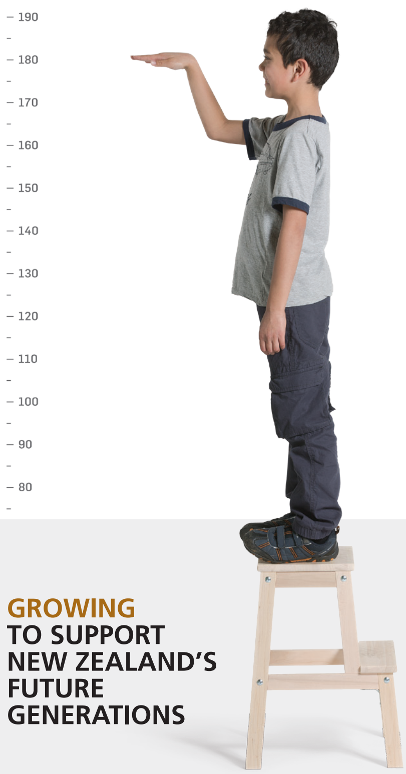
STATEMENT OF PERFORMANCE EXPECTATIONS

FOR THE PERIOD 1 JULY 2014 TO 30 JUNE 2015

Guardians of New Zealand Superannuation



GROWING TO SUPPORT NEW ZEALAND'S FUTURE GENERATIONS

NZSUPERFUND
Te Kaitiaki Tāhua Penihana Kaumatua ō Aotearoa

Contents

1. Introduction

The New Zealand Superannuation Fund is a global investment fund designed to help pre-fund the future costs of universal superannuation. By using the Fund to save now in order to pay for future retirement benefits, the Government aims to smooth the cost of New Zealand Superannuation between today's taxpayers and future generations.

The Fund, which was established in 2001, is managed by the Guardians of New Zealand Superannuation, a Crown entity. Investing began in 2003. To date, the Government has contributed NZ$14.88 billion to the Fund.

	SINCE INCEPTION
Government Contributions	$14.88 billion
Investment Returns	$14.21 billion
NZ tax paid	$(3.89) billion
Fund size, as at 31 March 2014	$25.20 billion

From about 2029/30 the Government will begin to withdraw money from the Fund to help pay the cost of universal superannuation. On current projections, however, the Fund will continue to grow in size until the 2080s.

The activities of the Guardians are paid for out of Fund investment returns, with the exception of Board expenses and audit fees, which are paid for by Parliamentary appropriation.

2. Our Mandate

As required by the NZ Superannuation and Retirement Income Act 2001, the Guardians must invest the Fund on a prudent, commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with:

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

The Guardians' mission is to maximise the Fund's return over the long-term, without undue risk, so as to reduce future New Zealanders' tax burden.

For more information about the Guardians and the Fund, see www.nzsuperfund.co.nz.

3. 2014/15 Activities

As set out in our 2014-2019 Statement of Intent, the Guardians' output comprises five work programmes covering:

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

In this Statement of Performance Expectations we describe key 2014/15 activities under each of these five work programmes. These activities support the objectives of our 2014-2019 Strategic Plan.

We will report on our performance in implementing these activities in our 2014/15 Annual Report.

We also provide, for 2014/15:

- a statement of estimated Fund returns (section 4);
- a statement of the key risks to the performance of the Fund over the coming year and the actions being taken by the Board to manage those risks (section 5);
- financial projections (section 6);
- prospective financial statements and a summary of significant accounting policies (section 7).

