,868	109,384	9,450,970	34,012
1 to 2 years	–	–	291,950	1,529
	8,249,868	**109,384**	**9,742,920**	**35,541**

All equity total return swaps are settled net.

TOTAL RETURN SWAPS – BONDS

	FUND ACTUAL			
	NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
	2017	2017	2016	2016
	NZD'000	NZD'000	NZD'000	NZD'000
Less than 1 year	99,751	(2,308)	–	–
	99,751	**(2,308)**	**–**	**–**

All bond total return swaps are settled net.

CREDIT DEFAULT SWAPS

		FUND ACTUAL			
		NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
		2017	2017	2016	2016
		NZD'000	NZD'000	NZD'000	NZD'000
Buy protection	Less than 1 year	6,255,122	(24,688)	1,646,728	(10,420)
	1 to 2 years	50,533	(550)	3,428,812	(43,168)
	2 to 5 years	5,315,339	(215,710)	7,070,263	(147,820)
		11,620,994	**(240,948)**	**12,145,803**	**(201,408)**
Sell protection	Less than 1 year	10,057,499	39,949	1,688,851	13,677
	1 to 2 years	3,116,635	3,680	12,573,015	145,307
	2 to 5 years	5,263,592	186,842	7,786,602	93,723
		18,437,726	**230,471**	**22,048,468**	**252,707**

All credit default swaps are settled net.

SECTION 4: FINANCIAL ASSETS AND LIABILITIES (continued)

(e) Investments (continued)

INTEREST RATE SWAPS

	FUND ACTUAL			
	NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
	2017	2017	2016	2016
	NZD'000	NZD'000	NZD'000	NZD'000
Less than 1 year	54,558	(586)	437,162	(990)
1 to 2 years	241,424	(6,097)	289,536	(2,961)
2 to 5 years	547,166	(11,901)	801,932	(37,749)
5 to 10 years	652,203	16,069	643,507	(27,371)
Later than 10 years	798,334	40,111	–	–
	2,293,685	**37,596**	**2,172,137**	**(69,071)**

All interest rate swaps are settled net.

OTHER OVER-THE-COUNTER SWAPS

		FUND ACTUAL			
		NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
		2017	2017	2016	2016
		NZD'000	NZD'000	NZD'000	NZD'000
Credit default arbitrage swaps	1 to 2 years	95,602	20	–	–
Credit default arbitrage swaps	2 to 5 years	–	–	98,287	20
		95,602	**20**	**98,287**	**20**

All other over-the-counter swaps are settled net.

WARRANTS

	FUND ACTUAL			
	NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
	2017	2017	2016	2016
	NZD'000	NZD'000	NZD'000	NZD'000
2 to 5 years	4,302	–	3,078	12,870
5 to 10 years	43,900	16,096	35,102	1,129
	48,202	**16,096**	**38,180**	**13,999**

OPTIONS

	FUND ACTUAL			
	NOTIONAL VALUE	FAIR VALUE	NOTIONAL VALUE	FAIR VALUE
	2017	2017	2016	2016
	NZD'000	NZD'000	NZD'000	NZD'000
Equity options	684,239	(2)	–	–
	684,239	**(2)**	**–**	**–**

MATURITY PROFILE OF DERIVATIVE FINANCIAL INSTRUMENT LIABILITIES

	FUND ACTUAL				
2017	LESS THAN 1 YEAR	1 – 2 YEARS	2 – 5 YEARS	5 – 10 YEARS	10+ YEARS
	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000
Net-settled derivative financial instruments	(21,564)	(7,413)	(65,178)	(8,750)	(20)
Gross-settled derivative financial instruments – cash inflow	11,792,790	308,443	–	–	–
Gross-settled derivative financial instruments – cash outflow	(12,020,672)	(310,154)	–	–	–
	(249,446)	**(9,124)**	**(65,178)**	**(8,750)**	**(20)**
2016					
Net-settled derivative financial instruments	(75,832)	(18,542)	(176,429)	(32,369)	(18,340)
Gross-settled derivative financial instruments – cash inflow	7,737,119	1,281	3,678	–	–
Gross-settled derivative financial instruments – cash outflow	(7,945,740)	(1,390)	(4,166)	–	–
	(284,453)	**(18,651)**	**(176,917)**	**(32,369)**	**(18,340)**

SECURITIES LENDING

Accounting Policy

Securities lending transactions are usually collateralised by securities or cash. The transfer of the securities to counterparties is only reflected on the Statement of Financial Position if the risks and rewards of ownership are also transferred. Collateral advanced by the borrower in the form of readily marketable securities (non-cash) is held in escrow by a third party agent. Recourse of those securities is only available in the event of default of the borrower and, because of this, the non-cash collateral is not recognised in the Statement of Financial Position. Collateral advanced by the borrower in the form of cash is recognised as an asset in the Statement of Financial Position, along with a corresponding obligation to repay the cash collateral to the borrower, once the securities have been returned.

(f) Offsetting financial assets and financial liabilities

At balance date the Fund was subject to multiple master netting arrangements with its derivative financial instrument and securities lending and similar agreements' counterparties.

The Fund offsets financial assets and financial liabilities when it has a current legally enforceable right to set-off the recognised amounts and there is an intention to settle on a net basis. Each master netting arrangement allows for net settlement of certain open contracts where the Fund and respective counterparty both elect to settle on a net basis. In the absence of such an election, contracts will be settled on a gross basis. However, each party to the master netting arrangement will have the option to settle all open contracts on a net basis in the event of default of the other party. Under the terms of the master netting arrangements, collateral can only be seized by a party in the event of default of the other party.

SECTION 4: FINANCIAL ASSETS AND LIABILITIES (continued)

(f) Offsetting financial assets and financial liabilities (continued)

The following tables present the Fund's financial assets and financial liabilities subject to offsetting, enforceable master netting arrangements and similar arrangements:

	FUND ACTUAL					
	AMOUNTS OFFSET IN THE STATEMENT OF FINANCIAL POSITION			RELATED AMOUNTS NOT OFFSET IN THE STATEMENT OF FINANCIAL POSITION		
2017	GROSS AMOUNTS	GROSS AMOUNTS SET-OFF IN THE STATEMENT OF FINANCIAL POSITION	NET AMOUNTS PRESENTED IN THE STATEMENT OF FINANCIAL POSITION	FINANCIAL INSTRUMENTS	CASH COLLATERAL	NET AMOUNT
	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000	NZD'000
Financial assets						
Derivative financial instrument assets	1,616,869	305,629	1,311,240	–	865,635	445,605
Securities lending and similar agreements(i)	90,973	–	90,973	91,453	–	(480)
Financial liabilities						
Derivative financial instrument liabilities	(638,147)	(305,629)	(332,518)	–	(142,636)	(189,882)
2016						
Financial assets						
Derivative financial instrument assets	1,964,963	398,255	1,566,708	–	861,216	705,492
Securities lending and similar agreements(i)	–	–	–	–	–	–
Financial liabilities						
Derivative financial instrument liabilities	(928,985)	(398,255)	(530,730)	–	(424,989)	(105,741)

(i) Financial instruments held as collateral against securities lending and similar agreements are held in escrow by a third party agent. Recourse of those securities is only available in the event of default of the borrower and, because of this, the non-cash collateral is not recognised in the Statement of Financial Position.

(g) Trade and other payables

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
Trade payables	–	32
Accrued expenses	20,797	22,158
Unsettled purchases	2,335,849	268,319
Amounts owed for reimbursement of the Guardians' expenses	10,542	8,157
Trade and other payables	**2,367,188**	**298,666**
Represented by:		
Current	2,366,632	297,652
Non-current	556	1,014
	2,367,188	**298,666**

Trade and other payables represent amounts due to third parties in the normal course of business and to the Guardians for the reimbursement of expenses. The average credit period on trade payables is 30 days. No interest is charged on overdue balances. The Fund has risk management policies in place to ensure that all payables are paid within the credit time frame.

The timing and amount of expected cash flows for unsettled purchases are certain as they are based on contractual terms and corporate actions.

Other than the non-current portion of trade and other payables, all payables are expected to settle within one year. The non-current payable will settle progressively over a four-year period.

Short-term payables are initially recognised at fair value, then subsequently at amortised cost. As a result of their short-term nature, the carrying amount of trade and other payables held at amortised cost approximates fair value.

(h) Financial assets and financial liabilities expected to be recovered or settled after more than 12 months

Certain financial assets and financial liabilities combine amounts expected to be recovered or settled no more than 12 months after balance date and amounts expected to be recovered or settled more than 12 months after balance date. The following table sets out the amounts expected to be recovered or settled after more than 12 months:

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
ASSETS		
Investments – derivative financial instrument assets	198,963	232,619
Investments – other financial assets	7,124,141	5,075,586
Total financial assets	**7,323,104**	**5,308,205**
LIABILITIES		
Trade and other payables	556	1,014
Investments – derivative financial instrument liabilities	83,073	246,277
Total financial liabilities	**83,629**	**247,291**
Net financial assets	**7,239,475**	**5,060,914**

For the year ended 30 June 2017

SECTION 5: NON-FINANCIAL ASSETS AND LIABILITIES

(a) Property, plant and equipment

	FUND ACTUAL			
	LAND AND LAND IMPROVEMENTS	BUILDINGS	OTHER	TOTAL
	NZD'000	NZD'000	NZD'000	NZD'000
Gross carrying amount				
Balance at 1 July 2015	105,348	16,116	8,072	129,536
Additions	34,042	4,164	2,800	41,006
Disposals	–	(3)	(255)	(258)
Net revaluation increments/(decrements)	(8,512)	36	–	(8,476)
Balance at 30 June 2016	**130,878**	**20,313**	**10,617**	**161,808**
Additions	296	59	1,258	1,613
Disposals	–	–	(86)	(86)
Transfer to unconsolidated subsidiaries(i)	(131,174)	(20,372)	(7,786)	(159,332)
Net revaluation increments/(decrements)	–	–	–	–
Balance at 30 June 2017	**–**	**–**	**4,003**	**4,003**
Accumulated depreciation				
Balance at 1 July 2015	–	–	3,065	3,065
Depreciation expense	–	551	860	1,411
Depreciation recovered	–	–	–	–
Depreciation reversed on revaluation	–	(533)	(205)	(738)
Balance at 30 June 2016	**–**	**18**	**3,720**	**3,738**
Depreciation expense	–	313	728	1,041
Depreciation recovered	–	–	(9)	(9)
Transfer to unconsolidated subsidiaries(i)	–	(331)	(2,454)	(2,785)
Depreciation reversed on revaluation	–	–	–	–
Balance at 30 June 2017	**–**	**–**	**1,985**	**1,985**
Net book value				
As at 30 June 2016	**130,878**	**20,295**	**6,897**	**158,070**
As at 30 June 2017	**–**	**–**	**2,018**	**2,018**

(i) During the year the Fund's property, plant and equipment relating to its rural holdings were transferred at book value into newly-formed unconsolidated subsidiaries. Refer to Note 9(a) for further detail on these asset transfers.

Accounting Policy

RECOGNITION AND MEASUREMENT

All items of property, plant and equipment are initially recognised at cost. Cost includes the value of consideration exchanged and those expenses directly attributable to bringing the item to working condition for its intended use.

Subsequent to initial recognition, all items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses.

DERECOGNITION

An item of property, plant and equipment is derecognised when it is sold or otherwise disposed of or when no future economic benefits are expected to arise from its continued use. Any gain or loss arising on disposal (being the difference between the net disposal proceeds and the carrying amount of the item) is included in the Statement of Comprehensive Income in the year in which the item is disposed of.

IMPAIRMENT

All items of property, plant and equipment are assessed for indicators of impairment at each balance date. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated, being the greater of fair value less costs to sell and value in use. Where the carrying amount of an asset is greater than its recoverable amount, the asset is written down to its recoverable amount. The write-down is recognised in the Statement of Comprehensive Income. Where an impairment loss subsequently reverses, the carrying amount of the item is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount which would have been determined had no impairment loss been recognised for the item in prior years. A reversal of an impairment loss is recognised in the Statement of Comprehensive Income immediately.

Refer to Note 7(c) for the accounting policy on depreciation.

