Guardians of New Zealand Superannuation

STATEMENT OF INTENT

For the period commencing 1 July 2011 to 30 June 2016

NEW ZEALAND SUPERANNUATION FUND

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INTRODUCTION

The New Zealand Superannuation Fund and the Guardians of New Zealand Superannuation were established by an Act of Parliament to reduce the tax burden on future New Zealand taxpayers of the cost of New Zealand Superannuation (NZS).

What is the effect of New Zealand's ageing population?

Statistics New Zealand data projects that, between 2005 and 2050, the number of New Zealanders eligible to retire (aged 65+) will double. The associated cost of providing their retirement income, NZS, will more than double.

This means New Zealand will have:

- more people of retirement age, as a proportion of the population, than ever before; and
- fewer 'working-age' people whose productivity can be tapped, through taxation, to fund the greater cost of retirement income.

These projections have significant implications for future Governments' ability to fund other vital areas such as health, welfare, education and law enforcement. This information is therefore relevant for all New Zealanders, now and in the future.

How do the Guardians respond to New Zealand's ageing population?

The NZ Superannuation and Retirement Income Act 2001 (the Act) established:

- the Fund, as a pool of assets on the Government's balance sheet
- the Guardians, as a Crown agency charged with managing the Fund

Together, the Fund and Guardians exist to 'smooth' the tax burden between generations of New Zealanders arising from the higher future cost of NZS.

The tax smoothing occurs through the Government making contributions to the Fund. At a future date - currently from 2031 - the Government begins to withdraw money from the Fund to help to meet the cost, at that time, of NZS.

Saving now for this future cost is called 'pre-funding' NZS. Pre-funding means that future Governments do not have to seek as much from future New Zealand taxpayers (or from other sources, such as by raising debt) to meet the cost of NZS when it is increasing most sharply.

This is reflected in our Mission Statement:

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

We believe this statement frames the purpose of the Fund and Guardians in a way meaningful to all New Zealanders.

Note that in the 2009 Budget the Government decided to reduce contributions to the Fund until the Crown operating balance returns to surplus sufficient to resume contributions. At present the Treasury estimates this to be in 2018.

How do we reflect this context in our Statement of Intent?

We think of it this way:

1. the **Fund** is a special-purpose savings vehicle bringing certainty that some of the future cost of NZS is covered. The Fund is also expected to add to Crown wealth over the long term by earning more for the Government in investment returns than the Government would save in debt servicing. By doing this the Fund adds to Crown wealth, improves the ability of future Governments to meet increased NZS commitments in the future, and ultimately reduces the tax burden on future New Zealand taxpayers of the cost of NZS.

   That is the Fund's long-term **outcome**, and we discuss how we have framed it for shorter-term measurement in our Outcome Framework on page 6.

2. The **Guardians** are expected to manage the Fund according to a legislated mandate. The mandate requires us to manage the Fund in a commercial, prudent fashion comprising:
   - best-practice portfolio management
   - maximising return without undue risk
   - avoiding prejudice to New Zealand's reputation as a responsible member of the world community

In our Statement of Intent (SOI) we frame our output simply as 'managing the Fund' consistent with this mandate. This is also captured in the Outcome Framework on page 6.

We also have a Directive from the Minister of Finance requiring us to actively identify and consider opportunities to increase the allocation of New Zealand assets in the Fund. The Directive is subject to our mandated duty to invest in a commercial, prudent fashion.

On page 6 we set out how we plan to manage the Fund toward its outcome, and how we intend to measure our progress toward it.

If you are interested in further information about the reason why the Fund and Guardians exist, more on the ageing population issue and how the Guardians and Fund are designed to respond to it, you can find it on our website www.nzsuperfund.co.nz. On the front page of the website is a link to our Introduction to the Guardians and Fund. At various places in our SOI we refer you to specific sections of the website for more information.

BOARD STATEMENT

On behalf of the Guardians of New Zealand Superannuation we are pleased to present our Statement of Intent (SOI) for the five-year period commencing 1 July 2011.

Structure of 2011 SOI

The structure of this document is consistent with the 2010 SOI. However, we also:

- clarify the relationship between our Outcome Framework and our Forecast Statement of Service Performance (FSSP);
- simplify the presentation of the FSSP; and
- align the management priorities of our organisational Strategic Plan, with the FSSP

Content of 2011 SOI

We focus on two complementary things:

- ensuring we maximise the opportunities available to us as a genuine long-term investor, while managing the investment risks – including any new 'fault lines' that have emerged following the Global Financial Crisis (GFC); and
- being able to demonstrate the value that our investment activity adds to the Fund and therefore to the financial position of the Crown.

We are mindful of the Minister of Finance's 2011 Letter of Expectations, the general Government focus on fiscal prudence and on demonstrating the value provided by cost incurred. Our 2011 SOI is based on the following management priorities, all of which are set out in more detail in our FSSP on page 14:

Excellence in investment search, evaluation and selection

This management priority involves a focus on further strengthening our investment decision-making frameworks, enabling us to:

- make investment decisions that represent the best returns, net of costs and adjusted for the risk brought into the Fund; and which therefore maximise the value added to the Fund;
- have the capability and flexibility to pursue a dynamic approach to investing;
- organise our team and financial resources to focus on activities which add the most value; and
- monitor and assess the results.

We expect our work in this area over the next five years to have a positive impact on the breadth of our investment focus and our abilities to identify and assess investment opportunities; to allocate risk; to assess how investments are best accessed (for example through a manager or through direct equity holdings); and to monitor and learn from our actual investment experiences. We will report on our progress in this work in our Annual Reports, via the Statement of Service Performance.

Significantly progressing implementing value-add investment strategies

We undertake active investment only when we believe it will reduce the risk in the Fund, improve

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We undertake active investment only when we believe it will reduce the risk in the Fund, improve the returns of the Fund, or both...

BOARD STATEMENT (continued)

the returns of the Fund, or both (this is improving the 'Sharpe Ratio' of the Fund – see the sidebar). We:

- actively invest only when we have a high degree of confidence that we can add value to the Fund net of costs
- access investment opportunities in the most efficient (i.e. cheapest) and effective (i.e. value-adding) manner and we seek continuous improvement in our abilities, and the tools we use, to achieve this
- publicly benchmark our value-add through the Reference Portfolio (see page 10) and, relative to peer funds, through the CEM Survey (see page 11)

The challenge of this approach for New Zealand investments is to find opportunities that stack up against global alternatives. Success will depend on the number and scale of opportunities that emerge, and our continued ability to maintain the quality processes and resources to assess them.

Cost management

As a Board we are conscious that the ultimate measure of the success of the Fund will be its absolute return net of all costs. So, as set out above, the overall focus is on ensuring the expenses we incur add value to the Fund. Cost efficiency is central to all of our investment decisions. Within that overall absolute return focus we seek to ensure that the cost we incur is optimal by:

- ensuring that any fees paid to external managers of our investments are commensurate with the complexity of the investment and with the market standards for fees at the time. We also seek to use our negotiating ability – arising from our attractiveness as a genuine long-term investor, including our ability to tolerate illiquidity – in this regard
- assessing whether portfolio management activity, such as due diligence, should be done internally rather than externally (crucially, we assess whether doing it internally adds better risk-adjusted value in terms of the results it produces)
- comparing our cost structure with our peers, via the CEM survey (see page 11) and in the general course of business. This includes comparing the cost of internal and external management and the fees we pay our

Improving the Sharpe Ratio of the Fund

All of our active investment aims to improve what is known as the Sharpe Ratio of the Fund.

The Sharpe Ratio of the Fund is:

$$\frac{\textbf{Total Return (- cash)}}{\textbf{Risk}}$$

'Total Return' is a combination of Excess Return and Active Return

Excess Return = the return premium earned on financial assets such as equities and property over and above what would be possible to earn investing in cash (a 'risk-free' investment). This is the contribution of the Reference Portfolio (see page 10) and is why cash is netted off.

Active Return = the additional return earned by investing outside of the Reference Portfolio. This is the contribution of our value-adding strategies.

Risk = the level of risk collectively brought into the Fund by the sum of all investment activity in the Actual Portfolio. Risk is measured by the volatility (standard deviation) of returns.

The formula above makes clear that if the risk denominator is high, the Returns must be higher. So each active investment we undertake must raise the sum of the top line, reduce the sum of the bottom line, or both.

BOARD STATEMENT (continued)

Custodian. Comparisons are not simple because cost structure is always a function of an investor's purpose, which drives their appetite for risk, the structure of their portfolio, what investment styles they seek and the level of skill internally and externally they need to access. In comparing costs we are conscious that higher relative costs are not automatically bad and lower costs are not automatically good – what matters is why and how they are incurred and the value added. So while we want to avoid paying above market costs, it would be self-defeating to indiscriminately prune costs relating to important tasks such as adding value, due diligence and research

- acknowledging that while the CEM Survey is the best available external assessment for cost structure and value add, it is not perfect. We are looking to develop additional cost efficiency benchmarks and measures to reinforce those present in the CEM survey (as is set out under Management Priority 2 in the FSSP on page 14).

Cost management is an important part of the independent review of our governance of the Fund that happens every five years. We note that cost – in particular fees paid to external managers – was a particular focus of the latest review in 2009, conducted by Mercer under Terms of Reference established by the Minister of Finance. In that review Mercer concluded that our investment management fee levels and structures were competitive for a fund of our size and type and that most external investment mandates were at or below Mercer's expected median levels for the relevant asset classes.

Collaboration with peers

We have a high level of international connectivity with leading global peers with similar investment needs and practices. We are actively pursuing co-investment and research opportunities and partnerships. Success in this activity will widen our ability to access global and, in particular, illiquid opportunities we would be unlikely to access on our own. Developing our peer relationships to this point is an ongoing strategic objective, contained in the 2010 and the 2011 SOIs, reflecting that it is not a rapid process.

Building and maintaining a great team

Over the past few years we have built a strong organisation capable of adding value in an extremely competitive global investment market as well as assessing emerging NZ opportunities.

We strive to have a competitive employment offering relative to other New Zealand employers while remaining mindful of our status as a Crown entity. However, as global investment markets recover it is inevitable that international employers, including peer funds, will seek to project employment offerings not subject to the same considerations. Continuing to strengthen our team will therefore be a major challenge.

Our 2011/12 SOI reflects our wanting to ensure that key talent remains part of the team and contributes to driving Fund performance. We are particularly focused on developing our organisational leadership, culture and a working environment conducive to long-term investing. We are also focused on developing best-practice internal capabilities in risk management, governance, process management and IT.

"In comparing costs we are conscious that higher relative costs are not automatically bad and lower costs are not automatically good – what matters is why and how they are incurred and the value added.