STRATEGIC PLAN OBJECTIVES FOR 2014-19	KEY ACTIVITIES FOR 2014/15	RELEVANT WORK PROGRAMME, REPORTING, PERFORMANCE MEASURES
Best portfolio	• Pursue more NZ and International direct deals: originate, execute and manage • Complete implementation of the Risk Budget investment approach and supporting infrastructure • Improve collateral pool management • Expand direct arbitrage strategy and exploit new Portfolio Completion opportunities (including options) • Broaden and deepen the Strategic Tilting programme	**Investment** (SOI pages 9-11): • Actual Fund returns relative to Reference Portfolio **Risk** (SOI pages 12-13): • Transparency ratings • UNPRI assessment • Voting records • Responsible Investment activity report **Cost control** (SOI page 11): • Costs and value-add relative to peers in CEM survey
Collaboration with peers	• Focussed peer engagement: fewer, deeper relationships targeting co-investments • Active participation, leadership, and agenda-setting at multi-lateral forums	**Investment** (SOI pages 9-11): • Actual Fund returns relative to Reference Portfolio **Cost control** (SOI page 11): • Costs and value-add relative to peers in CEM survey **Risk** (SOI pages 12-13): • Response to Santiago Principles • Transparency ratings • UNPRI assessment • Voting records • Responsible Investment activity report
Building and maintaining a great team	• Implement formal learning and development programme • Automate and simplify Human Resources systems and processes	**Organisational capability** (SOI page 14): • Board approval for key person risk plans and 3-6 month cover in place for all critical roles and key people • Staff achieve their individual incentive plan targets **Cost control** (SOI page 11): • Costs and value-add relative to peers in CEM survey **Risk** (SOI pages 12-13): • Transparency ratings • Response to best practice Santiago Principles
Efficiency, scalability and innovation	• Develop or improve several Operational systems and approaches: IT Mobility, capability in trading over-the-counter derivatives, Intranet, collateral optimisation • Examine and incubate new ideas for business innovation through a standing Innovation Hub	**Cost control** (SOI page 11): • Costs and value-add relative to peers in CEM survey **Risk** (SOI pages 12-13): • Best practice – response to Santiago Principles • Transparency ratings • UNPRI assessment • Responsible Investment activity report

For further detail on how the activities described in this section support the purpose of the Guardians and Fund, how they align with our 2014-19 Strategic Plan, and on our performance measures, see our 2014-19 Statement of Intent.

HIGHLIGHTED KEY ACTIVITIES

In this section we discuss in more detail three of the most significant key activities for 2014/15. We will report on our progress in implementing these activities in the Statement of Performance in our 2014/15 Annual Report.

Direct Investment – pursuing more deals

We invest as directly as possible. This means that where there is a strong business case to do so, we originate, execute and manage investments ourselves, instead of working through external managers. We only invest directly, however, when we have a high level of confidence that:

- the Fund will achieve a better risk-adjusted return;
- the Fund's interests are aligned with those of the investee company;
- we have the internal capacity and governance to successfully implement and manage the investment.

In order to strengthen our focus on direct investments, two parallel teams have been created within the Guardians. One team, which is predominantly focussed on New Zealand, has responsibility for large equity investments in New Zealand companies and natural resource investments (timber and rural) domestically and overseas. The other team focusses on global infrastructure and expansion capital, energy sector opportunities, and managing the Guardians' offshore co-investments with peers.

Both teams are targeting opportunities of NZ$100m-NZ$300m+.

Staffing has been strengthened in both teams with analysts focussed on due diligence and operational support, portfolio managers to monitor investments, and team leaders tasked with deal origination.

We aim to increase the total number of deals explored, and the number of suitable deals taken to due diligence stage, compared to 2013/14.

Portfolio Completion – expansion of activities

Internally-executed arbitrage, an investment strategy managed by the Guardians' Portfolio Completion team, has been a successful value-adding investment strategy in recent years. The strategy takes advantage of pricing differentials between two securities or indices that are economically the same. For example, a stock may be dual-listed; we can generate returns by buying it on one exchange and selling it on the other for a higher price, with no economic risk.

In 2014/15, we are aiming to increase the number of types of arbitrage transactions undertaken, and to develop new investment opportunities within Portfolio Completion, including options.

We are also looking to improve our management of the Guardians' pool of collateral (liquid assets held to meet certain investment obligations) in order to maximise risk-adjusted returns for the Fund.

Innovation Hubs – ensuring continuous learning and improvement

During 2014/15, we plan to establish an 'innovation hub' programme to foster organisation-wide innovation in investment and risk management, and in back-office processes. The purpose of the innovation hubs is to ensure that the competitive advantages that the Guardians has built up over the last decade (e.g. investment partner of choice in New Zealand; strong external reputation for good governance and responsible investment) are exploited. The hubs will be designed to help harness existing institutional knowledge to explore the potential of new systems and practices and to bring a cross-team, whole-of-Guardians perspective to key activities.

The topics for the first innovation hubs are dashboard reporting and knowledge management.