Included in other property, plant and equipment are leasehold improvements relating to office premises leased by the Guardians at 21 Queen Street, Auckland. The Guardians is the legal party to the lease, however all lease expenses incurred are reimbursed by the Fund. The Guardians are able to appropriate funds from the Crown to cover certain expenses, however these do not extend to property, plant and equipment. As a result, the Fund directly meets the cost of all leasehold improvements and accordingly, these assets are reflected in the financial statements of the Fund.

SECTION 5: NON-FINANCIAL ASSETS AND LIABILITIES (continued)

(b) Provision for performance-based fees

	FUND ACTUAL	
	2017 NZD'000	2016 NZD'000
Opening balance	16,214	19,834
New provision during the year	10,922	4,715
Unused provision released during the year	–	–
Current portion transferred to accrued expenses	(11,494)	(8,335)
Closing balance	**15,642**	**16,214**

Accounting Policy

A provision is recognised in the Statement of Financial Position when the Fund has a present obligation arising as a result of a past event, it is probable that cash will be paid to settle the obligation and the amount can be estimated reliably. The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at balance date, taking into consideration the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

Where some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that recovery will be received and the amount of the receivable can be measured reliably.

A provision is recognised by the Fund for performance-based fees payable to external investment managers where it is uncertain how much cash will be required to settle a liability and therefore an estimate is required. Performance-based fees are payable to certain external investment managers based on the performance of the assets under their management over and above an agreed benchmark. For some of these external investment managers, the pay-out of the current year's fee is capped, with the remainder of the fee being held by the Fund for possible pay-out in future periods. For those managers, poor performance in the following years may lead to a reduction in the entitlement that is being held. Thus, the amount and timing of the eventual pay-out is uncertain.

All provisions for performance-based fees are non-current.

SECTION 6: MANAGEMENT OF FUND CAPITAL AND RESERVES

(a) Fund capital

PURPOSE

Fund capital, which comprises investments and all other assets of the Fund less any liabilities, is the property of the Crown. The Fund's purpose is to build a portfolio of assets to help reduce the impact of providing retirement income, in the form of New Zealand superannuation, to an ageing population.

CAPITAL CONTRIBUTIONS

The Crown is required to make capital contributions to the Fund in accordance with Sections 42 to 44 of the New Zealand Superannuation and Retirement Income Act 2001 (Act). These capital contributions are made by the Crown for investment purposes based on a percentage of Gross Domestic Product (GDP). Under Section 44 of the Act, the Crown is entitled to contribute lesser amounts than calculated using the formula under Section 43 of the Act. The Government announced in the 2009 Budget a reduction in capital contributions to the Fund. As a consequence, no capital contributions have been received during the current year. Full capital contributions are projected to resume from 2020/21 under current Treasury modelling, but this may change based on future Economic and Fiscal Updates. Fund capital contributions are recorded in the Statement of Changes in Public Equity.

CAPITAL WITHDRAWALS

Under Section 47 of the Act, no withdrawal of capital is permitted from the Fund prior to 1 July 2020.

SUPERANNUATION ENTITLEMENTS

Under Section 45 of the Act, the Minister of Finance must ensure that sufficient money is transferred into the Fund in each financial year to meet the net cost of the superannuation entitlements that are payable out of the Fund during that year. This requirement is additional to and separate from the obligation to make annual capital contributions. As no capital withdrawals are permitted from the Fund prior to 1 July 2020, the Minister of Finance is obliged to provide funding to meet superannuation entitlements in the interim. The Treasury, through the New Zealand Debt Management Office, has facilitated funding for these superannuation entitlements from the Minister of Finance to the Ministry of Social Development on behalf of the Fund. The Guardians has no control over these transfers, with The Treasury acting as agent for the Fund. Transfers for superannuation entitlements are recorded in the Statement of Changes in Public Equity.

MANAGEMENT OF FUND CAPITAL

The Fund is a profit-oriented entity, managed by the Guardians. The Guardians' mandate is to invest the Fund on a prudent, commercial basis and, in doing so, ensure that the Fund is managed and administered in a manner consistent with best-practice portfolio management, maximising return without undue risk to the Fund as a whole, and avoiding prejudice to New Zealand's reputation as a responsible member of the world community.
The contributions from the Crown to the Fund are invested in accordance with its Statement of Investment Policies, Standards and Procedures, which is available at www.nzsuperfund.co.nz.

(b) Reserves

ASSET REVALUATION RESERVE

The asset revaluation reserve is used to record increases and decreases in the fair value of land and land improvements, buildings and intangible assets.

AVAILABLE-FOR-SALE RESERVE

This reserve records movements in the fair value of available-for-sale financial assets.

SECTION 7: FINANCIAL PERFORMANCE

(a) Income

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
Interest income	299,213	271,941
Dividend income	450,272	423,531
Net fair value gains on financial instruments designated at fair value through profit or loss upon initial recognition	2,804,443	(121,805)
Net fair value gains on financial instruments held at fair value through profit or loss – held for trading	2,003,756	(517,709)
Net foreign exchange gains	758,425	589,411
Other income	6,947	12,669
Net operating income	**6,323,056**	**658,038**
Interest income – financial instruments at fair value through profit or loss	203,321	187,606
Interest income – financial instruments not at fair value through profit or loss	95,892	84,335
Total interest income	**299,213**	**271,941**

Accounting policy

Income is recognised when it is probable that economic benefits will flow to the Fund and the income can be reliably measured, regardless of when payment is being made. The following specific recognition criteria must also be met before income is recognised:

INTEREST INCOME

For financial instruments measured at fair value, interest income is recognised on an accruals basis, either daily or on a yield-to-maturity basis. For financial instruments not at fair value through profit or loss, interest income is recognised as the interest accrues using the effective interest method, which allocates interest at a constant rate of return over the expected life of the financial instrument based on the estimated future cash flows.

DIVIDEND INCOME

Dividend income is recognised when the shareholder's rights to receive payment has been established, normally the ex-dividend date. Where the Fund has elected to receive dividends in the form of additional shares rather than cash, the amount of the cash dividend foregone is recognised as income. Any excess in the value of shares received over the amount of cash dividend foregone is recognised as a gain in the Statement of Comprehensive Income.

(b) Income received and gains and losses recognised from interests in unconsolidated structured entities

The following table summarises income received and fair value gains and losses on financial instruments held at fair value through profit or loss recognised in the Statement of Comprehensive Income from interests in unconsolidated structured entities:

	FUND ACTUAL				
STRUCTURED ENTITY TYPE	INTEREST INCOME NZD'000	DIVIDEND INCOME NZD'000	FAIR VALUE GAINS NZD'000	FAIR VALUE LOSSES NZD'000	TOTAL NZD'000
2017					
Fixed income securities:					
Asset-backed securities	12,644	–	1,406	(59)	13,991
Collateralised debt obligations and collateralised loan obligations	83	–	15	–	98
Mortgage-backed securities	13,912	–	25,108	(6,741)	32,279
Agency mortgage-backed securities	5,502	–	1,020	(6,450)	72
Shareholder loans	8,571	–	18	(84)	8,505
Collective investment funds	273	–	83,992	(21,388)	62,877
Insurance-linked investments – catastrophe bonds	4,125	–	1,947	(1,213)	4,859
Private equity investments	–	2,402	387,786	(30,103)	360,085
Unconsolidated subsidiaries	–	277	102,997	(9,191)	94,083
2016					
Fixed income securities:					
Asset-backed securities	7,035	–	1,500	(184)	8,351
Collateralised debt obligations and collateralised loan obligations	1,080	–	93	(38)	1,135
Mortgage-backed securities	22,165	–	6,683	(21,541)	7,307
Agency mortgage-backed securities	3,512	–	3,987	(1,328)	6,171
Shareholder loans	9,383	–	62	(141)	9,304
Collective investment funds	858	–	58,986	(194,670)	(134,826)
Insurance-linked investments – catastrophe bonds	4,954	–	320	(12)	5,262
Private equity investment funds	–	14,900	301,333	(64,037)	252,196
Unconsolidated subsidiaries	–	80	42,637	(11,768)	30,949

SECTION 7: FINANCIAL PERFORMANCE (continued)

(c) Operating expenditure

	FUND ACTUAL	
	2017 NZD'000	2016 NZD'000
Reimbursement of Guardians' expenses	40,540	37,041
Managers' fees – base	24,967	22,579
Managers' fees – performance	15,659	4,716
Farm operating expenses	8,126	12,347
Custody fees	5,050	5,587
Depreciation	1,041	1,411
Amortisation	396	830
Loss on disposal of property, plant and equipment	11	41
Loss on revaluation of property, plant and equipment	–	398
Revaluation gain on intangible assets	–	(127)
Auditor's remuneration	453	427
Other expenses	25,090	13,709
Operating expenditure	**121,333**	**98,959**

Accounting policy

DEPRECIATION

Depreciation is provided on a straight-line basis to write off the cost of property, plant and equipment to estimated residual value over their estimated useful lives. The estimated useful lives of the major categories of property, plant and equipment are as follows:

Computer and office equipment	3 years
Office fit-out	up to 12 years

The cost of office fit-out is capitalised and depreciated over the unexpired period of the lease (held by the Guardians) or the estimated remaining useful lives of the improvements, whichever is shorter.

(d) Auditor's remuneration

	FUND ACTUAL	
	2017 NZD'000	2016 NZD'000
Audit of the Fund's financial statements	411	405
Audit of the Fund's unconsolidated subsidiaries financial statements met by the Fund	20	–
Other fees paid to auditor	22	22
Total auditor's remuneration	**453**	**427**

The auditor of the Fund is Graeme Bennett of Ernst & Young, on behalf of the Auditor-General. Audit fees paid to the auditor for the audit of the Fund's unconsolidated subsidiaries relate to the audit of NZSF Land Holdings Limited, NZ Hobsonville Investments Limited and NZSF Tui Investments Limited. Not all of the Fund's unconsolidated subsidiaries are audited by the auditor of the Fund. As a consequence, not all audit fees relating to unconsolidated subsidiaries are reflected in the above fees.

The other fees paid to the auditor of the Fund were for the assurance review of the calculation of Fund performance and the assurance review of the annual self-assessment of the Guardians' adherence to the Generally Accepted Principles and Practices for Sovereign Wealth Funds (Santiago Principles).

(e) Income tax

The income tax expense included in the Statement of Financial Performance is analysed as follows:

	FUND ACTUAL	
	2017 NZD'000	2016 NZD'000
Components of income tax expense		
Current tax expense:		
Current period	1,197,424	540,708
Prior period adjustment	(3,597)	(29,469)
Total current tax expense	**1,193,827**	**511,239**
Deferred tax expense:		
Current period	62,361	16,850
Prior period adjustment	(1,157)	9,709
Total deferred tax expense	**61,204**	**26,559**
Income tax expense	**1,255,031**	**537,798**
Reconciliation of income tax expense and accounting profit for the year		
Profit for the year before income tax expense	6,201,723	559,079
Income tax expense calculated at 28%	1,736,482	156,542
Fair Dividend Rate[(i)]	(308,841)	512,156
Dividend imputation credits	(17,858)	(22,231)
Portfolio Investment Entities (PIE) Regime	(161,666)	(100,995)
Controlled Foreign Companies (CFC) Regime	(2,240)	4,385
Expenses non-deductible for tax purposes	986	(523)
Prior period adjustments	(4,754)	(19,760)
Other items	12,922	8,224
Income tax expense	**1,255,031**	**537,798**
Tax expense relating to items charged or credited directly to equity		
Deferred tax on asset revaluation reserve	2,094	(167)
	2,094	**(167)**

(i) The Fund applies the 'Fair Dividend Rate' (FDR) to all equity investments excluding New Zealand equities and certain Australian equities listed on the Australian Stock Exchange (ASX). The investments subject to FDR are taxed on 5% of their market value. Gains, losses and dividends on these investments are not subject to any further tax.