Conclusion

We believe that the Guardians and Fund are well positioned to make a solid contribution in the next five years to the Fund's purpose of reducing the tax burden on future New Zealand taxpayers of the cost of NZS. The work completed in the past 12 months to further refine our investment approach, to strengthen peer relationships relevant to New Zealand, and to make our Team the best it can be will assist us in finding and capturing investment opportunities to benefit New Zealanders now and in the future.

DAVID MAY
Chairman
11 May 2011

DAVID NEWMAN
Deputy Chairman
11 May 2011

OUTCOME FRAMEWORK

The Fund's **outcome** is reducing the tax burden on future New Zealand taxpayers arising from the cost of New Zealand Superannuation. That is a long-term outcome, the results of which will not be tangible until 2031. For the shorter term, we focus on maximising return without undue risk, which facilitates the Fund's ultimate impact on NZers' tax burden.

Our single **output** is managing the Fund.

Managing the Fund involves work programmes covering investment, cost control, risk management, governance and organisational capability. Under each work programme we have identified key management priorities and activities for 2011/12. Together these priorities and activities, sourced from our Strategic Plan, comprise our FSSP – a key part of this document.

Measurement

We have set out on pages 7-9 short, medium and long-term qualitative and quantitative measurements for every level of our Outcome Framework. We will report on progress against each measure in our *Statement of Service Performance (SSP)* in Annual Reports from 2012 onward, depending on the time period of the goal.

OUTCOME OF NEW ZEALAND SUPERANNUATION FUND: WHAT IS OUR GOAL?

Maximising return without undue risk, so as to reduce the tax burden on future New Zealand taxpayers of the cost of New Zealand Superannuation

(See page 1)

OUTCOME OF GUARDIANS OF NEW ZEALAND SUPERANNUATION: WHAT SERVICES WILL THEY PROVIDE TO MAKE A DIFFERENCE?

Managing the Fund

(See page 7)

WORK PROGRAMMES: WHAT ACTIVITIES CONTRIBUTE TO OUR OUTPUT?

Investment	Cost control	Financial and reputation Risk management	Governance	Organisational capability

(See pages 11-13)

WHAT ARE THE KEY PRIORITIES AND ACTIVITIES WITHIN OUR WORK PROGRAMMES FOR 2011/12?

Management priorities and key activities:
FSSP (see page 16)

What else influences the Fund's outcome?

To keep the SOI an efficient document we have chosen to focus on factors we can measure performance against, and which also are likely to be meaningful to New Zealanders.

A broader picture of the internal and external influences on our management of the Fund and its subsequent performance includes: Our Values; Our Investment Beliefs; Our Mission; Our legislated mandate.

If you are interested in further detail on these influences, you can find them on our website under the 'Who we are' and 'What we do' sections.

> ***Managing the Fund involves work programmes covering investment, cost control, risk management, governance and organisational capability.***

MEASURING PROGRESS

Context

On current Treasury projections the Government begins capital withdrawals in 2031. Those who are eligible to first receive New Zealand Superannuation in 2031 are now aged 45.

Setting targets in a five-year SOI for such a long-term outcome presents a challenge (internally, we use rolling 20-year periods to assess the performance of the Fund against our objective). To illustrate: at current policy settings, the 2027 SOI will be the first to cover actual withdrawals from the Fund.

However, we acknowledge that there is considerable interest in the Fund's progress and that most observers would not expect to wait until 2027. Accordingly we have provided a set of short and medium-term measures so New Zealanders can track the Fund's progress.

Using the tables

We have set up the tables so that you can easily identify what we are measuring, how we are measuring it and when and how we report back. At the end of this section we explain why we are using the measures we have selected.

Measuring and reporting outcome

We have set specific, quantitative goals for one, five and 20-year periods and will report against each in the relevant SSP, which is a key element of the relevant period's Annual Report.

These measures concern the Fund's performance and its volatility over time

Measure	1-year expected outcome	5-year expected outcome	20-year expected outcome	Where reported
Reference Portfolio Returns relative to T-Bills (per annum)	+3.5%	+3.4%	+2.5%	SSP[1], 2012 Annual Report SSP, 2016 Annual Report SSP, 2031 Annual Report
Actual Fund returns relative to Reference Portfolio (per annum, net of costs)	+0.8%	+1.1%	+1.2%	SSP, 2012 Annual Report SSP, 2016 Annual Report SSP, 2031 Annual Report
Expected worst case downside return (per annum)	-31%	-5%	-3%	SSP, 2012 Annual Report SSP, 2016 Annual Report SSP, 2031 Annual Report

Measuring and reporting outputs

We have set a mixture of qualitative and quantitative goals for one, five and 20-year periods. Where the goals are qualitative we have ensured that the relevant measurement is derived from a third party (independent surveys and the like).

Additionally, we have identified specific activities we expect to achieve in the 2011/12 financial year that contribute to the overall success of the work programme they sit under. These activities are drawn from the five-year management priorities we have established within our Strategic Plan. We believe it is appropriate and efficient to align the goals and measurements we use for our SOI and our Strategic Plan.

1. Statement of Service Performance which is a performance **report** in an Annual Report.

MEASURING PROGRESS (continued)

Collectively, these activities form our FSSP which is on page 14. The FSSP is a key part of each SOI and it draws together the priorities and activities from our Strategic Plan with the measurements, goals and reporting deadlines of our SOI. We reiterate this as part of our discussion of the FSSP.

These measures concern the five work programmes which comprise the output of Managing the Fund.

Investment programme

Measure	1-year expected outcome	5-year expected outcome	20-year expected outcome	Where reported
As per Outcome measures (because our outcome is fundamentally an investment outcome)				
Relevant FSSP activities in 2011/12?				**Where reported**
Yes. See Management Priorities 1,2,3 pages 14-15				SSP, 2012 Annual Report

Cost control programme

Measure	1-year expected outcome	5-year expected outcome	20-year expected outcome	Where reported
Costs relative to peers in CEM Survey	Achieve/better rating of 'median cost, value-adding'			SSP, 2012 Annual Report (1 year) SSP, 2016 Annual Report (5 years) SSP, 2031 Annual Report (20 years)
Relevant FSSP activities in 2011/12?				**Where reported**
Yes. See Management Priority 2 page 14				SSP, 2012 Annual Report

Financial and reputation risk management programme

Note that 'worst-case downside return' measure is the same as that which appears under the Outcome measures.

Measure	1-year expected outcome	5-year expected outcome	20-year expected outcome	Where reported
Expected worst case downside return (per annum)	-31%	-5%	-3%	SSP, 2012 Annual Report SSP, 2016 Annual Report SSP, 2031 Annual Report
Transparency ratings over time (at least Linaburg Maduell)	10/10 Linaburg, results as appropriate to other surveys			SSP, 2012 Annual Report (1 year) SSP, 2016 Annual Report (5 years) SSP, 2031 Annual Report (20 years)
Annual updating of response to 'Santiago Principles'	Completed			SSP, 2012 Annual Report (1 year) SSP, 2016 Annual Report (5 years) SSP, 2031 Annual Report (20 years)
UNPRI Assessment over time	Top quartile			SSP, 2012 Annual Report (1 year) SSP, 2016 Annual Report (5 years) SSP, 2031 Annual Report (20 years)
Published records of voting, RI in Practice	Published			SSP, 2012 Annual Report (1 year) SSP, 2016 Annual Report (5 years) SSP, 2031 Annual Report (20 years)
Relevant FSSP activities in 2011/12?				**Where reported**
Yes. See Management Priorities 1,2,3 pages 14-15				SSP, 2012 Annual Report

Governance

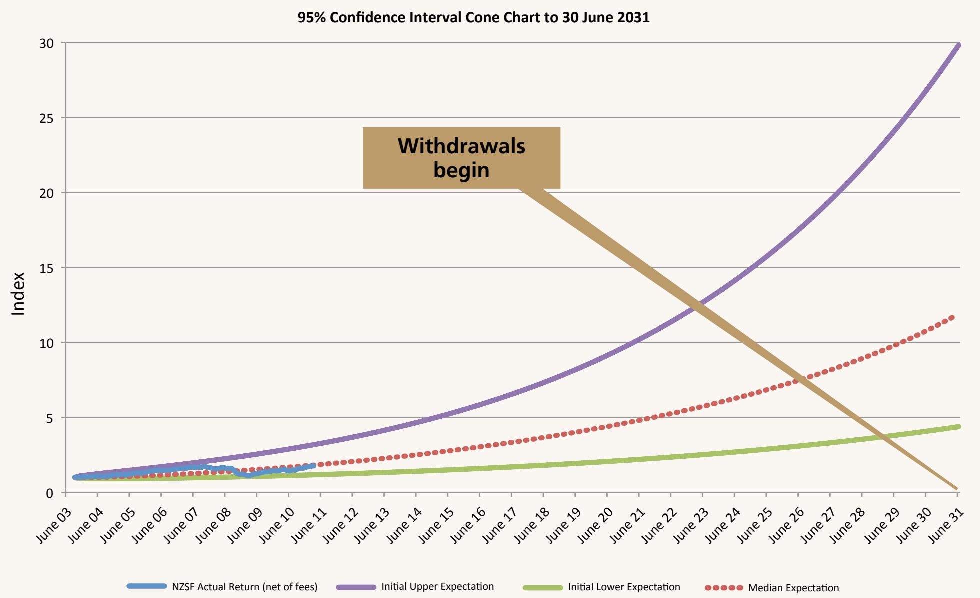
Measure	1-year goal	5-year goal	20-year goal	Where reported
Outcome of independent reviews	n/a (done five yearly)	Good review with review and our response published	Good review with review and our response published	SSP, 2015 Annual Report (5 years) SSP, 2031 Annual Report (20 years)
Relevant FSSP activities in 2011/12?				**Where reported**
No (review is complete, not due again until 2014)				n/a

Organisational capability

Measure	1-year goal	5-year goal	20-year goal	Where reported
Key person risks identified and covered	Board approval received for our assessment of our key persons risks and our plans to mitigate that risk			SSP, 2012 Annual Report (1 year) SSP, 2016 Annual Report (5 years) SSP, 2031 Annual Report (20 years)
Key performance indicators achieved	Staff achieve their personal key performance indicators. Non-achievement to be explained.			SSP, 2012 Annual Report (1 year) SSP, 2016 Annual Report (5 years) SSP, 2031 Annual Report (20 years)
Relevant FSSP activities in 2011/12?				**Where reported**
Yes. See Management Priorities 3,4 page 15				SSP, 2012 Annual Report

A short way into a long-term purpose

At the beginning of this section we discussed the challenges of setting short and even medium-term measurements for a Fund with such a long-term purpose. The graph shows that the Fund has been in existence for less than eight years, which is a very short time relative to its long-term purpose; and that in the short-term the Fund can experience large movements up and down – because of its weighting to growth assets – but that these shifts must be seen in the context of a long-term purpose.