4. 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. We therefore show our long-term, or equilibrium, expectations for the Reference Portfolio return (see our 2014-2019 Statement of Intent for more information about the Reference Portfolio). To that 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 2014/15, given our assumed volatility of market returns. Using this approach, we have estimated as follows:

	RISK-FREE RATE	EXCESS RETURN AFTER COSTS	REWARD FOR VALUE-ADDING ACTIVITIES	
COMPONENT OF RETURN	6.0% +	2.5% + (which is the reward for taking market risk above cash or the risk-free rate)	1.0% =	9.5%
EXPLANATION	Our estimate of the equilibrium return on 90-day Treasury Bills.	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%). Although the estimates of market risk vary over time, we provide the equilibrium, or long term, expectation of the rewards for market risk on the Reference Portfolio. 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, +/- 6% for ten years and +/- 3.5% for 20 years.	Our estimation of the return from the investment activities we undertake to add value. We summarise those activities as part of our explanation of the Reference Portfolio in our Statement of Intent.	The mid-point of our estimated range for the Fund return over 2014/15 is 9.5%.

5. Risk Statement

The Guardians has extensive risk-management policies, procedures and other internal controls for application by our staff. These policies and procedures also cover our expectations of risk management for our external investment managers and other expert service providers.

The Guardians' approach to managing investment risks is set out in our Statement of Investment Policies, Standards and Procedures including the Risk Management Policy, both of which are available on www.nzsuperfund.co.nz.

WHAT ARE OUR RISKS?

The Guardians have identified five major categories of risk:

1) Investment risk: The risk inherent in achieving investment goals and objectives (that is, the risk of not achieving them), including market, credit, counterparty, manager and liquidity risk;
2) Strategic risk: The risk that we make inappropriate strategic choices or that we are unable to successfully implement selected strategies;
3) Legislative and regulatory risk: The risk of financial loss or reputational damage due to non-compliance with actual or proposed laws, rules and regulations and prescribed industry practices;
4) Operational risk: The risk of financial loss from inadequate or failed internal processes, people or systems, or from external factors; and
5) Reputation risk: Risk of loss of reputation or credibility due to internal or external factors.

GUARDIANS' RISK MANAGEMENT PROCESS

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

The Guardians' risk-management process has four stages:

1) Identifying risk: we list events that could negatively impact the achievement of the business objectives we have set out in our strategic and business plans.
2) Analysing risk: we rate how likely it is that the events on the list will happen and the severity of their impact on business plans. Each risk is assigned an Initial Risk rating, which is our initial assessment of how serious the risk is without any controls.
3) Rating effectiveness of controls: we analyse the effectiveness of our existing controls in addressing the risks we've identified. Our controls include policies, procedures, standards, processes and codes of practice. We do this analysis annually, using findings from external and internal audits, case studies of reported incidents and any other relevant and useful information. We then assign a current risk rating to each instance where we've concluded that a risk still presents a threat even after taking account of all available controls.
4) Analysing residual risk: finally, we decide how to deal with current risks. Typically, this involves developing management plans specific to that risk to ensure the threat it presents remains within acceptable limits. These plans then feed back into strategic and business planning.

Each year, we report on a series of investment and business risk indicators in our Annual Report. For further detail see our 2014-19 Statement of Intent and the Risk Management section in our Annual Report.

6. Financial Projections for 2014/15

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 fees paid to external managers and the master custodian.
- The Guardians' 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 (2004).

We have prepared prospective financial statements for the Fund. The estimates assume that earnings will be broadly in line with the medium-term estimate (i.e. 9.5% 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).

We have prepared estimates of these variable costs based on our expectations of the Fund over the year.

EXPECTED TOTAL COST OF MANAGING THE FUND IN 2014/15

The forecast cost of managing the Fund in 2014/15 – excluding performance fees – is $120.4 million or 0.46% of expected average funds under management, compared to the forecast for 2013/14 of $116.2 million or 0.52%.

Of this amount the Guardians' expenses are $41.5 million (of which $0.53 million are Board expenses met by Parliamentary Appropriation), amounting to 0.16% of expected average funds under management.

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. However, if we include forecast performance fees, the forecast cost of managing the Fund in 2014/15 is $148.7 million or 0.57%, compared to the forecast for 2013/14 of $144.3 million or 0.64%.

It is important to emphasise that these are forecast figures and that actual fees will be dependent on market conditions and the availability of suitable investment opportunities and access points. Actual performance fees paid each financial year are disclosed in our Annual Report.

7. 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 Performance Expectation. These prospective financial statements rely on assumptions with respect to unknown or uncertain future events. Assumptions represent a risk in that actual events may vary from the assumption and that all of the outcomes that may flow from actual events cannot be guaranteed.