SECTION 7: FINANCIAL PERFORMANCE (continued)

(e) Income tax (continued)

The table below sets out the deferred tax liability recognised in the Statement of Financial Position, together with movements during the year:

	FUND ACTUAL			
	RECOGNISED 2016	CHARGED TO PROFIT OR LOSS	CHARGED DIRECTLY TO EQUITY	RECOGNISED 2017
	NZD'000	NZD'000	NZD'000	NZD'000
Deferred tax liability comprises temporary differences attributable to:				
Timber investments – forest revaluation	(314,955)	(48,069)	–	(363,024)
Asset revaluation	(2,094)	–	2,094	–
Other items	11,436	(13,135)	–	(1,699)
Total deferred tax liability	**(305,613)**	**(61,204)**	**2,094**	**(364,723)**

Accounting Policy

In accordance with Section HR 4B of the Income Tax Act 2007, income derived by the Fund is subject to New Zealand tax determined using the rules applying to companies. The income tax expense recognised in profit or loss in the Statement of Comprehensive Income comprises current and deferred tax and is based on accounting profit, adjusted for permanent differences between accounting and tax rules. Income tax relating to items of other comprehensive income is recognised in other comprehensive income.

Current tax is the expected tax payable to or receivable from the taxation authorities based on the taxable income or loss for the year and any adjustment in respect of prior years. It is calculated using tax rates and tax laws that have been enacted or substantively enacted at balance date.

Deferred tax is recognised in respect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the tax bases of assets and liabilities at balance date. Deferred tax liabilities are recognised for all taxable temporary differences, except:

- the initial recognition of goodwill;
- the initial recognition of assets or liabilities that affects neither accounting nor taxable profit or loss other than in a business combination; and
- temporary differences relating to investments in subsidiaries, associates and interests in joint ventures where it is probable that they will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, the carry forward of unused tax credits and unused tax losses only to the extent that it is probable that sufficient taxable profit will be available to utilise the deductible temporary differences, the carry forward of unused tax credits and unused tax losses. The carrying amount of deferred tax assets is reviewed at each balance date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at balance date.

Deferred tax assets and liabilities are offset when a legally enforceable right to set-off exists, the deferred tax balances relate to income taxes levied by the same taxation authority and the Fund intends to settle on a net basis.

(f) Reconciliation of profit for the year to net cash flows from operating activities

The following is a reconciliation of profit for the year to cash provided by operating activities as per the Statement of Cash Flows.

	FUND ACTUAL	
	2017 NZD'000	2016 NZD'000
Profit for the year after income tax expense	4,946,692	21,281
Add/(Deduct) non-cash items:		
Depreciation and amortisation	1,437	2,241
Loss on revaluation of property, plant and equipment	–	398
Revaluation gain on intangible assets	–	(127)
Fair value changes in investments at fair value through profit or loss	(4,808,199)	639,514
Net foreign exchange (gains)/losses	(758,425)	(589,411)
Increase in deferred tax	59,110	26,726
Other non-cash items	(2,220)	7,918
Add items classified as investing activities:		
Loss on disposal of property, plant and equipment	11	41
Changes in working capital:		
(Increase)/Decrease in assets:		
Trade and other receivables	(1,036,210)	520,744
Other current assets	924	(190)
Increase/(Decrease) in liabilities:		
Trade and other payables	2,068,522	(285,185)
Provisions	(572)	(3,620)
Increase/(Decrease) in current tax	257,680	525,239
Add/(Deduct) changes in net assets and liabilities related to operating cash flows not included in net profit:		
Unsettled sales	1,012,349	(511,831)
Unsettled purchases	(2,067,459)	275,892
Add/(Deduct) net operating cash flows not included in net profit[i]	776,896	385,013
Net cash provided by/(used in) operating activities	**450,536**	**1,014,643**

(i) Net operating cash flows not included in net profit is primarily comprised of the cash flows arising from the sale and purchase of investments and the net movement in cash collateral.

SECTION 8: UNRECOGNISED ITEMS

(a) Commitments and contingencies

OPERATING LEASE COMMITMENTS

Accounting Policy

The determination of whether an arrangement is (or contains) a lease is based on the substance of the arrangement at the inception of the lease. The arrangement is (or contains) a lease if fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. Leases in which the lessor retains substantially all the risks and benefits of ownership of an asset are classified as operating leases. Operating lease expenses are recognised on a straight-line basis over the period of the lease.

The Fund has no operating leases at balance date. All leases relating to farming operations were transferred to the newly-formed unconsolidated subsidiaries NZSF Southland Farms Limited, NZSF Canterbury Farms Limited and NZSF Waikato Farms Limited. In 2016 all operating leases related to the leasing of dairy farm land.

The base future minimum amounts payable under non-cancellable operating leases are as follows:

	FUND ACTUAL	
	2017 NZD'000	2016 NZD'000
Less than 1 year	–	87
1 to 5 years	–	51
Later than 5 years	–	–
	–	**138**

CAPITAL COMMITMENTS

At 30 June 2017, the Fund had outstanding commitments to private equity investment funds (excluding those classified as unconsolidated subsidiaries) totalling $127,093,000 (2016: $130,504,000), of which $3,402,000 has been called but not yet paid (2016: $1,322,000). Additionally, private equity investment funds that have reached the end of their contracted investment periods can call for 'follow on capital' under restricted conditions to support existing investments. The Fund has an additional commitment of $306,703,000 for follow on capital (2016: $148,414,000). These commitments are denominated in the foreign currency of the respective investment fund and have been translated at the exchange rate prevailing at balance date.

At 30 June 2017, the Fund had outstanding commitments under loan agreements totalling $267,884,000 (2016: $81,803,000). Under the loan agreements, the borrower can call for cash by giving the Fund up to 10 business days notice.

CONTINGENT LIABILITIES

The Fund has no contingent liabilities at 30 June 2017. In 2016 the Fund had a contingent liability in respect of its forests which were part of the New Zealand Emissions Trading Scheme (ETS). Had the Fund harvested, and not replanted the forests held, it would have resulted in a liability under the ETS of approximately $2,648,000.

(b) Subsequent events

There were no reportable events subsequent to balance date (2016: nil).

SECTION 9: OTHER INFORMATION

(a) Related party transactions

Parties are considered related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operating decisions. The definition includes subsidiaries, associates and joint ventures. All related party transactions have been entered into on an arm's length basis.

PARENT ENTITY

The Fund is managed and administered by the Guardians which is a wholly owned entity of the Crown. Both the Guardians and the Crown prepare financial statements that are available to the public.

The Guardians pays expenses relating to the Fund, as it is required to do under the Act. A portion of these expenses is reimbursed by the Fund as is entitled under the Act. These expenses are included in the financial statements of the Guardians. The amount of reimbursement to the Guardians for the year ended 30 June 2017 was $40,540,000 (2016: $37,041,000). The related party payable to the Guardians as at 30 June 2017 is $10,542,000 (2016: $8,157,000).

SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

Transactions entered into with subsidiaries, associates and joint ventures during the year are as follows:

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
Subsidiaries		
Expenses paid by the Fund on behalf of unconsolidated subsidiaries	63	91
Transfer of rural assets to unconsolidated subsidiaries	206,106	–

During the year, the Fund established 4 new Fund Investment Vehicles (FIVs), accounted for as unconsolidated subsidiaries, for the purpose of holding, facilitating and managing its New Zealand rural investments, as outlined in Note 1(e). These FIVs are made up of 3 regional FIVs, each holding the assets of the farms based in Southland, Canterbury and Waikato respectively, and 1 holding FIV. Holding these investments under this new FIV structure, rather than holding them directly, provides the Fund with greater flexibility in terms of future investment decisions.

On 1 January 2017, all of the Fund's rural assets were transferred into the respective FIVs at book value. No gains or losses were recognised as a result of this transfer. The impact of this on the Fund's Statement of Financial Position has been a transfer of property, plant and equipment; livestock; forests; investments in cooperative and processing companies and working capital items collectively into 'investments in unconsolidated subsidiaries'. As a result of this transfer, all comprehensive income arising from these rural operations since 1 January 2017 is reflected in 'net fair value gains on financial instruments held at fair value through profit or loss upon initial recognition'.

The Fund has made a financial commitment to Bain Capital Credit Managed Account (NZSF) Limited Partnership totalling $241,444,000 (equivalent to EUR 155m) (2016: $241,782,000), of which $146,152,000 remains outstanding at balance date (2016: $127,512,000). The unconsolidated subsidiary can call on this financial commitment at any time by giving not less than 10 business days notice. This financial commitment expires on 22 September 2019.

The Fund has made a financial commitment to KKR Energy Investor Limited Partnership totalling $341,437,000 (equivalent to USD 250m) (2016: $351,025,000), of which $216,990,000 remains outstanding at balance date (2016: $268,743,000). The unconsolidated subsidiary can call on this financial commitment at any time by giving not less than 10 business days notice. This financial commitment expires on 12 February 2019.

The Fund has made a financial commitment to NZSF Land Holdings Limited totalling $11,603,000 (2016: $11,815,000), of which $9,945,000 remains outstanding at balance date (2016: $11,306,000). The unconsolidated subsidiary can call on this financial commitment at any time by giving not less than 5 business days notice.

The Fund has made a financial commitment to NZSF Hobsonville Investments Limited totalling $46,787,000 (2016: $42,924,000), of which $39,901,000 remains outstanding at balance date (2016: $41,989,000). The unconsolidated subsidiary can call on this financial commitment at any time by giving not less than 5 business days notice.

SECTION 9: OTHER INFORMATION (continued)

(a) Related party transactions (continued)

The Fund has made a financial commitment in the current year to Canyon NZ-DOF Investing Limited Partnership totalling $341,436,000 (equivalent to USD 250m) of which $204,862,000 remains outstanding at balance date. The unconsolidated subsidiary can call on this financial commitment at any time by giving not less than 10 business days' notice. This financial commitment expires on 30 November 2019.

The Fund has made a financial commitment in the current year to NZSF US Renewables, Inc. totalling $61,459,000 (equivalent to USD 45m) of which $26,974,000 remains outstanding at balance date. The unconsolidated subsidiary can call on this financial commitment at any time by giving not less than 10 business days' notice. This financial commitment expires on 31 January 2020.

The Fund has made a financial commitment in the current year to NZSF Side Car (Movac) Limited Partnership totalling $25,000,000 of which $23,207,000 remains outstanding at balance date. The unconsolidated subsidiary can call on this financial commitment at any time by giving not less than 10 business days' notice. This financial commitment expires on 2 November 2021.

The Fund has made a financial commitment in the current year to NZSF Side Car (Pioneer) Limited Partnership totalling $60,000,000 of which $55,161,000 remains outstanding at balance date. The unconsolidated subsidiary can call on this financial commitment at any time by giving not less than 10 business days' notice. This financial commitment expires on 2 December 2021.

The Fund has made a financial commitment in the current year to NZSF Variable Co-Investment (Direct Capital) Limited Partnership totalling $50,000,000 of which $49,547,000 remains outstanding at balance date. The unconsolidated subsidiary can call on this financial commitment at any time by giving not less than 10 business days' notice. This financial commitment expires on 14 December 2022.

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
Associates		
Interest income	3,548	3,556

Related party loans to Kaingaroa Timberlands Partnership and associated companies comprise interest-bearing loans of $50,340,000 (2016: $50,340,000) repayable on 24 May 2043 and an interest-free loan of $20,418,000 (2016: $24,521,000) repayable on demand.

	FUND ACTUAL	
	2017	2016
	NZD'000	NZD'000
Joint ventures		
Dividend income	8,112	5,920
Other income	–	49
Purchase of property, plant and equipment	48	7
Purchase of intangible assets	28	10

Amounts accrued or payable to joint ventures for purchases of property, plant and equipment and intangible assets at 30 June 2017 were $48,000 (2016: $nil). Payables have standard 30-day credit terms. No interest is charged on overdue balances.

OTHER GOVERNMENT-RELATED ENTITIES

The Fund transacts with the New Zealand Debt Management Office (NZDMO) for a portion of its cross currency swaps. The rates at which the Fund transacts are negotiated with the NZDMO. There were no outstanding contracts at balance date (2016: asset $34,253,000). Gains on contracts with the NZDMO recognised in the Statement of Comprehensive Income for the year were $23,706,000 (2016: gains $20,287,000).