MEASURING PROGRESS (continued)

Explanation of measures chosen

Outcome measures

The 20-year measure

We confidently expect to outperform 90-day Treasury Bills by 2.5%, averaged over rolling 20-year periods. This is reflected in the performance expectation for the 20-year period in the Outcome Framework.

The expectation is based on movement toward long-run equilibrium for each asset class[2] within the Fund. This involves two assessments:

- first, an estimate of what we would expect each asset class to return over certain periods, if their actual market values started at 'equilibrium' levels; but we then incorporate
- an estimate of what the impact would be of a move from current market value toward those equilibrium levels.

The five and one-year measures

Predicting short-term financial market returns with useful accuracy over shorter periods is considerably more difficult. Making accurate predictions for a one-year period, as we are required to do, is impossible.

The expectations we have set against the one and five-year periods in our Outcome Framework must be seen in that context. Those expectations are interpolations of the expectation for the 20-year period and reflect the mid-point of the range of possible returns our modelling has shown us are possible for the portfolio we have constructed.

Maximising return without undue risk

Our three outcome measures will show whether our management of the Fund is maximising its return, without undue risk. Below we explain how.

Why use Treasury Bills as a measurement of 'maximising returns'?

The Fund is a pool of financial assets held by the Crown. As such, contributions to the Fund make no difference to net Crown assets/liabilities. However, contributions can impact the level of the Crown's gross debt.

Accordingly Treasury Bills proxy the 'opportunity cost' to the Government of contributing capital to the Fund, instead of using the money to retire debt. This is because Treasury Bills represent the interest cost to the Government of raising debt.

Over time, the Fund is expected to earn more for the Government in investment returns than it would save in debt servicing i.e. it is expected to add to Crown wealth, putting future governments in a better position to meet increased NZS commitments.

2. Taking global equities as an example, we assume that earnings yields (adjusted for the economic cycle) will move half-way towards our assessment of equilibrium value in five years and essentially all the way in 20 years. Because annualised returns are more widely dispersed over shorter periods, we have greater confidence in a 20-year estimate than we have in a five-year estimate.

Why use the Reference Portfolio as the measurement of 'maximising returns'?

The Reference Portfolio is our estimate of the best simple, low-cost, passive portfolio we could invest in to achieve our mandate. It therefore represents a benchmark for our ability to add value with more complex, more expensive, active investment strategies such as strategic tilting, investing in private and/or illiquid assets, and investing in specific skills. We see these active investment strategies as consistent with our statutory duty regarding best-practice portfolio management; our investment beliefs and our competitive advantages.

As we have made clear in the documentation we have put on our website explaining what the Reference Portfolio is, and how it works, there is a possibility of the actual Fund underperforming the Reference Portfolio. That is because markets can be volatile and where active investment is part of the investment approach, it too can be particularly affected by that volatility in the short term.

However, we have checks and balances in place so that Board and management can examine sustained underperformance by the Fund of the Reference Portfolio (and of Treasury Bills, discussed in the next section on downside return risk) and, where necessary, make changes to particular investment strategies or more generally to our investment approach.

A good example of this is what occurred during the Global Financial Crisis. Board and management worked closely together to examine at a very deep level what was affecting the performance of the Fund in what were extremely volatile conditions. As a result, and as we set out in detail in our 2009 Annual Report, we examined the very fundamentals of our investment approach, right down to our investment beliefs, rationalised and refocused our active management approach and terminated some of our investment managers.

Why use a worst-case downside return as a measure of 'undue risk'?

Our Act requires us to maximise returns without undue risk to the Fund as a whole. This is the trade-off all investors must consider and maximise. The term 'undue risk' is not defined in our Act; rather, it is up to us to interpret. Accordingly in establishing the Reference Portfolio we weigh up the amount of expected return per unit of risk that comes with different combinations of assets. The resulting combination of risk and return is that which we think best meets our statutory obligations.

Financial market returns are inherently volatile. In any given period actual returns will fall somewhere within a wide range of possible returns. For the estimated 'worst case' downside return we look at lowest percentile expected return (or a 1-in-100 event) for the period. If actual returns are worse than this, then either a rarer-than-expected event has occurred or we have taken more risk than we assumed.

Our 'worst-case' modelling work (based on a 20-year investment horizon, which is also the basis for the Reference Portfolio) suggests there is a 1-in-100 chance of Fund returns being worse than: -31% in any one year; -5% p.a. in any consecutive five-year periods; or -3% p.a. in any consecutive 20-year period. In any such case, we need to explain what has happened (and will do so in the relevant period's Annual Report).

"Our Act requires us to maximise returns without undue risk to the Fund as a whole. This is the trade-off all investors must consider and maximise.

MEASURING PROGRESS (continued)

Output measures

Cost Control - CEM

The Guardians participate in the annual cost structure benchmarking survey by CEM Benchmarking Inc. (CEM). The survey is the most widely used and comprehensive financial benchmarking available.

It assesses the cost structure of the Fund against more than 300 funds from around the world, focussing on 20 with similar risk profiles that also use active management strategies.

Our goal for each CEM survey is to be rated as having costs consistent with our peers but to have a higher net-value-added rating. In the most recent survey, for the four years ended 31 December 2009, we were rated lower cost and as adding slightly less net value add than our peers. We publish the results of each CEM Survey in our Annual Report.

We note that we are looking at additional benchmarks to complement the CEM Survey and this is included in our FSSP on pages 14-15.

Financial and reptutational risk management

Financial

We explain this important risk under 'worst case downside risk' on the facing page.

Reputation - transparency

Currently there are not many third-party mechanisms rating the transparency of Sovereign Wealth Funds. One such rating is compiled by the San Francisco-based Sovereign Wealth Fund Institute and published on a quarterly basis. The rating is out of 10 and based on the Institute's conception about what the average person would expect to find out, easily, about a Sovereign Wealth Fund. Our Fund has been rated 10 since the inception of the index and our target is simply to remain a 10. The Institute's website is www.swfinstitute.org

We have published our ratings in ad hoc transparency surveys by other organisations, in the *How Transparent Are We?* section of our website.

We will report how we are rated by other such mechanisms as we become aware of them (and regard them as relevant). We aspire to a top-quartile or higher ranking, as is appropriate to the mechanism.

Reputation - Santiago Principles

The Santiago Principles are essentially principles for best practice by Sovereign Wealth Funds, drawn up by the International Forum for Sovereign Wealth Funds (IFSWF), which was established under the auspices of the IMF, and of which New Zealand is a member. The principles are explained, and we at least annually review and publish our response to them, on our website under the *How Transparent are We?* section mentioned above.

Reputation - UNPRI assessment

This is the self-assessment administered and scored by the secretariat of the United Nations Principles for Responsible Investment as to the extent to which, and how effectively, UNPRI signatories are actually carrying out the principles in their investment activity. Achieving a top quartile rating is our aspiration as it is a moving target and requires a constant process of improvement in Responsible Investment policy and practice to maintain. We report on our website about our performance under the UNPRI.

Reputation - voting and Responsible Investment in Practice reports

A simple transparency measure of the extent to which interested parties can see and understand how we have voted on Responsible Investment and governance issues with respect to investee companies; and more generally the Responsible Investment initiatives we have undertaken. We report on our website about how we have voted our holdings and our Responsible Investment activities more generally.

Governance - independent review

An independent review of our governance of the Fund is required every five years. The terms of reference, and funding, for the review are provided by the Minister of Finance. The Fund has had two such reviews since inception. They are both available on our website under the section dealing with Independent Reviews.

Organisational capability – Key person risk

This measure is essentially an indicator of how well we attract and retain the best people relative to our assessment, given the purpose of the Guardians and Fund, of our capability requirements.

Organisational capability - Achieving Key Performance Indicators (KPI's)

Each staff member must achieve KPIs which cover desired behaviours and their achieving key projects, all of which are designed to contribute to the Fund achieving its purpose. This measure is therefore an indicator of the extent to which our people are performing to that end.

FORECAST STATEMENT OF SERVICE PERFORMANCE (FSSP)

Our FSSP frames our single output as managing the Fund. As set out in our Outcome Framework, that output comprises five work programmes covering expected investment returns; risk management; cost control; governance and organisational development. For each work programme we have set performance measures which, collectively, are performance measures for our output. We note that while contributions to the Fund are suspended, we receive no funding from the Crown other than an appropriation to meet the cost of our Board (an appropriation required by our legislation). All other costs are met from the Fund and our cost control programme relates to that.

In the 2010 SOI we provided two tables which set out the important initiatives, and key activities under each, occurring under each work programme within the financial year. We described how the initiatives and activities had been taken directly from our Strategic Plan.

For this FSSP we have taken the same approach. However we have simplified the presentation to make even more obvious the linkage between our Strategic Plan and this document and to make it easier to understand how it all fits together (it may also be helpful for readers to revisit the Outcome Framework on page 6 in this regard). The FSSP sets out:

- management's key priorities for the 2011-16 period as set out in our Strategic Plan together with some detail about what achieving these priorities would look like
- the key activities occurring in 2011/12 financial year, which are relevant to those priorities (we detail a selection of these on pages 16-19)
- the SOI work programme(s) toward which each priority and key activity contributes, together with a reference back to the table setting out how each programme is measured and where and when it is reported (typically, in the Statement of Service Performance in the Annual Report).

In the pages following this FSSP we have provided further detail around some of the key activities under each Work Programme.

Focus of Strategic Plan			Where reflected in SOI
Strategic Plan Management Priority for 2011-2016	**What does success look like in 2016?**	**Key activities for 2011/12**	**Relevant work programme(s), measurements and reporting**
1. Excellence in investment search, evaluation, selection	• Single view across a wide range of investment opportunities and access points. • Higher reliance on internal capability to identify opportunities. • Opportunistic investing in structured and consistent way. • Systematic monitoring of strategies and managers.	• Ongoing refinement of investment framework across listed and unlisted assets. • Enhanced stress testing capability. • Undertaken implementation reviews of investment strategies. • Further embedding Responsible Investment considerations into manager selection process.	**Investment** • Actual Fund returns relative to Reference Portfolio (page 10). **Risk management** • Expected worst-case downside return (page 11). • UNPRI Assessment over time (page 12).