These prospective financial statements should be read within the context of the 2014-19 Statement of Intent and this Statement of Performance Expectation. Information in these prospective financial statements may not be appropriate for purposes other than those described.

The Board authorised the issue of these prospective financial statements on 30 April 2014. 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.

Contents

Prospective Statement of Comprehensive Income

FOR THE YEAR ENDING 30 JUNE 2015	$000
Revenue from parliamentary appropriation	528
Revenue from New Zealand Superannuation Fund	40,858
Other income	130
Total revenue	**41,516**
Board-related expenses	(688)
Employee remuneration and related expenses	(33,656)
Depreciation	-
Other expenses	(7,172)
Total expenses	**(41,516)**
Net surplus/(deficit)	**-**
Other comprehensive income	-
Total comprehensive income for the year	**-**

Prospective Statement of Financial Position

AS AT 30 JUNE 2015	$000
ASSETS	
Current assets	
Cash and cash equivalents	575
Trade and other receivables	246
Related party receivables	8,119
Non-current assets	
Property, plant and equipment	-
Total assets	**8,940**
LIABILITIES	
Current liabilities	
Trade and other payables	779
Accrued employee benefits	7,065
Lease incentive	75
Non-current liabilities	
Lease incentive	521
Total liabilities	**8,440**
Net assets	**500**
EQUITY	
Accumulated surplus	-
General equity reserve	500
Total public equity	**500**

Prospective Statement of Changes in Public Equity

FOR THE YEAR ENDING 30 JUNE 2015	$000
Balance at 30 June 2014	**500**
Profit for the year	-
Other comprehensive income	-
Total recognised revenue and expense for the year	**-**
Balance at 30 June 2015	**500**

Prospective Statement of Cash Flows

FOR THE YEAR ENDING 30 JUNE 2015	$000
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash was provided from:	
Receipts from the Crown	528
Receipts from New Zealand Superannuation Fund	37,717
Interest received	34
Other income	78
Total cash inflow from operating activities	**38,357**
Cash was applied to:	
Payments to suppliers	(10,198)
Payments to employees	(28,848)
Goods and Services Tax	(32)
Total cash outflow from operating activities	**(39,078)**
Net cash provided by/(used in) operating activities	**(721)**
Net increase/(decrease) in cash and cash equivalents	**(721)**
Cash and cash equivalents at the beginning of the financial year	1,296
Cash and cash equivalents at the end of the financial year	**575**

Summary of significant accounting policies

GENERAL INFORMATION

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

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

STATEMENT OF COMPLIANCE

The Guardians is 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. They comply with the Public Benefit Entity Accounting Standards (PBE) and other applicable financial reporting standards as appropriate for public benefit entities.

The prospective financial statements of the Guardians of New Zealand Superannuation and Subsidiaries (Group) for the year ended 30 June 2015 were authorised for issue by the Board of Guardians of New Zealand Superannuation on 30 April 2014.

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 Public Benefit Entity Financial Reporting Standard 42: Prospective Financial Statements. These are the first prospective financial statements presented in accordance with PBE Standards.

The prospective financial statements have been prepared on a historical cost basis, are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars (NZD'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 preparation of the prospective financial statements have been applied:

a) Consolidation of subsidiaries

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

Subsidiaries are those entities that are controlled by the Guardians. The prospective 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 results of any subsidiaries that become or cease to be part of the Group during the year are consolidated from the date on which control commenced or until the date such 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 which 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:

REVENUE FROM NON-EXCHANGE TRANSACTIONS

Crown appropriations:

Revenue is recognised from the Crown when it is probable that future economic benefits or service potential associated with an asset will flow to the entity and the fair value of the asset can be measured reliably. To the extent that there is a related condition attached to the asset that would give rise to a liability to repay the amount, deferred income is recognised instead of revenue.

Summary of significant accounting policies (continued)

REVENUE FROM EXCHANGE TRANSACTIONS

Rendering of services

New Zealand Superannuation Fund reimbursement of costs:

Revenue from the rendering of services is recognised by reference to the stage of completion when the transaction can be measured reliably. The stage of completion is measured by the proportion of costs incurred to date, compared to the total costs of the outputs.

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, it is recognised as part of the related asset or expense.