At balance date, the Fund held fixed income securities issued by the New Zealand Government valued at $1,385,000 (2016: $795,000). Interest income earned from these investments for the year was $58,000 (2016: $32,000).

At balance date, the Fund held 36,341,000 (2016: 34,245,000) shares in Meridian Energy Limited, valued at $105,751,000 (2016: $88,010,000). Dividend income earned during the year from holdings in this entity amounted to $6,612,000 (2016: $8,233,000).

At balance date, the Fund held 4,253,000 (2016: 3,346,000) shares in Air New Zealand, valued at $13,864,000 (2016: $6,960,000). Dividend income earned during the year from holdings in this entity amounted to $887,000 (2016: $575,000).

At balance date, the Fund held nil (2016: 36,000) shares in Genesis Energy Limited, valued at $nil (2016: $77,000). Dividend income earned during the year from holdings in this entity amounted to $6,000 (2016: $152,000).

At balance date, the Fund held 14,712,000 (2016: 13,326,000) shares in Mercury NZ Limited, valued at $48,844,000 (2016: $40,043,000). Dividend income earned during the year from holdings in this entity amounted to $2,327,000 (2016: $3,042,000).

During the year, the Fund established a new Fund Investment Vehicle (NZSF Tui Investments Limited) for the purpose of purchasing 25% of Kiwi Group Holdings Limited from New Zealand Post for $262,500,000. NZSF Tui Investments Limited subsequently subscribed for additional capital of $61,750,000.

The Fund places cash on deposit with Kiwibank Limited. The amount on deposit at 30 June 2017 was $nil (2016: $nil). Interest income earned during the year on these deposits was $nil (2016: $981,000).

(b) Comparison to budget (unaudited)

During the year ended 30 June 2017 the specific asset mix of the Fund varied from the budgeted figures and market returns were higher than the medium-term return expectations on which the budget is based. Given the weight of growth assets in the Fund, management expects significant year to year variations in the Fund's returns. It is not possible to accurately predict these variations and incorporate them into the budget.

Building a better
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Chartered Accountants

Independent Auditor's Report

TO THE READERS OF THE NEW ZEALAND SUPERANNUATION FUND'S FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2017

The Auditor-General is the auditor of the New Zealand Superannuation Fund (the Fund). The Auditor-General has appointed me, Graeme Bennett, using the staff and resources of Ernst & Young, to carry out the audit of the financial statements of the Fund on his behalf.

OPINION

We have audited the financial statements of the Fund on pages 117 to 175, that comprise the Statement of Financial Position as at 30 June 2017, the Statement of Comprehensive Income, Statement of Changes in Public Equity and Statement of Cash Flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information.

In our opinion the financial statements of the Fund on pages 117 to 175:

- present fairly, in all material respects:
  - its financial position as at 30 June 2017; and
  - its financial performance and cash flows for the year then ended; and
- comply with generally accepted accounting practice in New Zealand in accordance with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

Our audit was completed on 27 September 2017. This is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Guardians and our responsibilities relating to the financial statements, we comment on other information, and we explain our independence.

BASIS OF OPINION

We carried out 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 Responsibilities of the auditor section of our report.

We have fulfilled our responsibilities in accordance with the Auditor-General's Auditing Standards.

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

RESPONSIBILITIES OF THE GUARDIANS FOR THE FINANCIAL STATEMENTS

The Guardians are responsible on behalf of the Fund for preparing financial statements that are fairly presented and that comply with generally accepted accounting practice in New Zealand.

The Guardians are responsible for such internal control as they determine is necessary to enable them to prepare financial statements that are free from material misstatement, whether due to fraud or error.

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

The Guardians' responsibilities arise from the New Zealand Superannuation and Retirement Income Act 2001.

RESPONSIBILITIES OF THE AUDITOR OF THE FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the 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 carried out in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements are differences or omissions of amounts or disclosures, and can arise from fraud or error. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of readers taken on the basis of these financial statements.

We did not evaluate the security and controls over the electronic publication of the 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. Also:

- We identify and assess the risks of material misstatement of the 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.
- We 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 Fund's internal control.
- We evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Guardians.
- We conclude on the appropriateness of the use of the going concern basis of accounting by the Guardians and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund'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 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 Fund to cease to continue as a going concern.
- We evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Guardians 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.

Our responsibilities arise from the Public Audit Act 2001.

OTHER INFORMATION

The Guardians are responsible for the other information. The other information comprises the information included on pages 1 to 115, but does not include the financial statements, and our auditor's report thereon.

Our opinion on the 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 financial statements, our responsibility is to read the other information. In doing so, we 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. If, based on our work, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

INDEPENDENCE

We are independent of the Fund in accordance with the independence requirements of the Auditor-General's Auditing Standards, which incorporate the independence requirements of Professional and Ethical Standard 1(Revised): Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board.

We have performed limited assurance engagements in respect of Fund performance and the Fund's self-assessment against the Santiago Principles. Other than these engagements and the audit, we have no relationship with or interests in the Fund, or any of its subsidiaries.

Graeme Bennett
Ernst & Young
On behalf of the Auditor-General
Auckland, New Zealand

STATEMENT OF RESPONSIBILITY

For the year ended 30 June 2017

The Board and management of the Guardians of New Zealand Superannuation accept responsibility for the preparation of the annual financial statements and the Statement of Performance of the Guardians of New Zealand Superannuation and Group and the judgements used in them.

The Board and management of the Guardians of New Zealand Superannuation accept responsibility for establishing and maintaining a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of financial and non-financial reporting of the Guardians of New Zealand Superannuation and Group.

In the opinion of the Board and management of the Guardians of New Zealand Superannuation, the annual financial statements and the Statement of Performance for the year ended 30 June 2017 fairly reflect the financial position, operations and cash flows of the Guardians of New Zealand Superannuation and Group.

CATHERINE SAVAGE, CHAIR
27 September 2017

PIP DUNPHY, BOARD MEMBER
27 September 2017

For the year ended 30 June 2017	NOTE	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000	BUDGET (UNAUDITED) 2017 NZD'000
Revenue	2(a)	41,629	37,657	49,568
Expenses	2(b)	41,629	37,657	49,568
Surplus/(Deficit) for the year		**–**	**–**	**–**
Other comprehensive revenue and expense		–	–	–
Total comprehensive revenue and expense for the year		**–**	**–**	**–**

The attached notes form part of, and should be read in conjunction with, these financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June 2017	NOTE	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000	BUDGET (UNAUDITED) 2017 NZD'000
ASSETS				
Current assets				
Cash and cash equivalents	4(b)	1,286	1,861	774
Receivables from exchange transactions	4(c)	10,628	7,534	9,830
Receivables from non-exchange transactions	4(c)	96	290	–
Prepayments		363	453	–
Total current assets		**12,373**	**10,138**	**10,604**
Non-current assets				
Receivables from exchange transactions	4(c)	556	1,014	–
Property, plant and equipment	4(d)	–	–	–
Total non-current assets		**556**	**1,014**	**–**
Total assets		**12,929**	**11,152**	**10,604**
LIABILITIES				
Current liabilities				
Payables under exchange transactions	4(e)	885	609	601
Employee entitlements	4(f)	10,143	8,226	8,652
Income received in advance		76	282	–
Deferred lease incentive	4(g)	86	75	75
Total current liabilities		**11,190**	**9,192**	**9,328**
Non-current liabilities				
Employee entitlements	4(f)	556	1,014	405
Deferred lease incentive	4(g)	683	446	371
Total non-current liabilities		**1,239**	**1,460**	**776**
Total liabilities		**12,429**	**10,652**	**10,104**
Net assets		**500**	**500**	**500**
PUBLIC EQUITY				
Accumulated comprehensive revenue and expense		–	–	–
General equity reserve		500	500	500
Total public equity	4(h)	**500**	**500**	**500**

The attached notes form part of, and should be read in conjunction with, these financial statements.

For the year ended 30 June 2017	ACTUAL		
	GENERAL EQUITY RESERVE NZD'000	ACCUMULATED COMPREHENSIVE REVENUE AND EXPENSE NZD'000	TOTAL NZD'000
Balance at 1 July 2015	**500**	**–**	**500**
Total comprehensive revenue and expense for the year	–	–	–
Balance at 30 June 2016	**500**	**–**	**500**
Total comprehensive revenue and expense for the year	–	–	–
Balance at 30 June 2017	**500**	**–**	**500**

The attached notes form part of, and should be read in conjunction with, these financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June 2017	NOTE	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000	BUDGET (UNAUDITED) 2017 NZD'000
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash was provided from:				
Receipts from the Crown		791	210	528
Receipts from the New Zealand Superannuation Fund		38,155	38,050	46,000
Interest received		52	73	34
Goods and Services Tax		–	58	–
Other receipts		51	104	92
Total cash inflow from operating activities		**39,049**	**38,495**	**46,654**
Cash was applied to:				
Payments to Board members		(409)	(281)	(417)
Payments to suppliers		(9,147)	(8,247)	(13,090)
Payments to employees		(30,000)	(29,632)	(33,197)
Goods and Services Tax		(68)	–	(32)
Total cash outflow from operating activities		**(39,624)**	**(38,160)**	**(46,736)**
Net cash provided by/(used in) operating activities		**(575)**	**335**	**(82)**
Net cash provided by investing activities		**–**	**–**	**–**
Net cash provided by financing activities		**–**	**–**	**–**
Net increase/(decrease) in cash and cash equivalents		**(575)**	**335**	**(82)**
Cash and cash equivalents at the beginning of the financial year		1,861	1,526	856
Cash and cash equivalents at the end of the financial year	4(b)	**1,286**	**1,861**	**774**

The attached notes form part of, and should be read in conjunction with, these financial statements.

For the year ended 30 June 2017	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000
RECONCILIATION OF SURPLUS/(DEFICIT) FOR THE YEAR TO NET CASH FLOWS FROM OPERATING ACTIVITIES		
Surplus/(Deficit) for the year	–	–
Changes in working capital:		
(Increase)/Decrease in assets:		
Receivables and prepayments	(2,352)	375
Increase/(Decrease) in liabilities:		
Trade and other payables	1,529	35
Deferred lease incentive	248	(75)
Net cash provided by/(used in) operating activities	**(575)**	**335**

The attached notes form part of, and should be read in conjunction with, these financial statements.

SECTION 1: GENERAL INFORMATION, STATEMENT OF COMPLIANCE AND BASIS OF PREPARATION

(a) General information

These are the financial statements of the Guardians of New Zealand Superannuation (Guardians) and its subsidiaries (Group). The Guardians is a Crown entity as defined by the Crown Entities Act 2004. The Guardians is also a public authority in terms of the Income Tax Act 2007 and therefore is exempt from income tax.

The Guardians is domiciled in New Zealand and the address of its principal place of business is set out in the Corporate Directory on page 213.

The financial statements of the Guardians and Group for the year ended 30 June 2017 were authorised for issue in accordance with a resolution of the Board of the Guardians of New Zealand Superannuation on 27 September 2017.

(b) Statement of compliance

The financial statements have been prepared in accordance with the Crown Entities Act 2004 and the Public Finance Act 1989.

The Guardians is a public benefit entity, as the primary purpose is to manage and administer the New Zealand Superannuation Fund (Fund). The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP). They comply with Tier 1 Public Benefit Entity (PBE) Accounting Standards.

(c) Basis of preparation

The financial statements have been prepared on a historical cost basis.

The financial statements are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars (NZD'000) unless stated otherwise.

Accounting policies are selected and applied in a manner that ensures the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring the substance of the underlying transactions or other events is reported. Accounting policies relating to specific financial statement items are set out in the relevant notes to the financial statements. Accounting policies that materially affect the financial statements as a whole are set out below.

(d) Basis of consolidation

The consolidated financial statements comprise the financial statements of the Guardians and its subsidiaries as at 30 June 2017.

The financial statements of subsidiaries are prepared for the same reporting period as the Guardians using consistent accounting policies. In preparing consolidated financial statements, all inter-entity transactions, balances, unrealised gains and losses are eliminated.

(e) Subsidiaries

Subsidiaries are those entities that are controlled by the Guardians. The Guardians controls an entity when it has the power to govern the financial and operating policies of that entity so as to obtain benefits from their activities.