FORECAST STATEMENT OF SERVICE PERFORMANCE (continued)

2. Significantly progress implementing value-add strategies	• Fully implemented investment strategies. • Adding value net of costs to the reference portfolio. • Maximising cost efficiency and effectiveness.	• Developed and embedded resource allocation tools. • Progressed allocating capital to active investments, subject to opportunities. • Positive net value add comparing favourably to peers (as measured by the CEM Survey). • Developing additional cost effectiveness benchmarks to complement the CEM Survey.	**Investment** • Actual Fund returns relative to Reference Portfolio (page 10). **Cost control** • Costs relative to peers in CEM Survey (page 11).
3. Collaboration with peers	• Co-investments alongside peers in NZ and globally. • Regular bilateral exchange of information and best practice alongside wider industry benchmarking. • Active membership of global forums that exercise influence.	• Established investment protocols for co-investment with peer funds. • Concrete achievements in collaboration programme with other Crown Financial Institutions. • Continuing to hold active membership of forums that exercise influence (including International Forum of Sovereign Wealth Funds).	**Investment** • Actual Fund returns relative to Reference Portfolio (page 10). **Organisational development** • Key performance indicators achieved (page 13).
4. Building and maintaining a Great Team	• Best practice across governance, risk management, process management and IT. • Retention of key talent.	• Retaining and developing talent. • Maintain best practice governance, enterprise risk management and IT capability.	**Organisational development** • Key person risks identified and covered (page 13). • Key performance indicators achieved (page 13).s

HIGHLIGHTS OF KEY ACTIVITIES FOR 2011/12

This section provides commentary for some of the key activities for 2011/12 that we have put against each work programme in the FSSP.

Work programme	*Investment*
Management priority	*Single view across a wide range of investment opportunities and access points*
Activity	*Development of Investment Framework*

The Investment Framework was an initiative of our investment teams and refines our existing investment approach. The Framework itself was completed in 2010/11 and establishes a common investment language so that when any of our team members are discussing concepts such as risk, opportunity and value-add; they are talking about the same thing. This has value when team members' employment backgrounds are diverse and when different asset classes may have specific terminology for the same basic ideas.

Most important, it seeks to use a common internal understanding of the important concepts as the foundation for a common approach to how they are applied to each investment proposal regardless of the asset class, geographical location or how it is accessed (for example, directly or through an investment manager).

This common approach is tuned to take account of the characteristics particular to the Fund: its New Zealand location, Government ownership, long horizon and that the responsibility for investing it is independent of the Government.

The Framework allows us a consistent platform for assessing:

1. what risk we are bringing into the Fund with each investment proposal
2. the returns we expect for the risks – the 'Sharpe Ratio' assessment (see page 3)
3. our level of confidence in the expected returns, a judgement based on some or all of whether:
    a. the proposal assists with the diversification of the Fund
    b. the proposal is built around a genuine investment opportunity. Opportunities generally involve mispricing and examples include vendor distress, market failure, the impact of regulatory reform and exclusivity (which may arise because of the Fund's sovereign status)
    c. the proposal is built around a genuine skill, either our own skill or that of an external investment manager
4. whether we are accessing the opportunity in the ideal way

Work in 2011/12

In 2011/12 our focus is on doing further work to develop the necessary tools and systems to support each stage of the Framework. This work will be wide-ranging and complex but in summary it will cover the following:

Mapping risk

This means developing a clear picture of what risks we are likely to get with any given investment proposal and what returns we should expect from it. That, in turn, allows us to assess what are the optimal balances of risk and return for investment proposals and to actively pursue more proposals assessed as optimal – by 'more', we mean both the number of proposals and the size of the capital allocated to each.

Mapping opportunities

This means developing an ability to form a clear, current picture of where opportunities (as defined at point 3(b) above) are most likely to be found. This work is highly complementary to the risk-mapping exercise and will encompass assessments of the market conditions, asset classes (both listed and unlisted), geographical locations and industry sectors that typically produce genuine investment opportunities. Crucially, this work will inform our level of confidence in an opportunity.

Enhancing our valuation models

As our ability to map risk and opportunity becomes more sophisticated, so must our ability to robustly value those risks and opportunities. The mapping work assists us to better find good investment opportunities; the valuation work assists us to better capture them. A solid valuation capability is crucial to being able to add value to the Fund.

The essence of this work is to make the Investment Framework into a tool which can robustly assess the relative value-add merits of an investment in, say, New Zealand listed property against, say, rural land in Canada.

This will expand the range of areas where we can be more dynamic in our asset allocation, and enable us to examine a wide range of potential risk scenarios. A key element of this will be greater reliance on internal investment capabilities, reflected in the strategic issue relating to building and maintaining our team.

We believe the Investment Framework will be a powerful tool to assist us in adding value to the Fund.

Work programme	*Investment*
Management priority	*Co-investments alongside peers in NZ and globally*
Activity	*Established investment protocols for co-investment with peer funds.*

We pursue useful relationships across what we call the ‘three Cs’: co-investment, comparison and co-operation.

Comparison essentially involves regular bilateral exchanges of information and best-practice so that we can learn from and benchmark ourselves against other like organisations.

Co-operation is where we identify and work on issues of joint interest to ourselves and our peers, such as Responsible Investment, transparency and risk management, often through organisations such as the Public Funds Forum and International Forum of Sovereign Wealth Funds.

Co-investment is our particular focus as it is a potentially valuable access point to investment opportunities. Our peer organisations have access to considerable capital, skill and experience in investments. We have a strong position in New Zealand. We regard these as mutually beneficial advantages and accordingly we are seeking to establish protocols for investing alongside our peer funds during 2011/12. We would then hope to undertake coinvestments, including within New Zealand, from 2012/13.

Work programme	*Cost control*
Management priority	*Maximising cost efficiency and effectiveness*
Activity	*Developing a resource allocation tool*

This work is complementary to that set out under the Investment Framework section on page 16. When complete, the resource allocation tool will allow us to:

- rank expenditure priorities against investment opportunities according to where we have the most confidence (as defined at 3(b) under the Investment Framework section) in expected returns;
- assign people and expenditure accordingly; and
- after an investment is made, assess whether our expenditure of effort and money was actually the most effective (value-adding) and efficient (cheapest) use of both.

Developing this tool is important when returns are expected over time but costs are immediate and concrete.

Work programme	*Risk management*
Management priority	*Building and maintaining a Great Team*
Activity	*Maintaining best practice in enterprise risk management*

Managing financial, operational and reputational risk is of fundamental importance to our management of the Fund. We are therefore constantly seeking to ensure that our enterprise risk management is best practice. We are focussed on several activities in this regard in 2011/12:

- reviewing our governance of risk, primarily through examining whether it could be improved by broadening the mandate of our management Risk and Portfolio Monitoring Committee to have oversight of a broader range of activity involved in managing the Fund;
- enhancing our risk records to ensure that we have the most accurate and current register of what our risks are, their current status and the nature, quality and effectiveness of the controls for each; and
- enhancing our internal reporting of risk to management and the Board, through standardising how we report, and by adopting a 'key risk indicator' approach (meaning identifying potential sources of early warnings of things not being as they should within business units, which do not rely on a formal process of identifying and reporting risks)

Work programme	*Organisational development*
Management priority	*Retention of key talent*
Activity	*Retaining and developing key talent*

The Fund and its purpose benefits from having a breadth and a high common standard of skills and experience in the team that manages it. We therefore recognise the importance of being able to attract, retain and develop great people. We also recognise there are challenges to this from operating in a small market, being a Crown entity and, given those circumstances, that in a post-GFC environment there will be plenty of competition for good people from institutional investors, including our peers, not only for people we want but also the people we already have.

We strive for an employment offering which is reasonable in the New Zealand context. But it is inevitable that given our circumstances we have a challenge in a global context. So we must think laterally in trying to attract, retain and develop talent.

One way is to offer an organisation with a positive culture, driven by a leadership with well-benchmarked skills. We are focussed on being robustly able to demonstrate these qualities. In the meantime, we believe that the changes we have made to our organisational structure, and to our performance bonus scheme (both of which were discussed in the 2010 Annual Report) were significant steps. We believe they will assist to establish an organisation which pulls together in the right direction; where there is alignment between the Fund's purpose and our Team; and where our people see – and can directly control – the relationship between their efforts and their rewards.

REQUIRED STATEMENT OF ESTIMATED FUND RETURNS

We are legally required to outline our expectations for the performance of the Fund over the next financial year. Predicting short-term financial market returns with any useful accuracy over such a near-term horizon is, however, impossible. At best, we can use our modelling techniques to provide a range of likely outcomes for the year ahead and identify amid-point of this range.

Specifically, we begin with our expectation for market returns over the next five years and use this to form the mid-point of the range for the estimated Reference Portfolio Return for 2011/12. To that we add our expectations of returns from added-value activities to arrive at the mid-point for the Actual Fund. Finally, we estimate a range of possible Fund returns for 2011/12, given our estimate of the volatility of market returns. Using this approach we have estimated as follows:

Component of Return	Explanation
Risk-free rate **5.0%**	Our estimate of the return on 90-day Treasury Bills, estimated over a five-year horizon and reflecting that T-Bill yields are currently below equilibrium levels.
PLUS Excess return after costs (which is the reward for taking market risk above cash or the risk-free rate) **3.4%**	We define the reward for market risk as the margin between the risk-free rate and the return that would be generated on the Reference Portfolio (after assumed costs of 0.3%). We estimate this number over a five-year horizon, allowing for movement towards equilibrium valuations (see page 6) and treat this as representative for 2010/11. Over a 20-year horizon our estimate on the same basis is 2.35%. Although we expect similar returns from the Reference portfolio over five and 20-year horizons, we expect T-Bill returns to rise closer to equilibrium levels over the 20-year horizon. Hence we expect the margin between the Reference Portfolio return and the return from Treasury bills to be smaller over 20 years than over five years. Our estimate of the reward for market risk has a very wide range over a one-year horizon, although this range tightens over longer horizons. Around the mid-point the 90% probability range is around +/- 20% for one year, +/- 8% for five years and +/- 3.5% for 20 years.
PLUS Reward for value-adding activities **0.8%**	Our estimation of the return from the investment activities we undertake to add value. We summarise those activities as part of the explanation of the Reference Portfolio on page 10.
EQUALS 9.2%	**The mid-point of our estimated range for the Fund return over 2011/12 is 9.2%.** This estimate is above our corresponding estimate of 8.65% in the 2010 SOI. This reflects our expectation that we will undertake more value-added activity in a market conductive to that activity.

CONSULTATION AND REPORTING TO THE MINISTER

We strive to be as transparent as possible about our management of the Fund and how the Fund performs. Our important stakeholders, including the Minister of Finance, and any other interested party can easily access a wealth of current, detailed information on our website.

In addition we provide a quarterly report on the progress of the Guardians and the Fund to the Minister. This sets out the performance of the Fund and key investment and other operational developments during the preceding quarter.

Section 50 of our Act sets out a limited number of activities we cannot undertake without prior approval from the Minister. From time to time we have sought approvals, together with exemptions from restrictions in broader public sector legislation, and the Minister has given those approvals. An example is the ability we have to use derivatives as part of our investment strategy.

Section 58 of our Act sets statutory duties for our investment approach but gives the Guardians the responsibility for setting and executing the investment strategy of the Fund. Accordingly we would not expect to consult the Minister on the development or implementation of that strategy.

Section 64 of our Act states that the Minister may, after consulting with us, give directions regarding the Government's expectations as to the Fund's performance, including the Government's expectations as to risk and return. Such a direction cannot be inconsistent with our statutory duty to invest the Fund on a prudent, commercial basis. We must have regard to the any such direction and must notify the Minister how we propose to do this. We must also report how we are having regard to the direction in our Annual Report.

As part of the 2009 Budget we received a direction from the Minister on investing in New Zealand. We have disclosed the following:

- the wording of the direction and our response is on our website under the *Investing in New Zealand* section; and
- progress reports on the directive are in our Annual Report and in the *News and Reports* section of our website.

In common with other Crown entities we have also received from the Minister a Letter of Expectations, setting out the Minister's general requirements for prudent expenditure given the broader economic and fiscal environment.

The letter we received for the 2011/12 financial year is available on the website of the Crown Ownership Monitoring Unit. We have also provided a copy of the letter, and of our response, on our website.

ACQUISITIONS

We have no intention in respect of our own activities to acquire interests in companies, trusts or partnerships. We do however undertake such acquisitions in respect of the Fund.

Section 59 of our Act requires us to use our best endeavours to ensure that the Fund does not control any other entity or hold a percentage of the voting rights in any other entity that would require us to seek control of that entity. Consequently the investment guidelines we have in place with external managers place strict limits around the portion of a company's issued capital each manager can own. We monitor the portion of issued capital present in the Fund to ensure it is not deemed to represent a controlling interest. We also ensure that where the threshold for publicly reporting the Fund's holding in a company is reached, we do so promptly.

Opportunities to purchase privately traded assets carry associated obligations to take over operating entities specific to that asset. In these cases we need to balance the benefit to the Fund of going ahead with the transaction, against the Section 59 restriction.

Seeking a change to Section 59

We note that, as disclosed in the Letter of Expectation from the Minister, we are working with Treasury officials on potential changes to the Section 59 restriction. The intention of the changes is to permit more effective structuring of the investments we make for the Fund. We also believe that the changes will put us in a better position to make progress against the Minister's Directive (referred to on the facing page).

In the meantime, our approach is to continue to consider transactions on their commercial merit and then aim to change the ownership structure of the operating entities 'as soon as practicable', as required by the Act, to comply with Section 59. We seek and follow appropriate legal and taxation advice on these transactions and ensure that the Minister of Finance is kept informed.

FINANCIAL PROJECTIONS FOR 2011/12

Cost Allocation Model

Our Cost Allocation Model is made up of two main components – The Guardians and the Fund.

- Fund expenses are met from the Fund and are those incurred in the establishment and implementation of investment policy and the financial and risk management of Fund assets including base fees paid to external managers; and
- Our expenses – with the exception of those incurred by the Board – are met from the Fund and include remuneration, staff expenses such as office services, travel, and professional development.

The expenses of the Board are met from Parliamentary appropriation and include Board fees, the cost of travel to and from Board meetings and the cost of external audit for the Guardians.

All operating costs, irrespective of whether they are sourced from appropriations or Fund assets, are consolidated in the financial statements of the Guardians and subject to the reporting and disclosure obligations of the Crown Entities Act.

The Guardians have prepared prospective financial statements for the Fund. The estimates assume that earnings will be broadly in line with their medium-term estimate (i.e. 9.2% p.a. after costs but before New Zealand tax). Some costs are fixed (e.g. audit costs) and can be easily estimated, but the majority are variable (i.e. base and performance fees paid to investment managers or transaction fees paid to the custodian). The Guardians have prepared estimates of these variable costs based on their expectations of the portfolio over the year.

Expected total cost of managing the Fund in 2011/12

The forecast cost of managing the Fund in 2011/12 is higher than what was forecast in our previous SOI. This is because we expect more value-added investment activity. We are pushing ahead with our investment strategies and believe that, subject to appropriate commercial opportunities arising which stack up against global alternatives, there will be more activity in New Zealand in the five years covered by this SOI (the extent to which such investment opportunities are available is, of course, a major determinant of actual costs incurred relative to forecasts). This activity could, potentially, include co-investment with global peer funds.

The forecast cost of managing the Fund in 2011/12 – excluding performance fees – is $128.3 million or 0.67% of expected average funds under management. Of this amount the Guardians' expenses are $26.2 million (of which $0.53 million are Board expenses met by Parliamentary Appropriation) which amounts to 0.14% of expected average funds under management.

We note that we have excluded investment manager performance fees from this forecast. Performance fees are only paid when investment managers outperform their benchmarks and so they are better described as an offset against returns than a cost.

If we include forecast performance fees, the forecast cost of managing the Fund in 2011/12 is $149.6 million or 0.78% of expected average funds under management. We note that this is a forecast and reiterate that the actual fees paid will be entirely dependent on market conditions and the availability of suitable investment opportunities. We clearly disclose the actual performance fees paid each financial year in our Annual Report.

FINANCIAL PROJECTIONS FOR 2011/12 (continued)

Expected total cost of managing the Fund from 2011/12 to 2015/16

We are forecasting for total costs – excluding performance fees – to increase from 0.67% to 0.70% of expected average funds under management over the period covered by this SOI. This is consistent with the cost track set out in our 2010 SOI.

If we include forecast performance fees, the forecast cost over this period increases from 0.78% to 0.86% of expected average funds under management.

We note that this order of total costs is low relative to the history of the Fund when total expected costs – excluding performance fees – were consistently at or above 0.80% of expected average funds under management.

Note our discussion of cost management on page 3.

Prospective Financial Statements

We have prepared prospective financial statements for the Guardians (in our role as manager and administrator of the Fund) and for the Fund consistent with this Statement of Intent.

These prospective financial statements should be read within the context of the Statement of Intent. Information in these prospective financial statements may not be appropriate for purposes other than those described.

The Board has authorised the issue of these prospective financial statements by way of resolution on 11 May 2011. The Board is responsible for the prospective financial statements presented, including the appropriateness of the assumptions underlying the prospective financial statements and all other required disclosures.

The assumptions used in preparing the prospective financial statements have been disclosed following the accounting policies of each entity.

Actual financial results have not been incorporated into the prospective financial statements. It is not the intent of the Board to update these prospective financial statements subsequent to presentation.

Guardians of New Zealand Superannuation and Group

Prospective Statement of Comprehensive Income

For the year ending 30 June 2012

	$000
Revenue from parliamentary appropriation	528
Revenue from New Zealand Superannuation Fund	25,545
Other income	120
Total revenue	**26,193**
Board-related expenses	(708)
Employee remuneration and related expenses	(20,115)
Depreciation	-
Other expenses	(5,370)
Total expenses	**(26,193)**
Net surplus	**-**
Other comprehensive income	-
Total comprehensive income for the year	**-**

Guardians of New Zealand Superannuation and Group

Prospective Statement of Financial Position

As at 30 June 2012

	$000
Assets	
Current assets	
Cash and cash equivalents	2,562
Trade and other receivables	3,719
Non-current assets	
Property, plant, and equipment	2
Total assets	**6,283**
Liabilities	
Current liabilities	
Trade and other payables	725
Accrued employee benefits	5,058
Non-current liabilities	
Provisions	-
Total liabilities	**5,783**
Net assets	**500**
Equity	
Accumulated surplus	-
General equity reserve	500
Total public equity	**500**

Guardians of New Zealand Superannuation and Group

Prospective Statement of Changes in Public Equity

For the year ending 30 June 2012

	$000
Balance at 30 June 2011	**500**
Net surplus for the year	-
Other comprehensive income	-
Total comprehensive income for the year	**-**
Balance at 30 June 2012	**500**

Guardians of New Zealand Superannuation and Group

Prospective Statement of Cash Flows

For the year ending 30 June 2012

	$000
Cash flows from operating activities	
Cash was provided from:	
Receipts from the Crown	528
Receipts from New Zealand Superannuation Fund	24,079
Other income	90
Interest received	14
Goods and Services Tax	616
Cash was applied to:	
Payments to suppliers	(3,768)
Payments to employees	(20,115)
Net cash provided by/(used in) operating activities	**1,444**
Net increase in cash and cash equivalents	
Cash and cash equivalents at the beginning of the year	1,118
Cash and cash equivalents at the end of the year	**2,562**

Guardians of New Zealand Superannuation and Group

Summary of Significant Accounting Policies

GENERAL INFORMATION

These are the prospective financial statements of Guardians of New Zealand Superannuation (Guardians), a Crown entity in terms of the Crown Entities Act 2004.

The Guardians are domiciled in New Zealand and the address of their principal place of business is 21 Queen Street, Auckland.

STATEMENT OF COMPLIANCE

The Guardians are a public benefit entity, as the primary purpose is to manage and administer the New Zealand Superannuation Fund (Fund). The prospective financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP) as it applies to prospective financial statements.

The prospective financial statements of the Guardians of New Zealand Superannuation and Subsidiaries (Group) for the year ended 30 June 2012 were authorised for issue in accordance with a resolution of the Board on 11 May 2011.

BASIS OF PREPARATION

The prospective financial statements have been prepared in accordance with the Crown Entities Act 2004 and the Public Finance Act 1989, and comply with *Financial Reporting Standard No. 42: Prospective Financial Statements.*

The prospective financial statements have been prepared on a historical cost basis and are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars (NZ$000).

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

The following particular accounting policies which materially affect the measurement of comprehensive income and financial position have been applied:

(a) Consolidation of subsidiaries

The Group financial statements comprise the Guardians of New Zealand Superannuation and their subsidiaries.

Subsidiaries are those entities that are controlled by the Guardians. The financial statements of subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies.

Adjustments are made to bring into line any dissimilar accounting policies that may exist.

The Group financial statements incorporate the financial statements of the Guardians and their subsidiaries, which have been consolidated using the purchase method. The results of any subsidiaries that become or cease to be part of the Group during the year are consolidated from the date that control commenced or until the date that control ceased.

All inter-entity transactions, balances and unrealised profits are eliminated on consolidation.

(b) Revenue and income

The Group primarily derives revenue through the provision of outputs to the Crown and to the Fund, and also derives income from its investments. Revenue and income is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Rendering of services

Revenue from the rendering of services is recognised by reference to the stage of completion.

New Zealand Superannuation Fund reimbursement of costs:

Stage of completion is measured by the proportion of costs incurred to date, compared to the total costs of the outputs.

Crown appropriations:

Revenue is recognised on a straight line basis over the period the appropriations relate to, because the services are performed by an indeterminate number of acts over a specified period of time.

Other service revenue:

Where outputs cannot be measured reliably, revenue is recognised only to the extent that the expenses recognised are recoverable.