The Guardians has interests in the following subsidiaries:

				OWNERSHIP INTEREST AND VOTING RIGHTS	
NAME	NOTE	BALANCE DATE	COUNTRY OF INCORPORATION	2017 %	2016 %
New Zealand Superannuation Fund Nominees Limited	(i)	30 June	New Zealand	100	100
NZSF Timber Investments (No. 1) Limited	(i)	30 June	New Zealand	100	100
NZSF Timber Investments (No. 2) Limited	(i)	30 June	New Zealand	100	100
NZSF Timber Investments (No. 3) Limited	(i)	30 June	New Zealand	100	100
NZSF Timber Investments (No. 4) Limited	(i)	30 June	New Zealand	100	100
NZSF Private Equity Investments (No. 1) Limited	(i)	30 June	New Zealand	100	100
NZSF Rural Investments (No. 1) Limited	(i)	30 June	New Zealand	100	100
CNI Timber Operating Company Limited	(ii)	30 June	New Zealand	–	100
NZSF Aotea Limited	(iii)	30 June	New Zealand	100	100

(i) The principal activity of each subsidiary is to act as a nominee company, holding assets and liabilities on behalf of the Fund. These assets and liabilities are recognised in the financial statements of the Fund and accordingly are not presented in these financial statements. Nominee companies may only act on the direction of the Guardians.

(ii) CNI Timber Operating Company Limited was wound up during the year and removed from the companies register on 8 November 2016.

(iii) The principal activity of NZSF Aotea Limited is to hold assets and liabilities on behalf of the Fund. These assets and liabilities are recognised in the financial statements of the Fund and accordingly are not presented in these financial statements.

(f) Significant judgements and estimates

The preparation of the Guardians financial statements requires the Board and management to make judgements and use estimates that affect the reported amounts of revenue, expenses, assets, liabilities and the accompanying disclosures. Uncertainty about these judgements and estimates could result in outcomes that require a material adjustment to the carrying amounts of assets and liabilities in future periods. The judgements and estimates used by the Board and management are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the Guardians and that are believed to be reasonable under the circumstances. The judgements and estimates that the Board and management have assessed to have the most significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are as follows:

- Employee entitlements – long service leave (Note 4(f)); and
- Employee entitlements – long-term portion of incentives (Note 4(f)).

SECTION 1: GENERAL INFORMATION, STATEMENT OF COMPLIANCE AND BASIS OF PREPARATION (continued)

(g) Other significant accounting policies

FOREIGN CURRENCY TRANSLATION

Transactions denominated in foreign currencies are converted to New Zealand dollars using the exchange rates prevailing at the dates of the transactions. Foreign currency monetary assets and liabilities are translated at the exchange rate prevailing at balance date. Where there is a movement in the exchange rate between the date of a foreign currency transaction and balance date, the resulting exchange differences are recognised in the Consolidated Statement of Comprehensive Revenue and Expense.

GOODS AND SERVICES TAX (GST)

Revenue, expenses, assets and liabilities are recognised in the financial statements exclusive of GST, with the exception of receivables and payables which are stated inclusive of GST. Where GST is irrecoverable as an input tax, it is recognised as part of the related asset or expense.

STATEMENT OF CASH FLOWS

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

Operating activities include all activities other than investing or financing activities. Cash inflows include all receipts from the sale of goods and services, interest and other sources of revenue that support the Group's operating activities. Cash outflows include payments made to employees, suppliers and for taxes and levies, other than income tax.

Investing activities are those activities relating to the acquisition, holding and disposal of current and non-current securities and any other non-current assets.

Financing activities are those activities relating to changes in public equity and debt capital structure of the Group and those activities relating to the cost of servicing the Group's equity capital.

Cash flows are included in the Consolidated Statement of Cash Flows on a gross basis. The GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority, is classified as operating cash flows.

(h) Changes in accounting policies

There have been no changes in accounting policies during the year. All accounting policies have been applied consistently throughout these financial statements.

Certain prior year comparatives have been restated to conform with current year presentation.

(i) Standards issued but not yet effective

The following standard has been issued but is not yet effective for the year ended 30 June 2017.

REFERENCE	TITLE	SUMMARY	APPLICATION DATE OF STANDARD*	IMPACT ON FINANCIAL STATEMENTS	APPLICATION DATE FOR GUARDIANS*
PBE IFRS 9	Financial Instruments	PBE IFRS 9 introduces into PBE Standards the reforms introduced by NZ IFRS 9 in the for-profit sector. This standard replaces most of the requirements of PBE IPSAS 29. The new standard: (a) Introduces a new classification model for financial assets, which may cause certain financial assets to be classified and measured differently as compared with PBE IPSAS 29. (b) Introduces a more flexible and less rules-based hedge accounting model, which allows hedge accounting to be applied to a wider range of risk management strategies. (c) Introduces a new forward-looking impairment model for financial assets, based on expected credit loss, which may cause certain assets to be impaired earlier than they would under the current 'incurred loss' model. (d) Requires PBE's to provide additional disclosures about hedge accounting and impairment. Early application of the standard is permitted.	1 January 2021	The new standard will affect the classification and measurement of the Guardians' financial assets and disclosures in the financial statements.	1 July 2018

* Designates the beginning of the applicable annual reporting period.

(j) Budget figures

The budget was approved by the Board of the Guardians of New Zealand Superannuation for the year ended 30 June 2017. The budget figures are unaudited.

SECTION 2: FINANCIAL PERFORMANCE

(a) Revenue

	NOTE	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000
Cost reimbursement from the New Zealand Superannuation Fund	3(a)	40,540	37,041
Other revenue		440	115
Interest income		52	73
Revenue from exchange transactions		**41,032**	**37,229**
Appropriations from the Crown	3(a)	597	428
Revenue from non-exchange transactions		**597**	**428**
Total revenue		**41,629**	**37,657**

Accounting Policy

The Guardians primarily derives revenue through the provision of services to the Crown and to the Fund. Revenue is recognised when it is probable that economic benefits will flow to the Guardians and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

REVENUE FROM EXCHANGE TRANSACTIONS

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Rendering of services

Cost reimbursement from the Fund is recognised by reference to the stage of completion of services provided at balance date when the transaction involving the rendering of services can be reliably estimated. The stage of completion is measured by the proportion of costs incurred to date compared with estimated total costs of the transaction.

Interest income

Interest income is recognised as the interest accrues, using the effective interest method. The effective interest method allocates interest at a constant rate of return over the expected life of the financial instrument based on the estimated future cash flows.

REVENUE FROM NON-EXCHANGE TRANSACTIONS

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

Appropriations from the Crown

Revenue is recognised from the Crown when it is probable that appropriations will be received, the value of those appropriations can be reliably measured and the transfer is free from conditions that require the assets to be refunded or returned to the Crown if the conditions are not fulfilled. To the extent there is a related condition attached to the appropriations that would give rise to a liability to repay the appropriate amount, deferred revenue is recognised instead of revenue. In such situations, revenue is then recognised as the conditions are satisfied.

(b) Expenses

	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000
Employee benefits (including salaries, annual leave and long service leave)	23,704	22,610
Employee incentive scheme	7,861	7,112
Employer contributions to KiwiSaver	968	814
Employee entitlements	**32,533**	**30,536**

Further disclosures on employee entitlements are contained in Note 4(f).

	NOTE	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000
Travel and accommodation expenses		1,918	1,971
IT expenses		2,993	2,304
Operating lease expenses		657	638
Professional fees		360	114
Board members' fees	3(a)	409	290
Auditor's remuneration	2(c)	46	46
Other expenses		2,713	1,758
Other expenses		**9,096**	**7,121**
Total expenses		**41,629**	**37,657**

Operating lease expenses relate to office premises in one location with a remaining term of 9 years. The Group does not have an option to purchase the leased asset at the expiry of the lease period. Non-cancellable lease commitments payable in relation to the leased asset have been disclosed in Note 6(a).

Accounting Policy

OPERATING LEASES

The determination of whether an arrangement is (or contains) a lease is based on the substance of the arrangement at the inception of the lease. The arrangement is (or contains) a lease if fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. Leases in which the lessor retains substantially all the risks and benefits of ownership of an asset are classified as operating leases. Operating lease expenses are recognised on a straight-line basis over the period of the lease.

(c) Auditor's remuneration

	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000
Audit of the Guardians financial statements	46	46
Audit of subsidiaries of the Group	–	–
Total auditor's remuneration	**46**	**46**

The auditor of the Group is Graeme Bennett of Ernst & Young, on behalf of the Auditor-General.

The financial statements of the Group's subsidiaries are not separately audited following the July 2013 amendments to the Crown Entities Act 2004 which include removal of the requirement for subsidiaries to prepare and have audited individual financial statements.

SECTION 3: RELATED PARTY TRANSACTIONS AND EMPLOYEE REMUNERATION

(a) Related party transactions

Parties are considered related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operating decisions.

All related party transactions have been entered into on an arm's length basis. Outstanding amounts with related parties at balance date are unsecured and subordinate to other liabilities. Interest is not charged on outstanding balances. There have been no guarantees provided or received for any related party receivables or payables. For the year ended 30 June 2017, the Group has not recorded any impairment of receivables relating to amounts owed by related parties (2016: $nil).

PARENT ENTITY

The parent entity in the Group is the Guardians which is a Crown Entity. Crown appropriations for the year ended 30 June 2017 were $597,000 (2016: $428,000). The related party receivable from the Crown as at 30 June 2017 is $96,000 (2016: $290,000).

SUBSIDIARIES

Details of the Guardians interests in subsidiaries are disclosed in Note 1(e). There were no related party transactions with these entities during the year.

OTHER RELATED PARTIES

The Guardians pays expenses relating to the Fund, as it is required to do under the Act. A portion of these expenses is reimbursed by the Fund as is entitled under the Act. The amount of reimbursement from the Fund for the year ended 30 June 2017 was $40,540,000 (2016: $37,041,000). The related party receivable from the Fund as at 30 June 2017 is $10,542,000 (2016: $8,157,000).

In addition to the above, the Group purchases services from Datacom Employer Services Limited and Datacom Systems Limited, which are subsidiaries of a joint venture owned by the Fund. These purchases totalled $1,317,000 for the year ended 30 June 2017 (2016: $930,000). The related party payable to these entities as at 30 June 2017 is $144,000 (2016: $108,000).

OTHER GOVERNMENT-RELATED ENTITIES

In conducting its activities, the Group is required to pay various taxes and levies (such as GST, Fringe Benefit Tax (FBT), Pay As You Earn (PAYE), and ACC levies) to the Crown and entities related to the Crown. The payment of these taxes and levies, other than income tax, is based on the standard terms and conditions that apply to all tax and levy payers. The Group is exempt from paying income tax.

The Group has entered into a number of other transactions with other government-related entities. These transactions have not been separately disclosed as they occur within normal supplier/recipient relationships and are undertaken on terms and conditions equivalent to those that prevail in arm's length transactions.

KEY MANAGEMENT PERSONNEL

Key management personnel of the Guardians comprise members of the Board and the Leadership Team.

The compensation of the Board and the Leadership Team is set out below:

	ACTUAL	ACTUAL
	2017	2016
	NZD'000	NZD'000
Leadership team		
Number of employees	7	7
Employee benefits (including salaries, annual leave and long service leave)	3,170	2,988
Employee incentive scheme	1,937	1,621
	5,114	**4,609**
Board members' fees		
Board members earned the following fees during the year:		
G Walker (Chairman, retired 31 December 2015)	–	27
C Savage (Deputy Chair until 31 December 2015, appointed Chair 1 January 2016)	98	66
L Wright (appointed Deputy Chair 1 January 2016)	61	44
P Dunphy (appointed Audit Committee Chair 13 May 2016)	54	39
S Moir	49	38
C Ansley	49	38
M Tume (retired 30 April 2016)	–	30
D Pearce (appointed 30 May 2016)	49	4
J Williamson (appointed 30 May 2016)	49	4
	409	**290**

Board remuneration is set by the Minister of Finance in accordance with the Fees Framework for the Members of Statutory and Other Bodies Appointed by the Crown. Part way through the year ended 30 June 2016, the Minister set the annual base fees for all Board members at $49,000, plus additional annual amounts for the Chair (a further $49,000), Deputy Chair (a further $12,250) and Chair of the Audit Committee (a further $4,900).