Interest

Interest revenue is recognised as the interest accrues (using the effective interest method which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

(c) Goods and Services Tax (GST)

Revenues, expenses, assets, and liabilities are recognised exclusive of GST, with the exception of receivables and payables which are stated with GST included. Where GST is irrecoverable as an input tax, then it is recognised as part of the related asset or expense.

Cash flows are included in the cash flow statement 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.

(d) Taxation

The Guardians are exempt from income tax under the Income Tax Act 2007.

(e) Receivables

Short-term receivables are stated at their estimated realisable value after providing for doubtful and uncollectible debts.

Collectability of receivables is reviewed on an ongoing basis. Individual debts that are known to be uncollectible are written off when identified. An impairment provision is recognised when there is objective evidence that the Group will not be able to collect the receivable. Financial difficulties of the debtor, default payments or debts more than 60 days overdue are considered objective evidence of impairment. The amount of the impairment loss is the receivable carrying amount compared to the present value of the estimated future cash flows, discounted at the original effective interest rate.

(f) Subsidiaries

Subsequent to initial recognition, investments in subsidiaries are measured at cost.

(g) Property, plant, and equipment

Initial recording

All items of property, plant, and equipment are initially recognised at cost. Cost includes the value of consideration exchanged, or fair value in the case of donated or subsidised assets, and those costs directly attributable to bringing the item to working condition for its intended use.

Guardians of New Zealand Superannuation and Group

Summary of Significant Accounting Policies (continued)

(g) Property, plant, and equipment (continued)

Subsequent expenditure

Subsequent expenditure relating to an item of property, plant, and equipment is capitalised to the initial cost of the item when the expenditure increases the economic benefits over the life of the item or where that expenditure was necessarily incurred to enable the future economic benefits to be obtained and the expenditure would have been included in the initial cost of the item had the expenditure been incurred at the time of acquisition.

All other subsequent expenditure is expensed in the period in which it is incurred.

Subsequent measurement

Subsequent to initial recognition, property, plant, and equipment is stated at cost less accumulated depreciation and any impairment in value.

Disposal

An item of property, plant, and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Any gain or loss arising on disposal of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of an item) is included in the statement of comprehensive income in the year the item is disposed of.

Impairment

All items of property, plant, and equipment are assessed for indications of impairment at each balance date.

Where the carrying amount is assessed to be greater than its recoverable amount, the item 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 that 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.

Recoverable amount is the greater of fair value less costs to sell and value in use. The recoverable amount is determined for an individual asset, unless the asset's value in use cannot be estimated to be close to its fair value less costs to sell and it does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash generating unit to which the asset belongs.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Held for sale

Items of property, plant, and equipment classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Items of property, plant, and equipment are classified as 'held for sale' if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. The sale of the asset is expected to be completed within one year from the date of classification.

(h) Depreciation

Depreciation is provided on a straight-line basis on all property, plant, and equipment at a rate which will write off the cost of the assets to their estimated residual value over their useful lives.

The useful lives and associated depreciation rates of major classes of assets have been estimated as follows:

Office equipment	3 years
Computer equipment	1–3 years

(i) Intangible assets

Software and licences are finite life intangibles and are recorded at cost less accumulated amortisation and impairment. Amortisation is charged on a straight-line basis over their estimated useful lives of 3 years. The estimated useful life and amortisation method is reviewed at the end of each annual reporting period.

(j) Employee benefits

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

Provisions made in respect of employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits which are not expected to be settled within 12 months are measured as the present value of the estimated future cash outflows to be made by the Group in respect of services provided by employees up to reporting date.

(k) Operating leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether the 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 where the lessor effectively retains substantially all the risks and benefits of ownership of the leased items are classified as operating leases. Operating lease expenses are recognised on a straight-line basis over the period of the lease.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as deferred income in the statement of financial position. The aggregate benefits of incentives are recognised as a reduction of rental expense on a straight-line basis over the period of the lease.

(l) Foreign currency transactions

Transactions denominated in a foreign currency are converted to New Zealand dollars at the exchange rate in effect at the date of the transaction.

Monetary assets and liabilities denominated in a foreign currency at balance date are translated at the rate of exchange ruling as at that date. The resulting exchange differences are recognised in the statement of comprehensive income. Foreign exchange gains and losses for fair value through profit or loss investments are included within the change in their fair value.

Guardians of New Zealand Superannuation and Group

Summary of Significant Accounting Policies (continued)

(m) Financial instruments

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 statement of financial position and all revenues and expenses in relation to financial instruments are recognised in the statement of comprehensive income.

Financial assets and financial liabilities are recognised in the statement of financial position when the Group becomes a party to the contractual provisions of the instrument. The Group offsets financial assets and financial liabilities when the Group has a legally enforceable right to set off the recognised amounts and interests and intends to settle on a net basis.

Except for items covered by a separate accounting policy, all financial instruments are shown at their amortised cost.

(n) Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, the future sacrifice of economic benefits is probable, and the amount of the provision can be measured reliably.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account 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.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the 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.

(o) Payables

Short-term payables are not interest bearing and are stated at their nominal value.

(p) Equity

Equity is the Crown's interest in the Guardians and is measured as the difference between total assets and total liabilities..

(q) 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 and financing activities. The 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.

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 equity and debt capital structure of the Group and those activities relating to the cost of servicing the Group's equity capital.

Cash and cash equivalents include cash balances on hand, held in bank accounts, demand deposits, and other highly liquid investments with an original maturity of three months or less.

(r) Changes in accounting policies

There have been no changes in accounting policies. All policies are consistent with prior year.

(s) Critical accounting estimates and assumptions

In preparing these prospective financial statements the Group has made estimates and assumptions concerning the future. These estimates and assumptions may differ from the subsequent actual results. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are discussed below:

Employee entitlements – long-term incentives

A component of the long-term incentive scheme is a measure of the performance of the Fund, calculated based on a rolling four-year performance average. The calculation of this liability utilises assumptions regarding the future performance of the Fund, the employee's average salary over the vesting period, the percentage of service rendered and the likelihood of the employee leaving before the long-term incentive is fully vested. The key variable is the performance of the Fund. Should the performance of the Fund differ from the assumption utilised in the calculation of the long-term incentive liability, this will impact the employee benefits expense in the statement of comprehensive income, and the carrying amount of the liability in the statement of financial position. The Group minimises the risk of this estimation uncertainty by using a model based on historical evidence to forecast future returns of the Fund.

SIGNIFICANT ASSUMPTIONS ADOPTED IN THE PREPARATION OF PROSPECTIVE FINANCIAL STATEMENTS

The Guardians' forecast is based on the key assumption that the headcount for the Guardians will increase from 69.3 as at the end of February 2011 to 77.3 full-time equivalent employees by 30 June 2012.

The forecast increase in headcount numbers was determined from the annual business plan compiled by the Guardians senior management team.

In the event that the Guardians are unable to recruit the additional headcount as forecast, actual results may vary materially from the forecast. Any variance in actual headcount is likely to result in a material reduction of expenses, resulting in a corresponding decrease in revenue received from the Fund.

New Zealand Superannuation Fund and Group

Prospective Statement of Comprehensive Income

For the year ending 30 June 2012

	$000
Income	
Interest income	152,260
Dividend income	350,889
Timber sales	47,736
Fair value changes in investments at fair value through profit or loss	1,138,455
Net foreign exchange gain / (loss)	-
Share of profit of investments accounted for using the equity method	76,077
Other income	-
Net operating income / (loss)	**1,765,417**
Expenses	
Timber expenses	(21,554)
Depreciation and amortisation	(1,448)
Managers' fees – base	(57,556)
Managers' fees – performance	(21,293)
Custody fees	(5,584)
Other expenses	(41,531)
Profit / (loss) for the year before income tax expense	**1,616,451**
Income tax expense	(389,731)
Profit / (loss) for the year after income tax expense	**1,226,720**
Other comprehensive income	
Net fair value gains on available-for-sale financial assets	5,978
Gain on revaluation of property, plant, and equipment	-
Translation of foreign operations	-
Income tax on items of other comprehensive income	-
Other comprehensive income for the year, net of tax	**5,978**
Total comprehensive income for the year	**1,232,698**

New Zealand Superannuation Fund and Group

Prospective Statement of Financial Position

As at 30 June 2012

	$000
Assets	
Cash and cash equivalents	3,950,571
Investments	
Derivative financial instrument assets	256,052
Other financial assets	14,525,595
Investments accounted for using the equity method	822,486
Timber investments - forests	184,932
Total investments	**15,789,065**
Trade and other receivables	275,205
Property, plant, and equipment	152,693
Total assets	**20,167,534**
Liabilities	
Trade and other payables	76,356
Provisions	24,411
Taxation Payable	31,754
Deferred Tax Liability	133,921
Total liabilities	**266,442**
Net assets	**19,901,092**
Equity	
Retained surplus	4,997,747
Available-for-sale reserve	13,388
Land revaluation reserve	7,878
Contributed capital	14,882,079
Total public equity	**19,901,092**

New Zealand Superannuation Fund and Group

Prospective Statement of Changes in Public Equity

For the year ending 30 June 2012

	$000
Balance at 30 June 2011	**18,668,394**
Profit for the year	1,226,720
Other comprehensive income	5,978
Total comprehensive income for the year	1,232,698
Fund capital contributions from the Crown	-
Capital contributions from the Crown in respect of funding the net cost of New Zealand Superannuation entitlements	9,575,366
Capital withdrawals by the Crown in respect of funding the net cost of New Zealand Superannuation entitlements	(9,575,366)
Balance at 30 June 2012	**19,901,092**

New Zealand Superannuation Fund and Group

Prospective Statement of Cash Flows

For the year ending 30 June 2012

	$000
Cash flows from operating activities	
Cash was provided from:	
Dividends received	348,158
Interest received	152,762
Receipts from customers	17,105
Cash was applied to:	
Managers' fees	(63,898)
Payments to suppliers	(52,374)
Income tax paid	(575,648)
GST paid	(3,321)
Net cash provided by/(used in) operating activities	**(177,216)**
Cash flows from investing activities	
Cash was provided from:	
Proceeds from the sale of investments	20,996,751
Cash was applied to:	
Payment for the purchase of investments	(21,033,695)
Purchases of property, plant, and equipment	(1,116)
Purchases of intangible assets	(17)
Net cash provided by/(used in) investing activities	**(38,077)**
Cash flows from financing activities	
Cash was provided from:	
Capital contributions from the Crown	-
Net cash provided by/(used in) financing activities	-
Net increase/decrease in cash and cash equivalents	**(215,293)**
Cash and cash equivalents at the beginning of the year	4,165,864
Effects of exchange rate changes on foreign currency cash	**-**
Cash and cash equivalents at the end of the year	**3,950,571**

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies

GENERAL INFORMATION

These are the prospective financial statements of the New Zealand Superannuation Fund (Fund) and its subsidiaries (Group), a fund created under Section 37 of the New Zealand Superannuation and Retirement Income Act 2001 (Act). This Act commenced on 11 October 2001.

The consolidated financial statements comprise the Fund and its subsidiaries.

The Fund is managed and administered by the Guardians of New Zealand Superannuation (Guardians). The Guardians were established as a Crown entity by Section 48 of the Act and became operative from 30 August 2002.

Under Section 43 of the Act, the Crown is required to make capital contributions to the Fund for investment based on a percentage of GDP as set out in the Act. Capital contributions are made by the Crown into the Fund on a fortnightly basis for the purpose of investment, and funding the net cost of New Zealand superannuation entitlements. 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 Fund is domiciled in New Zealand and the address of its principal place of business is 21 Queen Street, Auckland.

STATEMENT OF COMPLIANCE

The Fund is a profit-oriented entity. The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP). They comply with the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS), as appropriate for profit-oriented entities. The financial statements also comply with International Financial Reporting Standards (IFRS).

The prospective financial statements for the year ended 30 June 2012 were authorised for issue in accordance with a resolution of the Board of Guardians of New Zealand Superannuation on 11 May 2011.

BASIS OF PREPARATION

The prospective financial statements have been prepared in accordance with the Act and comply with *Financial Reporting Standard No. 42: Prospective Financial Statements.*

The prospective financial statements have been prepared on a fair value basis, except for certain items as detailed in the policies below.

The prospective financial statements are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars ($000s).

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

The following particular accounting policies which materially affect the measurements in the prospective financial statements have been applied:

(a) Capital contributions

(i) Fund capital contributions

The Crown is required to make capital contributions to the Fund in accordance with sections 42 to 44 inclusive of the Act. Capital contributions are made by the Crown to the Fund on a fortnightly basis for investment and for the purpose of contribution to the net cost of paying superannuation entitlements after 2020. These capital contributions are recorded in the statement of changes in public equity.

(ii) Superannuation entitlement payments

The Minister of Finance, under section 45 of the Act, must ensure that sufficient money is transferred to the Fund in each year to meet the net cost of superannuation entitlements. These transfers are treated as capital contributions from the Crown in respect of funding the net cost of superannuation entitlements and are offset by capital withdrawals and recorded in the statement of changes in public equity.

(b) Capital withdrawals

(i) Fund capital withdrawals

In terms of Section 47 of the Act no withdrawals of Fund capital contributions are permitted in any financial year before 30 June 2020.

(ii) Superannuation entitlement payments

The net cost of superannuation entitlements is treated as capital withdrawals by the Crown in respect of funding the net cost of superannuation entitlements and is recorded in the statement of movements in public equity. These amounts equate to the associated capital contributions.

The payment of superannuation entitlements is an expense of the Crown and is recorded separately in the Crown's financial statements.

(c) Income tax

In accordance with Section 76 of the Act, the Group is treated as if it is a body corporate for tax purposes and is therefore subject to income tax on any income derived from investments, and that income is treated as gross income of the Fund under the Income Tax Act 2007.

The income tax expense recognised for the year is based on the accounting surplus, adjusted for permanent differences between accounting and tax rules together with the movement in deferred tax for the year.

Current tax is calculated by reference to the amount of taxes payable or recoverable in respect of the taxable profit or tax loss for the year. It is calculated using tax rates and tax laws that have been enacted or substantively enacted at balance date. Current tax for current and prior years is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred income tax is provided on all temporary differences at balance date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences:

(i) except for a deferred income tax liability arising from the initial recognition of goodwill;

(ii) except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

(iii) in respect of taxable temporary differences associated with investments in subsidiaries, associates, and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets, and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax assets, and unused tax losses can be utilised:

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies (continued)

(i) except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

(ii) in respect of deductible temporary differences associated with investments in subsidiaries, associates, and interests in joint ventures, except that deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet 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 income tax asset to be utilised.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to 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. The measurement of deferred tax liabilities and assets reflects the tax consequences of that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Income tax relating to items recognised directly in equity is recognised in the statement of comprehensive income.

(d) Financial instruments

The Group is party to financial instruments as part of its normal operations. These financial instruments include cash and cash equivalents, derivatives, investments, receivables, and payables. All financial instruments are recognised in the statement of financial position and all revenues and expenses in relation to financial instruments are recognised in the statement of comprehensive income.

Financial assets and financial liabilities are recognised in the statement of financial position when the Group becomes a party to the contractual provisions of the instrument. Purchases or sales of financial instruments that require delivery within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, i.e., the date that the Group commits to purchase or sell the instrument. Derivatives are recognised on a trade date basis. The Group offsets financial assets and financial liabilities when the Group has a legally enforceable right to set off the recognised amounts and interests and intends to settle on a net basis.

(e) Investments

Investments are represented by the following:	KEY
- Financial assets at fair value through profit or loss (either designated at fair value through profit or loss or held for trading):	
• Equities	i)
• Fixed interest securities	ii)
• Derivatives	iii)
• Collective investment funds	iv)
• Certain private equity investments	v)
• Unlisted unit trusts	vi)
• Insurance-linked investments	vii)

- Available for sale financial instruments:
  - Certain private equity investments viii)
  - Other available for sale investments ix)
- Loans and receivables: unlisted debt instruments x)
- Investments accounted for using the equity method (refer accounting policies (h) and (i))
- Timber investments – forests (refer accounting policy (j))

Financial instruments at fair value through profit or loss

Initial recording

Financial instrument investments at fair value through profit or loss are initially recognised at fair value on a trade date basis. Transaction costs, for example trading commission, are expensed immediately in the statement of comprehensive income.

Subsequent measurement

Subsequent to initial recognition, these investments are recorded at fair value and are classified in the category "at fair value through profit or loss". The Guardians manage and evaluate the performance of these investments on a fair value basis in accordance with the Fund's investment strategy and information about the investments is provided internally on this basis to the Guardians' key management personnel. Changes in fair value are recognised in profit or loss in the statement of comprehensive income.

Interest earned is accrued in income according to the terms of the contract, while dividend income is recorded when the right to payment has been established.

Determination of fair value

Fair value is an estimate of the amount of consideration that would be agreed upon in an arms length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair value is determined as follows:

i) Listed equities are valued at the last quoted bid price as quoted on the relevant exchange as of the close of business at balance date.

ii) Highly liquid fixed interest securities are valued at the last quoted bid price by a reputable pricing vendor or broker as of the close of business at balance date. Where the market for fixed interest securities is illiquid, prices are determined by a reputable pricing vendor who uses models to value these securities. The models can utilise a variety of inputs including loan level data, prepayment and default assumptions and benchmark prices for similar securities. Because of the inherent uncertainty of valuation, it is possible that those values estimated for the illiquid securities may differ from those values that would have been used had a ready market for those securities existed and those differences may be significant.

iii) Fair value for derivatives is outlined under "Derivatives" below.

iv) Investments in collective investment funds (unlisted investment funds) are valued at the last price of the unit or security as provided by the administrators at balance date. The price is based on the fair value of the underlying net assets or securities of the relevant collective investment fund.

v) Certain private equity investments (unlisted investment funds and unlisted equity investments) which are designated at fair value through profit or loss, are valued at the last price of the unit or security as provided by the investment managers or administrators at balance date. The price is based on the fair value of underlying net assets of the private equity investment. Fair value is determined using a variety of methods,

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies (continued)

including independent valuations, valuation models based on the price of recent investments, earnings multiples, or discounted cash flows. Certain private equity funds are classified as available for sale. The accounting policy for these investments is outlined under viii).

vi) Investments in unlisted unit trusts are valued at the last bid price of the unit or security as provided by the administrators at balance date. The price is based on the fair value of the underlying net assets or securities of the relevant unlisted unit trust.

vii) Insurance-linked investments which are catastrophe bonds are valued using prices provided by reputable pricing vendors or brokers.

Available-for-sale financial instruments

viii) Certain private equity funds that do not have a quoted market price in an active market and whose fair value cannot be reliably measured using the valuation methods outlined in v) above are classified as available for sale and are measured at cost less impairment. Transaction costs are included in the cost of the investment. Management has determined that fair value for these funds 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. Subsequently, where the fair value of these investments becomes able to be reliably measured, then the investment will be measured at fair value with gains or losses being recognised in other comprehensive income (reserves) until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in reserves is reclassified to profit or loss.

ix) Other available-for-sale investments include investments in cooperative and processing companies. The Group is required to hold these investments to facilitate farming investment operations. As such, the Group is normally unable to sell these investments without disrupting farming investment operations. These available-for-sale investments are valued at fair value with gains or losses being recognised in other comprehensive income (reserves) until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in reserves is reclassified to profit or loss.

Loans and receivables

x) Unlisted debt instruments including fixed and floating rate notes and redeemable preference shares are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired.

Derivatives

The Group enters into a variety of derivative financial instruments to manage its exposure to foreign currency risk, and achieve exposure to assets and asset classes. The use of derivatives is governed by the Fund's Statement of Investment Policies, Standards, and Procedures as approved by the Guardians, which provides written principles on the use of derivatives by the Group.

The fair value of forward foreign exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

The fair value of cross currency swaps is determined using a discounted cash flow model.

The fair value of asset swaps is determined using a model, with the key inputs being interest rates and the pricing of inflation futures.

The fair value of credit default swaps is determined using a discounted cash flow model which incorporates default rate and credit spread assumptions for the reference entity or index.

The fair value of futures contracts is calculated as being the present value of the difference between the contract price and the closing price reported on the primary exchange of the futures contract.

The fair value of index swaps (commodity, equity, real estate and longevity contingent swaps) is provided by the counterparty and is calculated by reference to the movement in the underlying index or basket of securities or other contracts. Index swaps are settled net in cash.

The fair value of insurance-linked swaps is calculated using a model which incorporates the premium paid or received and a price provided by reputable pricing vendors or brokers. Premiums are recognised based on a risk dissipation schedule, derived from third party catastrophe models.

The fair value of exchange-traded insurance-linked options is the closing price as reported by the primary exchange of the contract.

The fair value of options is calculated using a Black-Scholes option valuation model.

'Day 1' gains and losses

When the transaction price is different to the fair value from other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Group immediately recognises the difference between the transaction price and fair value (a 'Day 1' gain or loss) in profit or loss in the statement of comprehensive income. In cases where the fair value is determined using data which is not observable, the difference between the transaction price and the model value is recognised on a systematic basis over the expected life of the trade.

(f) Securities lending

Securities lending transactions are 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 to those securities is only available in the event of default by the borrower, and as such 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 in the statement of financial position as an asset, along with a corresponding liability to repay the cash collateral to the borrower, once the securities have been returned.