Board members' and employees' indemnity and insurance

The Guardians has indemnified Board members and certain employees (and one former employee) who have been appointed as directors, nominated by the Guardians, or as other officers of entities in which the Guardians has invested. These indemnities are given, to the maximum extent permitted by the Crown Entities Act 2004, in respect of any liability connected with acts or omissions carried out as a consequence of the role. Each indemnified person is also indemnified in respect of costs incurred by that employee in defending or settling any claim or proceeding.

The Guardians has effected Directors and Officers Liability insurance cover in respect of the liability or costs of Board members, employees and external director appointees.

SECTION 3: RELATED PARTY TRANSACTIONS AND EMPLOYEE REMUNERATION (continued)

(b) Employees' remuneration over $100,000 per annum

For a full discussion of the Guardians remuneration framework, please refer to page 79 of the Annual Report.

The total remuneration figures in the following table consist of both an employee's gross base salary and the proportion of their incentive entitlement that will be paid out after balance date and exclude any benefits. The remuneration bands are annual amounts. As some employees commenced part-way through the year, the actual remuneration they received during the year is less than the amount shown. For employees who left during the year, their actual remuneration paid has been reported, rather than their annual remuneration.

The employee incentive has both individual performance and, where applicable, financial performance targets of the Fund. The financial performance component is based on rolling four-year periods of returns against thresholds and benchmarks.

TOTAL REMUNERATION AND BENEFITS

ACTUAL					
BASE REMUNERATION RANGE	NUMBER OF EMPLOYEES	NUMBER OF EMPLOYEES	TOTAL REMUNERATION RANGE	NUMBER OF EMPLOYEES	NUMBER OF EMPLOYEES
NZD'000	2017	2016	NZD'000	2017	2016
100 – 110	6	3	100 – 110	5	3
110 – 120	4	3	110 – 120	7	5
120 – 130	11	11	120 – 130	5	7
130 – 140	3	1	130 – 140	4	2
140 – 150	3	2	140 – 150	5	6
150 – 160	6	8	150 – 160	4	1
160 – 170	6	5	160 – 170	4	4
170 – 180	3	2	170 – 180	3	3
180 – 190	2	5	180 – 190	4	4
190 – 200	1	5	190 – 200	2	2
200 – 210	8	4	200 – 210	4	3
210 – 220	8	1	210 – 220	1	1
220 – 230	2	4	220 – 230	2	4
230 – 240	4	5	230 – 240	2	2
240 – 250	5	5	240 – 250	3	4
250 – 260	4	3	250 – 260	6	–
260 – 270	2	4	260 – 270	2	2
270 – 280	1	2	270 – 280	3	2
280 – 290	3	–	280 – 290	–	4
290 – 300	–	–	290 – 300	2	2

ACTUAL					
BASE REMUNERATION RANGE NZD'000	NUMBER OF EMPLOYEES 2017	NUMBER OF EMPLOYEES 2016	TOTAL REMUNERATION RANGE NZD'000	NUMBER OF EMPLOYEES 2017	NUMBER OF EMPLOYEES 2016
300 – 310	–	2	300 – 310	4	4
310 – 320	1	1	310 – 320	1	2
320 – 330	1	–	320 – 330	–	4
330 – 340	1	2	330 – 340	2	–
340 – 350	1	–	340 – 350	2	2
350 – 360	–	1	350 – 360	2	1
360 – 370	3	4	360 – 370	5	2
370 – 380	1	1	370 – 380	1	2
380 – 390	2	–	380 – 390	–	1
390 – 400	–	1	390 – 400	1	2
400 – 410	1	–	400 – 410	2	2
410 – 420	–	2	410 – 420	–	–
420 – 430	1	–	420 – 430	–	–
430 – 440	–	–	430 – 440	3	–
450 – 460	–	–	450 – 460	2	1
470 – 480	–	–	470 – 480	–	1
500 – 510	–	1	500 – 510	–	1
510 – 520	–	–	510 – 520	1	–
520 – 530	1	–	520 – 530	–	1
530 – 540	–	–	530 – 540	–	1
540 – 550	–	–	540 – 550	–	3
550 – 560	–	–	550 – 560	1	–
580 – 590	–	–	580 – 590	1	1
590 – 600	–	–	590 – 600	2	–
600 – 610	–	–	600 – 610	2	1
610 – 620	–	–	610 – 620	1	–
620 – 630	–	–	620 – 630	–	1
640 – 650	–	–	640 – 650	1	–
680 – 690	–	–	680 – 690	1	–
690 – 700	–	1	690 – 700	–	–
740 – 750	1	–	740 – 750	–	–
760 – 770	–	–	760 – 770	–	1
840 – 850	–	–	840 – 850	1	–
1,020 – 1,030	–	–	1,020 – 1,030	–	1
1,100 – 1,110	–	–	1,170 – 1,180	1	–
	96	89		105	96

REDUNDANCY AND SEVERANCE PAYMENTS

During the year ended 30 June 2017 there was one payment made in respect of one individual who resigned during the year totalling $183,904 (2016: $63,327).

SECTION 4: FINANCIAL POSITION

(a) Financial instruments

2017	NOTE	ACTUAL LOANS AND RECEIVABLES NZD'000	ACTUAL FINANCIAL LIABILITIES AT AMORTISED COST NZD'000	ACTUAL TOTAL NZD'000
Financial assets				
Cash and cash equivalents	4(b)	1,286	–	1,286
Receivables from exchange transactions (excluding GST receivable)	4(c)	10,483	–	10,483
Receivables from non-exchange transactions	4(c)	96	–	96
Total financial assets		**11,865**	**–**	**11,865**
Financial liabilities				
Payables under exchange transactions	4(e)	–	885	885
Total financial liabilities		**–**	**885**	**885**
2016				
Financial assets				
Cash and cash equivalents	4(b)	1,861	–	1,861
Receivables from exchange transactions (excluding GST receivable)	4(c)	7,457	–	7,457
Receivables from non-exchange transactions	4(c)	290	–	290
Total financial assets		**9,608**	**–**	**9,608**
Financial liabilities				
Payables under exchange transactions	4(e)	–	609	609
Total financial liabilities		**–**	**609**	**609**

Accounting Policy

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

The Group is party to financial instruments as part of its normal operations. These financial instruments include cash and cash equivalents, receivables and payables. All financial instruments are recognised in the Consolidated Statement of Financial Position and all revenues and expenses in relation to financial instruments are recognised in the Consolidated Statement of Comprehensive Revenue and Expense.

INITIAL RECOGNITION

Financial assets and financial liabilities are recognised in the Consolidated Statement of Financial Position when the Group becomes a party to the contractual provisions of the financial instrument. They are initially recognised at fair value plus transaction costs.

SUBSEQUENT MEASUREMENT

Subsequent to initial recognition, the Group classifies its financial assets and financial liabilities into the following categories:

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. This category includes cash and cash equivalents and receivables. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less any allowance for impairment.

Financial liabilities at amortised cost

Financial liabilities at amortised cost are non-derivative financial liabilities. This category includes trade payables and accrued expenses. Subsequent to initial recognition, financial liabilities are measured at amortised cost using the effective interest method.

DERECOGNITION

Financial assets are derecognised when the rights to receive cash flows from the investments have expired or when the Group has transferred substantially all of the risks and rewards of ownership. The Group derecognises a financial liability when the obligation under the liability is discharged, cancelled or has expired.

IMPAIRMENT

The Board and management assess, at each reporting date, whether there is any objective evidence that a financial asset is impaired. A financial asset is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an 'incurred loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset that can be reliably estimated. Financial difficulty of a debtor, default payments or receivables of more than 60 days overdue are considered objective evidence of impairment of receivables. The amount of the impairment loss is the difference between the carrying amount of the financial asset and the present value of the estimated cash flows, discounted at the original effective interest rate.

OFFSETTING OF FINANCIAL INSTRUMENTS

The Group offsets financial assets and financial liabilities when it has a current legally enforceable right to set-off the recognised amounts and there is an intention to settle on a net basis.

(b) Cash and cash equivalents

Accounting Policy

Cash and cash equivalents includes cash balances on hand, cash held in bank accounts, demand deposits and other highly liquid investments with an original maturity of three months or less.

SECTION 4: FINANCIAL POSITION (continued)

(c) Receivables

	NOTE	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000
Current receivables			
Receivables from exchange transactions			
Receivable for reimbursement of the Guardians expenses from the New Zealand Superannuation Fund	3(a)	9,986	7,143
Trade receivables		497	314
GST receivable		145	77
		10,628	**7,534**
Receivables from non-exchange transactions			
Receivable for Crown appropriations	3(a)	96	290
		96	**290**
Non-current receivables			
Receivables from exchange transactions			
Receivable for reimbursement of the Guardians expenses from the New Zealand Superannuation Fund	3(a)	556	1,014
		556	**1,014**

Receivables are non-interest bearing and have standard 30-day credit terms. The Group does not have a history of default on receivables and accordingly, no allowance has been made for impairment.

(d) Property, plant and equipment

The Group's property, plant and equipment comprises office and computer equipment that are classified as non-cash-generating assets as they are not held for the primary objective of generating a commercial return. These assets are fully depreciated. The Group does not hold any cash-generating assets.

There were no additions or disposals of property, plant and equipment in the current or prior year. The cost of any leasehold improvements relating to the premises leased by the Guardians at 21 Queen Street, Auckland are met by the Fund and are discussed in note 5(a) of the Fund's financial statements.

(e) Payables

	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000
Payables under exchange transactions		
Trade payables	834	468
Accrued expenses	51	141
	885	**609**

Trade and other payables represent amounts due to third parties in the normal course of business. The average credit period on trade payables is 30 days. Short-term payables are non-interest bearing and are stated at their nominal value. The Group has risk management policies in place to ensure that all payables are paid within the credit time-frame.

(f) Employee entitlements

	ACTUAL 2017 NZD'000	ACTUAL 2016 NZD'000
Current liabilities		
Accrued salaries (including annual leave and long service leave) – key management personnel	289	201
Accrued salaries (including annual leave and long service leave) – other employees	1,302	1,199
Incentives – key management personnel	1,937	1,504
Incentives – other employees	6,615	5,322
	10,143	**8,226**
Non-current liabilities		
Long service leave – key management personnel	57	74
Long service leave – other employees	293	297
Incentives – key management personnel	50	161
Incentives – other employees	156	482
	556	**1,014**

Accounting Policy

Liabilities for salaries, annual leave, long service leave and incentives are recognised in the Consolidated Statement of Comprehensive Revenue and Expense during the period in which the employee rendered the related service when it is probable that settlement will be required and such employee entitlements are capable of being measured reliably.

Employee entitlements that are due to be settled within 12 months are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Employee entitlements that are not due to be settled within 12 months are measured at the present value of the estimated future cash outflows. The estimated future cash flows are based on likely future entitlements accruing to staff, based on years of service, years to entitlement, the likelihood that staff will reach the point of entitlement, and contractual entitlement information.

LONG SERVICE LEAVE

Employees become eligible for long service leave after five years of service.

INCENTIVES

The Guardians has an incentive scheme in place for all employees. For some employees, a component of their incentive payment is based on the performance of the Fund that vests progressively over a rolling four-year period. During the first three years of the four-year calculation period, the value of the accrual is dependent on the outcome of future periods. The liability reflected in the Consolidated Statement of Financial Position reflects the present value of the Guardians obligations in respect of that liability. The liability has been calculated based on a medium-term expectation of Fund performance.

SECTION 4: FINANCIAL POSITION (continued)

(f) Employee entitlements (continued)

Key judgement – long service leave

The key assumptions used in calculating the long service leave liability include the discount rate, the likelihood that the employee will reach the required level of service and the salary inflation factor. Any changes in these assumptions will affect the carrying amount of the liability. Expected future payments are discounted using forward rates derived from the yield curve of New Zealand government bonds. The discount rates used have maturities that match, as closely as possible, the estimated future cash outflows. The salary inflation factor has been determined after considering historical salary inflation patterns.