(g) Repurchase and reverse repurchase agreements

Securities sold under agreement to repurchase at a specified future date are not derecognised from the statement of financial position as the Group retains substantially all the risks and rewards of ownership. The corresponding cash received is recognised in the statement of financial position as an asset with a corresponding obligation to return it, including accrued interest as a liability, reflecting the transaction's economic substance as a loan to the Group. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of the agreement using the effective interest rate.

Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the statement of financial position. The consideration paid, including accrued interest, is recorded separately in the statement of financial position as 'cash collateral on reverse repurchase agreements', reflecting the transaction's economic substance as a loan by the Group. The difference between the purchase and resale prices is recorded in interest income and is accrued over the life of the agreement using the effective interest rate.

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies (continued)

(h) Consolidation of subsidiaries

Subsidiaries are those entities that are controlled by the Fund.

The Group's financial statements incorporate the financial statements of the Fund and its subsidiaries, which have been consolidated using the purchase method. The results of any subsidiaries that become or cease to be part of the Group during the year are consolidated from the date that control commenced or until the date that control ceased.

All inter-entity transactions, balances, and unrealised profits are eliminated on consolidation.

The acquisition of subsidiaries is accounted for using the acquisition method of accounting. The acquisition method of accounting involves recognising at acquisition date, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. The identifiable assets acquired and the liabilities assumed are measured at their acquisition date fair values.

The difference between the above items and the fair value of the consideration (including the fair value of any pre-existing investment in the acquiree) is goodwill or a discount on acquisition.

(i) Investments in associates

An associate is an entity over which the Fund is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the entity.

At inception, certain of the Fund's associates are designated at fair value through profit or loss under *NZ IAS-39 Financial Instruments: Recognition and Measurement* (in accordance with paragraph 1 of *NZ IAS-28 Investments in Associates*). All other associates are equity accounted in accordance with *NZ IAS-28 Investments in Associates*. The designation is made with reference to how the Guardians intend to manage the investment and the extent to which the Guardians will be involved in the management of the investment.

The results and assets and liabilities of associates which are accounted for under *NZ IAS-28 Investments in Associates* are incorporated into the financial statements using the equity method of accounting, except where the investment is classified as held for sale, in which case it is accounted for in accordance with *NZ IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*. Under the equity method, investments in associates are carried at cost as adjusted for post-acquisition changes in the Fund's share of the net assets of the associate, less any impairment in the value of the individual investments. Losses of an associate in excess of the Fund's interest in that associate are not recognised, unless the Fund has incurred legal or constructive obligations or made payments on behalf of the associate.

(j) Investments in joint ventures

A joint venture is a contractual arrangement whereby the Guardians and other parties undertake an economic activity that is subject to joint control, which is when the strategic financial and operating policy decisions relating to the activities of the joint venture require the unanimous consent of the parties sharing control.

At inception, certain of the Fund's joint ventures are designated at fair value through profit or loss under *NZ IAS-39 Financial Instruments: Recognition and Measurement* (in accordance with paragraph 1 of *NZ IAS-31 Interest in Joint Ventures*). All other joint ventures are equity accounted in accordance with *NZ IAS-31 Interests in Joint Ventures*. The designation is made with reference to how the Guardians intend to manage the investment and the extent to which the Guardians will be involved in the management of the investment.

The results of joint ventures which are accounted for under *NZ IAS-31 Interests in Joint Ventures* are incorporated into the financial statements using the equity method of accounting, except where the investment is classified as held for sale, in which case it is accounted for in accordance with *NZ IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*. Under the equity method, investments in joint ventures are carried at cost as adjusted for post-acquisition changes in the Fund's share of the net assets of the joint venture, less any impairment in the value of the individual investments. Losses of a joint venture in excess of the Fund's interest in that joint venture are not recognised, unless the Fund has incurred legal or constructive obligations or made payments on behalf of the joint venture.

(k) Timber investments - forests

Forest assets are predominantly standing trees. These are recognised in the statement of financial position at fair value less estimated point of sale costs. The costs to establish and maintain the forest assets are included in the statement of comprehensive income together with the change in fair value for each accounting period.

The valuation of forest assets is based on discounted cash-flow models. The annual harvest from forecast tree growth is multiplied by expected wood prices and the costs associated with forest management, harvesting, and distribution are then deducted to derive annual cash flows.

The fair value of the forest assets are measured as the present value of cash flows from one growth cycle based on productive forest land, taking into consideration environmental, operational, and market restrictions. Forests are valued separately from the underlying freehold land.

(l) Livestock

Livestock are recorded at fair value less estimated point-of-sale costs.

Changes in the value of livestock are recognised in the Statement of Comprehensive Income.

(m) Inventory

All inventory items are stated at the lower of cost or net realisable value at balance date. The cost of agricultural produce transferred into inventory is measured at its fair value less estimated point-of-sale costs at the date of harvest. The net realisable value represents the estimated selling price of inventories less all estimated costs of completion and costs necessary to make the sale.

(n) Receivables

Short-term receivables are initially recorded at fair value, then at amortised cost using the effective interest rate less any impairment.

(o) Property, plant, and equipment

Initial recording

All items of property, plant, and equipment are initially recognised at cost. Cost includes the value of consideration exchanged, or fair value in the case of donated or subsidised assets, and those costs directly attributable to bringing the item to working condition for its intended use.

Subsequent measurement

Subsequent to initial recognition, leasehold improvements, plant, and equipment are stated at cost less accumulated depreciation and any impairment in value.

Land is measured at fair value. Fair value is determined on the basis of an independent valuation prepared by external valuation experts, based on discounted cash flows or capitalisation of net income (as appropriate).

Any revaluation increase arising on the revaluation of land is credited to the asset revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense in the statement of comprehensive income, in which case the increase is credited to the statement of comprehensive income to the extent of the decrease previously charged.

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies (continued)

A decrease in carrying amount arising on the revaluation of land is charged as an expense in the statement of comprehensive income to the extent that it exceeds the balance, if any, held in the asset revaluation reserve relating to a previous revaluation of that asset.

Independent valuations of land are performed with sufficient regularity to ensure that the carrying amount does not differ materially from the asset's fair value at balance date.

Disposal

An item of property, plant, and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset.

Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of an item) is included in the statement of comprehensive income in the year the item is derecognised.

Impairment

All items of property, plant, and equipment are assessed for indications of impairment at each balance date.

Where the carrying amount is assessed to be greater than its recoverable amount, the item is written down to its recoverable amount. The write down is recognised in the statement of comprehensive income unless it relates to land, in which case it is treated as a revaluation decrease.

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 that 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 unless it relates to land, in which case it is treated as a revaluation increase.

Recoverable amount is the greater of fair value less costs to sell and value in use. It is determined for an individual asset, unless the asset's value in use cannot be estimated to be close to its fair value less costs to sell and it does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is determined for the cash generating unit to which the asset belongs.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

(p) Depreciation

Depreciation is provided on a straight line basis at a rate that will write off the cost of the assets to their estimated residual value over their useful lives.

The useful lives and associated depreciation rates of major classes of assets have been estimated as follows:

Land improvements	15-50 years
Office equipment	3 years
Computer equipment	3 years
Office fitout	term of the lease

The cost of office fitout 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.

(q) Intangible assets

Software and licences

Software and licences are finite life intangibles and are recorded at cost less accumulated amortisation and impairment. Amortisation is charged on a straight line basis over their estimated useful lives of 3 years. The estimated useful life and amortisation method is reviewed at the end of each annual reporting period.

(r) Payables

Short-term payables are not interest bearing and are stated at their nominal value.

(s) Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, the future sacrifice of economic benefits is probable, and the amount of the provision can be measured reliably.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at reporting date, taking into account 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.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the 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.

(t) Income recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

For financial instruments measured at fair value, interest income is recognised on an accrual basis, either daily or on a yield to maturity basis. Interest earned on cash balances is accrued at the effective interest rate.

Dividend income is recognised when the shareholder's right to receive payment has been established, normally the ex-dividend date. Where the Group 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.

Revenue from the sale of goods is recognised when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods.

Securities lending fees are recognised as earned.

(u) Foreign currency transactions

Transactions denominated in a foreign currency are converted to New Zealand dollars at the exchange rate in effect at the date of the transaction.

Monetary assets and liabilities denominated in foreign currency at balance date are translated at the rate of exchange ruling as at that date. The resulting exchange differences are recognised separately in the statement of comprehensive income.

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies (continued)

(v) Translation of the financial statements of independent foreign operations

Assets and liabilities of foreign operations with functional currencies other than New Zealand dollars are translated at the closing rate. Revenue and expense items are translated at a weighted average of exchange rates over the year, as a surrogate for the spot rates at transaction dates. Exchange differences arising from the foregoing are taken to the foreign currency translation reserve and recognised in the statement of changes in public equity.

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at exchange rates prevailing at the reporting date.

On disposal of an independent foreign operation, the accumulated amount of the exchange differences taken to the foreign currency translation reserve that relate to the foreign operation are transferred out of the foreign currency translation reserve and recognised in the statement of comprehensive income when the gain or loss on disposal of the foreign operation is recognised.

(w) Statement of cash flows

The following are the definitions of the terms used in the statement of cash flows:

- Operating activities include all transactions and other events that are not 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 (from 2020). 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 Group and is accordingly not recorded in the statement of cash flows.

Cash and cash equivalents

Cash and cash equivalents include cash balances on hand, held in bank accounts, demand deposits, and other highly liquid investments with an original maturity of three months or less.

(x) Goods and Services Tax (GST)

Revenues, expenses, assets, and liabilities are recognised exclusive of GST, with the exception of receivables and payables which are stated with GST included. Where GST is irrecoverable as an input tax, it is recognised as part of the related asset or expense.

Cash flows are included in the cash flow statement 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.

(y) Changes in accounting policies

There have been no changes in accounting policies. The accounting policies have been applied consistently throughout these financial statements.

(z) Significant estimates and judgments

In preparing these prospective financial statements, estimates and judgements have been made concerning the future. These estimates and judgments may differ from the subsequent actual results. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The estimates and judgments that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities are detailed within each accounting policy above.

SIGNIFICANT ASSUMPTIONS ADOPTED IN THE PREPARATION OF PROSPECTIVE FINANCIAL STATEMENTS

No capital contributions from the Government have been included in the forecast period, based on announcements made by the Government in the Budget 2009.

Investment returns for the forecast period are based on internal modelling of 20-year returns.

Management fees included in the forecast are based on investment management agreements that were in place on the date the forecast was approved by the Board. The Guardians' expenses are allocated according to the current allocation model.

The forecast has largely been based on actual experience to date with exception of the impact of foreign currency. No foreign currency impact has been forecast.

Material differences between the forecast and actual returns will occur due to two major factors:

1. investment markets generate returns at a level that is greater or lesser than the rate assumed in this forecast; and
2. foreign currency movements.

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