Key judgement – long-term portion of incentive

Calculation of the long-term portion of the incentive liability utilises assumptions regarding the future performance of the Fund, the employee's average salary over the vesting period and the percentage of service rendered. The key variable is the performance of the Fund. Should the performance of the Fund differ from the assumption used in the calculation of the long-term portion of the incentive liability, this will impact the employee entitlements expense in the Consolidated Statement of Comprehensive Revenue and Expense and the carrying amount of the incentive liability in the Consolidated Statement of Financial Position. The Group manages this risk by using a medium-term expectation of Fund performance.

(g) Deferred lease incentive

The deferred lease incentive relates to the lease of office premises. The lease incentive is recognised as a reduction of rental expense on a straight-line basis over the period of the lease. The remaining term is 9 years.

(h) Public equity

Equity is the Crown's interest in the Group and is measured as the difference between total assets and total liabilities.

As a public benefit entity that is fully funded by Crown appropriations (for budgeted Board and audit costs) and by Fund reimbursements (for all other operating costs), the Group has no specific liquidity policies, procedures or targets. Operating budgets are set on an annual basis, with an emphasis upon cost control. The Group is not permitted to borrow and ensures a positive cash position at all times through collection of appropriations and reimbursements.

SECTION 5: RISK MANAGEMENT

(a) Risk management

Through its activities, the Group is exposed to various types of risk including market risk, credit risk and liquidity risk. These risks are not considered significant because the Group does not hold significant financial assets or financial liabilities and it is fully funded by Crown appropriations and Fund reimbursements.

The Board and management of the Guardians are responsible for the management of risk. A separate Risk Committee has been established as a risk oversight body to support the Board with the management of risk.

The Guardians has established risk management policies, procedures and other internal controls to manage the Group's exposure to risk. The framework for managing this risk is set out in its Statement of Investment Policies, Standards and Procedures including its Risk Management Policy.

(b) Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market prices. The market risk that the Group is primarily exposed to is interest rate risk.

INTEREST RATE RISK

Interest rate risk is the risk that the fair value or future cash flows of the Group's cash and cash equivalents will fluctuate due to changes in market interest rates. The Group is primarily exposed to changes in New Zealand short-term interest rates in relation to its cash and cash equivalents which are held in short-term floating interest rate accounts.

The Group invests cash and cash equivalents, ensuring a fair market return on any cash position, but does not seek to speculate on interest returns and does not actively monitor exposure to interest rates or interest rate returns. Derivative financial instruments are not used to manage exposure to movements in interest rates.

The following table shows the Group's sensitivity to a change in interest rates with all other variables remaining constant. The basis point movement used represents the Board's and management's assessment of a reasonably possible change in interest rates.

	ACTUAL		
	BASIS POINTS	SURPLUS/(DEFICIT) FOR THE YEAR AND EQUITY	
		2017	2016
		NZD'000	NZD'000
Cash and cash equivalents	+100	13	19
Cash and cash equivalents	–100	(13)	(19)

SECTION 5: RISK MANAGEMENT (continued)

(c) Credit risk

Credit risk is the risk that a third party will default on its obligation to the Group, causing the Group to incur a loss. The Group is exposed to credit risk arising from its cash and cash equivalents and receivables. The maximum amount of credit risk for each class of financial asset is the carrying amount included in the Consolidated Statement of Financial Position.

The Group mitigates its exposure to credit risk by investing cash and cash equivalents with reputable financial institutions with a high credit rating. The Group does not require any collateral or security to support its financial instruments.

CONCENTRATIONS OF CREDIT RISK

The Group primarily invests cash and cash equivalents with Westpac New Zealand Limited which had a credit rating of AA- as at 30 June 2017 (2016: AA-).

(d) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities as they fall due. The Group's liquidity management framework is designed to ensure that the Group has the ability to generate sufficient cash in a timely manner to meet its financial commitments.

The Group has a positive cash position as it recovers all expenses from the Crown or the Fund.

MATURITY PROFILE OF FINANCIAL ASSETS

The following table shows the maturity profile of financial assets available to meet financial obligations. The maturity profile is based on the earlier of contractual repricing or maturity period and excludes accrued interest.

	ACTUAL	
2017	WEIGHTED AVERAGE EFFECTIVE INTEREST RATE	VARIABLE INTEREST RATE
	%	NZD'000
Financial assets		
Cash and cash equivalents – no fixed maturity	1.62	1,286
		1,286
2016		
Financial assets		
Cash and cash equivalents – no fixed maturity	2.35	1,861
		1,861

SECTION 6: UNRECOGNISED ITEMS

(a) Commitments and contingencies

OPERATING LEASE COMMITMENTS

The base future minimum amounts payable under non-cancellable operating leases are as follows:

	ACTUAL	ACTUAL
	2017	2016
	NZD'000	NZD'000
Less than 1 year	1,218	727
1 to 2 years	1,242	741
2 to 5 years	3,878	2,314
Later than 5 years	5,542	1,621
	11,880	**5,403**

In addition to the above, variable operating expenses in relation to the leased premises are required to be paid under the lease agreements.

The Guardians entered into a new lease for additional office premises at 21 Queen Street, Auckland and extended the existing lease agreement for an additional three years, with effect from June 2017.

CONTINGENT LIABILITIES

There were no contingent liabilities as at 30 June 2017 (2016: nil).

(b) Subsequent events

There were no reportable events subsequent to balance date (2016: nil).

(c) Comparison to budget (unaudited)

	ACTUAL	BUDGET (UNAUDITED)	FAVOURABLE/ (UNFAVOURABLE) VARIANCE
	2017	2017	2016
	NZD'000	NZD'000	NZD'000
Consolidated Statement of Comprehensive Revenue and Expense: total expenses incurred(i)	41,629	49,568	7,939
Consolidated Statement of Changes in Public Equity	500	500	–
Consolidated Statement of Financial Position	500	500	–

(i) Expenses were lower than budget predominantly due to lower remuneration and travel costs. This was due to recruitment activity being slower than was envisaged in the budget.

Chartered Accountants

Independent Auditor's Report

TO THE READERS OF THE GUARDIANS OF NEW ZEALAND SUPERANNUATION'S GROUP FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION

FOR THE YEAR ENDED 30 JUNE 2017

The Auditor-General is the auditor of the Guardians of New Zealand Superannuation and its subsidiaries (the Group). The Auditor-General has appointed me, Graeme Bennett, using the staff and resources of Ernst & Young, to carry out the audit of the financial statements and the performance information, including the performance information for appropriations, of the Group on his behalf.

OPINION

We have audited:

- the financial statements of the Group on pages 179 to 201, that comprise the Consolidated Statement of Financial Position as at 30 June 2017, the Consolidated Statement of Comprehensive Revenue and Expense, Consolidated Statement of Changes in Public Equity and Consolidated Statement of Cash Flows for the year ended on that date and notes to the financial statements including a summary of significant accounting policies and other explanatory information; and
- the performance information of the Group on pages 100 to 103.

In our opinion:

- the financial statements of the Group on pages 179 to 201:
  - present fairly, in all material respects:
    - its financial position as at 30 June 2017; and
    - its financial performance and cash flows for the year then ended; and
  - comply with generally accepted accounting practice in New Zealand and have been prepared in accordance with Public Benefit Entity Accounting Standards.
- the performance information on pages 100 to 103:
  - presents fairly, in all material respects, the Group's performance for the year ended 30 June 2017, including:
    - for each class of reportable outputs its standards of delivery performance achieved as compared with forecasts included in the statement of performance expectations for the financial year; and
    - complies with generally accepted accounting practice in New Zealand.

Our audit was completed on 27 September 2017. This is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Board and our responsibilities relating to the financial statements and the performance information, we comment on other information, and we explain our independence.

BASIS OF OUR OPINION

We carried out 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 Responsibilities of the auditor section of our report.

We have fulfilled our responsibilities in accordance with the Auditor-General's Auditing Standards.

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

RESPONSIBILITIES OF THE BOARD FOR THE FINANCIAL STATEMENTS AND THE PERFORMANCE INFORMATION

The Board is responsible on behalf of the Group for preparing financial statements and performance information that are fairly presented and comply with generally accepted accounting practice in New Zealand. The Board is responsible for such internal control as it determines necessary to enable it to prepare financial statements and performance information that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements and the performance information, the Board is responsible on behalf of the Group for assessing the Group's ability to continue as a going concern. The Board is also responsible for disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless there is an intention to merge or to terminate the activities of the Group, or there is no realistic alternative but to do so.

The Board's responsibilities arise from the Crown Entities Act 2004 and the Public Finance Act 1989.

RESPONSIBILITIES OF THE AUDITOR FOR THE AUDIT OF THE FINANCIAL STATEMENTS AND THE PERFORMANCE INFORMATION

Our objectives are to obtain reasonable assurance about whether the financial statements and the performance information, 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 carried out in accordance with the Auditor-General's Auditing Standards will always detect a material misstatement when it exists. Misstatements are differences or omissions of amounts or disclosures, and can arise from fraud or error. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of readers, taken on the basis of these financial statements and the performance information.

For the budget information reported in the financial statements and the performance information, our procedures were limited to checking that the information agreed to the Group's statement of performance expectations.

We did not evaluate the security and controls over the electronic publication of the financial statements and the performance information.

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. Also:

- We identify and assess the risks of material misstatement of the financial statements and the performance information, 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.
- We 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.
- We evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board.
- We evaluate the appropriateness of the reported performance information within the Group's framework for reporting its performance.
- We conclude on the appropriateness of the use of the going concern basis of accounting by the Board 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 financial statements and the performance information 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.
- We evaluate the overall presentation, structure and content of the financial statements and the performance information, including the disclosures, and whether the financial statements and the performance information represent the underlying transactions and events in a manner that achieves fair presentation.
- We obtain sufficient appropriate audit evidence regarding the financial statements and the performance information of the entities or business activities within the Group to express an opinion on the consolidated financial statements and the consolidated performance information. 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 Board 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.

Our responsibility arises from the Public Audit Act 2001.

OTHER INFORMATION

The Board is responsible for the other information. The other information comprises the information included on pages 1 to 115, but does not include the financial statements and the performance information, and our auditor's report thereon.

Our opinion on the financial statements and the performance information 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 financial statements and the performance information, our responsibility is to read the other information. In doing so, we consider whether the other information is materially inconsistent with the financial statements and the performance information or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on our work, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

INDEPENDENCE

We are independent of the Group in accordance with the independence requirements of the Auditor-General's Auditing Standards, which incorporate the independence requirements of Professional and Ethical Standard 1 (Revised): Code of Ethics for Assurance Practitioners issued by the New Zealand Auditing and Assurance Standards Board.

We have provided services in relation to employee and executive remuneration. Other than this engagement and the audit, we have no relationship with or interests in the Fund, or any of its subsidiaries.

Graeme Bennett
Ernst & Young
On behalf of the Auditor-General
Auckland, New Zealand


AIRTRAIN

SECTION

07

Appendix
He Āpitihanga

206. COMPLIANCE STATEMENTS

206. PRESENTATION OF THE ANNUAL REPORT

207. GLOSSARY

212. USEFUL LINKS

213. CORPORATE DIRECTORY

Image courtesy of **Metlifecare**

SIPSP COMPLIANCE

The Guardians' Statement of Investment Policies, Standards and Procedures (SIPSP) is published on our website www.nzsuperfund.co.nz. On behalf of the Board and Management of the Guardians of New Zealand Superannuation, we hereby certify that, to the best of our knowledge, the SIPSP has been complied with during the 2016/17 financial year.

CATHERINE SAVAGE, CHAIR

ADRIAN ORR, CEO

PRESENTATION OF THE ANNUAL REPORT

We are pleased to provide this Annual Report of the Guardians of New Zealand Superannuation for the year ended 30 June 2017.

CATHERINE SAVAGE, CHAIR

PIP DUNPHY, CHAIR – AUDIT COMMITTEE

ACC	Accident Compensation Corporation.
Access point	The actual investment the Fund makes to gain exposure to a desired risk (e.g. buying a listed equity). Access points are our way of exploiting opportunities, themes, stress test outcomes and manager skill. The access point can be passive, active, synthetic or funded, directly (internally) or externally managed.
Active return	Any return differential between the actual portfolio and the reference portfolio. In the context of an investment, the positive return we hope to earn for taking on active risk. Same as value add.
Active risk	Any deviation in risk in the actual portfolio relative to the reference portfolio. Active risk is a relative risk concept. The active risk in the portfolio is dominated by activities in our value adding strategies. Note that the actual portfolio can have the same total or absolute risk as the reference portfolio but still have active risk. Technically active risk is expressed as the expected standard deviation of the active returns.
Active strategies	Value add strategies.
Actual portfolio	The Fund's portfolio at any point in time reflecting all the positions arising from the Fund's value adding strategies as well as drift. Conceptually, the actual portfolio equals the reference portfolio (cash plus risk premiums) plus drift plus active risk.
Asset class	An asset class is a group of securities or assets that share common risk and return characteristics.
Basis point	One hundredth of a percentage point.
Belief	The Fund's stated view on some aspect of financial markets and investing. It a result of mixed judgment and evidence.
Benchmark	A standard against which the performance of a security, index, or investor can be measured.
BMO	Bank of Montreal – the Fund's responsible investment engagement service provider.
Capability	Management's ability to execute a value add strategy. Incorporates depth and breadth of experience, risk management abilities etc.
Capital	A corpus of funds which can be invested to generate economic value.
Cash	Generally taken to mean a very short term investment earning interest from a highly-rated bank or an equivalent bank bill.
CEM	CEM Global Benchmarking- a provider of benchmarking services and peer comparisons.
CFI	Crown Financial Institution.
Collateralisation	The primary means of managing credit exposure among our counterparties. It represents monies or securities that are posted between us and counterparties to mirror unrealised profit and loss on our open derivatives positions.
Compensation	Return for taking on risk. Often, the compensation is the risk premium, or excess return over cash, that the investment offers.
Conviction	A measure of the degree of confidence we have in an active manager's investment skill. The Fund's approach to rating an active manager. Applicable to both public and private market managers. The conviction rating is a quantitative overall score based on the scores of a number of individual, largely qualitative, factors.

Cost-asset ratio	Operating expenses ÷ average assets over the period.
Counter-party	A counter-party describes a legal entity that presents an exposure to financial risk. The Fund's counter-parties are typically banks.
Crown entity	An organisation that forms part of New Zealand's state sector, as established under the Crown Entities Act 2004. Crown entities are legal entities in their own right. A decision to assign a government activity or function to a Crown entity indicates that the function should be carried out at 'arm's-length' from the Government. The Crown entity's board directs the entity's day-to-day operations.
Cyber-security	Technologies, processes and practices that are designed to protect networks, computers, programmes and data from attack, damage or unauthorised access.
Derivative	A financial instrument which derives its value from the value of underlying entities such as an asset, index, or interest rate - it has no intrinsic value in itself. The derivative itself is merely a contract between two or more parties, the value of which at any one time is determined by fluctuations in value of the underlying asset. Derivatives can be used to manage risk, reduce cost and enhance returns.
Direct	A direct activity is a financial market transaction undertaken by the Fund's management.
Diversification	The potential improvement in a portfolio's Sharpe ratio that arises from introducing assets into the portfolio that behave differently to the assets in the Reference Portfolio. Introducing any new asset or asset class into the portfolio will have a diversification benefit. The more diversified a portfolio, the more difficult it is to achieve further diversification gains.
DM	Developed Markets.
Double arm's length	The Guardians is an autonomous Crown entity, meaning it is legally separate from the Crown and operates at 'double arm's-length'. The first arm of independence is that the Government does not decide the pool of candidates for the Board of the Guardians (candidates are identified by an independent Nominating Committee). The second arm of independence is that investment decisions are made by the Board and Management of the Guardians.
Endowment	A characteristic of the Fund that provides the Fund with a natural advantage or edge over the typical investor.
Equilibrium	The long term or steady state. Generally expressed in the context of long term average expected risks and returns.
Equities	More commonly known as shares or stocks. Securities that signify ownership in a corporation and represents a claim on part of the corporation's assets and earnings.
ESG	Environmental, Social and Governance.
Externally managed	An investment managed by an appointed external manager.
Fixed income	Assets providing income to investors via a fixed periodic payment. In the context of the Reference Portfolio, fixed income is a very well diversified set of exposures including sovereign bonds, investment grade credit, agency debt, high yield bonds and emerging market debt. Inflation-linked securities are also included though an element of the income is variable because it is linked to future inflation out-turns.
Foreign exchange	The Fund's exposure to non-NZD cash rates. In our Reference Portfolio there is no foreign exchange exposure as all non-NZD denominated assets (i.e. foreign funded assets) are hedged back to NZD. Hedging back to NZD essentially replaces foreign cash returns with NZD cash returns. Foreign exchange in the Fund's context refers to a basket of the major foreign currencies.

Fund Investment Vehicle (FIV)	An entity formed or controlled by the Guardians for the purpose of holding, facilitating, or managing investments in the Fund.
Futures	A financial contract obligating the buyer to purchase an asset (or the seller to sell an asset), such as a physical commodity or a financial instrument, at a predetermined future date and price.
Growth assets	In the Reference Portfolio, growth assets comprise of equities and REITs. Some private market assets are also growth assets, e.g., private equity. Over the long-term and on average, the largest share of returns accruing to investments in growth assets derive from underlying exposures to real economic growth.
Global Reporting Initiative (GRI)	An international independent organisation that helps businesses, governments and other organisations understand and communicate the impact of business on critical sustainability issues.
Hurdle	The minimum expected return required from a proposed investment to compensate the Fund for the inherent risks, fees and other costs (such as taxes) of that investment.
Illiquid	The inability to buy or sell an investment in a timely manner with minimal transaction costs.
Initial margin	Collateral exchanged between parties to protect against the potential future exposure of changes in the mark-to-market value of a derivatives transaction during the time it takes to close out and replace the position in the event the other party defaults.
Internal Investment Mandate (IIM)	The policy governing the management of an internal mandate falling under an active strategy.
Investment	An allocation of risk capital to a specific manager or activity. Could include an individual investment undertaken by the Fund's internal management under an Internal Investment Mandate (IIM).
Iwi	Meaning 'peoples'. Iwi is often translated as a tribe. Iwi forms the largest social units within Māori culture.
Liquidity	The degree to which an asset or security can be quickly bought or sold in the market without affecting the asset's price.
Mandate	An official order or commission to do something.
Market risk	Is the non-diversifiable risk associated with exposure to a broad mix of asset classes. The risk in the market portfolio. In the context of the Fund, this also refers to the risk in an investment that is correlated with the Reference Portfolio or some investable public market benchmark or asset class.
Merger arbitrage	Involves simultaneously purchasing and selling the stocks of two merging companies to take advantage of the difference in price of those stocks pre-merger.
Net return	Returns over and above the Treasury bill return – the Government's cost of debt.
Opportunity	A feature of the investment environment that is conducive to generating positive risk-adjusted active returns.
OTC	A financial instrument (securities, derivatives, stocks) traded in some context other than on a formal exchange. The phrase 'over the counter' (OTC) can be used to refer to financial instruments that trade via a dealer network as opposed to on a centralised exchange.
Passive management	Passive management, or 'index-tracking', is a style of investment management through which a fund's portfolio mirrors a selected market index. Stocks move in and out of the portfolio according to index inclusion rather than through an active investment decision.

Physical	An investment that is funded with cash to the full notional amount of the investment.
Portfolio	A portfolio can be thought of as a pie that is divided into pieces of varying sizes, representing a variety of asset classes and/or types of investments to achieve an appropriate risk-return portfolio allocation.
Portfolio completion	The set of market activities that deliver the desired portfolio, including placement of market orders, hedging activity and other Treasury functions.
Portfolio construction	The allocation of risk in a portfolio. Generally applied to active management, portfolio construction embraces the broad allocation of risk capital to various value-add strategies, as well as the specific allocations of risk capital to individual investments.
Private equity	Private placement of capital with defined ownership rights (i.e. claims to the profits generated by the business).
Rebalancing	The process of realigning the weightings of one's portfolio of assets. Rebalancing involves periodically buying or selling assets to maintain your original desired level of asset allocation.
Reference Portfolio	A simple low cost, passively managed and well diversified portfolio of listed asset classes that is consistent with the Fund achieving its return objectives without undue risk, i.e. fit for purpose. Conceptually, the reference portfolio comprises a 100% cash position (NZD) plus a set of risk premiums or excess returns that also sum to 100%.
Return	The financial reward on an investment after manager fees and taxes. This includes earnings (such as dividends) as well as capital gains that are realised when as asset is disposed of or matures.
Risk	The standard deviation of expected returns. The Fund's risk model uses equilibrium risk (and return) assumptions.
Risk allocation process (RAP)	The process by which risk capital is allocated to the Fund's opportunities. Under the RAP: 1. opportunities are assessed for relative attractiveness; 2. allocation approaches determine the how much risk capital should be allocated for various levels of attractiveness; and 3. the approaches are scaled to meet risk budgets set for groups of opportunities and for the Fund as a whole. This latter budget is referred to as the total active risk budget and the groups of opportunities as risk budget baskets.
Risk budget	Articulates the average amount of active risk that is expected to be allocated to an opportunity or group of opportunities referred to as risk budget baskets. Risk budgets aggregate to the total active risk budget. Risk budgeting is a stage of the risk allocation process.
Risk premium	The return in excess of cash earned by investors as compensation for taking passive exposure to the market or an asset class. Risk premium and excess return can be used interchangeably.
Santiago Principles	A set of principles and practices generally accepted by the member institutions of the International Forum of Sovereign Wealth Funds as amounting to a basic code of good practice for sovereign wealth funds.
Securities lending	Loaning a stock, derivative or other security to an investor or a firm.
Sharpe ratio	A characterisation of how well the return of an investment compensates the investor for the risk taken.
Short	A short or short position is an investment strategy where an entity sells a security, currency or derivative with the view of buying back the same amount of the relevant at a lower price.

SIPSP	Statement of Investment Policies, Statements and Procedures.
Skill	Active investment expertise. The ability to provide active returns.
Sovereign Wealth Fund	Pools of money derived from a country's reserves, which are set aside for investment purposes that will benefit the country's economy and citizens.
SOI	Statement of Intent.
Strategic tilting	Tilting is a value adding strategy where the mix of the Fund's market or currency exposures relative to the Reference Portfolio is changed to increase exposure to undervalued asset classes.
Swap	A derivative in which two parties agree to exchange one stream of cash flows against another.
Synthetic	Obtaining exposures using derivatives. Generally does not require to be funded.
Theme	Long term influences on the economy and capital markets that are expected to be relatively immune to business cycle and other short-term influences. An enduring characteristic or feature of the global economic or financial environment.
Tilt	Changes in the mix of the Fund's market or currency exposures relative to the reference portfolio (other than through drift or the proxies). Tilting is a value add strategy.
Total risk	Generally referring to the Fund's total or absolute risk.
Treasury Bill	Debt instruments issued by the government that mature in less than one year; the yield on these measures the cost of running a budget deficit.
UNPRI	United Nations Principles for Responsible Investment.
Value add	See active returns. In performance reporting, the difference between the actual return and the Reference Portfolio return, net of the costs of obtaining passive exposures.
Value adding strategies	Board approved strategies that define the objectives and parameters for taking on active risk. Also referred to as active strategies or just strategies.
Variation margin	Collateral exchanged between parties to protect against current exposures caused by changes in the mark-to-market value of a derivatives transaction.
Volatility	The amount of uncertainty or risk about the size of changes in a security's value.

USEFUL LINKS

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Watch a short animation video that explains our purpose at **www.ar2017.nzsuperfund.co.nz/our-purpose**

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See Catherine talk about the past year at **www.ar2017.nzsuperfund.co.nz/year-review**

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See Adrian talk about the global investment environment at **www.ar2017.nzsuperfund.co.nz/year-review**

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For further information, including the Carbon Footprint, a Q&A and videos explaining the strategy and the transition to a low carbon passive equity portfolio, see: **https://www.nzsuperfund.co.nz/how-we-invest-balancing-risk-and-return/climate-change**

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