Cash flows are included in the Prospective Statement of Cash Flows on a gross basis. The GST components of cash flows arising from investing and financing activities, which are recoverable from, or payable to, the taxation authority, are classified as operating cash flows.

d) Taxation

The Guardians is a public authority in terms of the Income Tax Act 2007 and consequently is exempt from income tax.

e) Receivables

Short-term receivables are stated at their estimated realisable value, net of impairment allowance.

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 difference between the carrying amount of the receivable and the present value of 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 expenses directly attributable to bringing the item to working condition for its intended use.

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 Prospective 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. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

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 Prospective Statement of Comprehensive Income.

Where an impairment loss subsequently reverses, the carrying amount of the item is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount which would have been determined had no impairment loss been recognised for the item in prior years. A reversal of an impairment loss is recognised in the Prospective Statement of Comprehensive Income immediately.

The 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 pre-tax 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 being 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 that will write off the cost of the assets to their estimated residual value over their useful lives.

The useful lives 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 three 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, incentives and sick leave when it is probable that settlement will be required and such benefits 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 that are not expected to be settled within 12 months are measured at 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. The estimated future cash flows are based on likely future entitlements accruing to staff, based on years of service, years to entitlement, the likelihood that staff will reach the point of entitlement, and contractual entitlement information.

Summary of significant accounting policies (continued)

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 Prospective 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 Prospective 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.

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 Prospective Statement of Financial Position and all revenues and expenses in relation to financial instruments are recognised in the Prospective Statement of Comprehensive Income.

Financial assets and financial liabilities are recognised in the Prospective 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 it currently 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) Prospective Statement of Cash Flows

The following are the definitions of the terms used in the Prospective 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 includes cash balances on hand, cash held in bank accounts, demand deposits and other highly liquid investments with an original maturity of three months or less.

r) Changes in accounting policies

Other than those disclosed above, there have been no changes in accounting policies. The accounting policies have been applied consistently throughout these prospective financial statements.

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 SERVICE LEAVE

The key assumptions used in calculating the long service leave liability include the discount rate, the likelihood that the employee will reach the required level of service, and the salary inflation factor. Any changes in these assumptions will affect the carrying amount of the liability. Expected future payments are discounted using forward rates derived from the yield curve of New Zealand government bonds. The discount rates used have maturities that match, as closely as possible, the estimated future cash outflows. The salary inflation factor has been determined after considering the historical salary inflation patterns.

EMPLOYEE ENTITLEMENTS - LONG-TERM PORTION OF INCENTIVE

A component of the incentive scheme is based on the long-term performance of the Fund. The calculation of this portion of the incentive liability utilises assumptions regarding the future performance of the Fund, the employee's average salary over the vesting period and the percentage of service rendered. The key variable is the performance of the Fund. Should the performance of the Fund differ from the assumption utilised in the calculation of the long-term portion of the incentive liability, this will impact the employee benefits expense in the Prospective Statement of Comprehensive Income and the carrying amount of the incentive liability in the Prospective Statement of Financial Position. The Group manages this risk by using a medium-term expectation of Fund performance.

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 92.4 as at the end of January 2014 to 118.4 full-time equivalent employees by 30 June 2015.

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.

Prospective Statement of Comprehensive Income

FOR THE YEAR ENDING 30 JUNE 2015	$000
INCOME	
Interest income	361,024
Dividend income	285,700
Milk sales	16,514
Fair value changes in investments at fair value through profit or loss	1,935,132
Net foreign exchange gain / (loss)	-
Net operating income / (loss)	**2,598,370**
EXPENSES	
Farm expenses	(20,939)
Depreciation and amortisation	(2,815)
Managers' fees – base	(25,079)
Managers' fees – performance	(28,335)
Custody fees	(4,570)
Other expenses	(66,290)
Profit / (loss) for the year before income tax expense	**2,450,342**
Income tax expense	(593,408)
Profit / (loss) for the year after income tax expense	**1,856,934**
OTHER COMPREHENSIVE INCOME	
Net fair value gains on available-for-sale financial assets	9,757
Gain on revaluation of property, plant and equipment	9,619
Income tax on items of other comprehensive income	-
Other comprehensive income for the year, net of tax	**19,376**
Total comprehensive income for the year	**1,876,310**

Prospective Statement of Financial Position

AS AT 30 JUNE 2015	$000
ASSETS	
Cash and cash equivalents	4,501,453
Trade and other receivables	957,551
Other assets	966
Investments	
Derivative financial instrument assets	499,787
Other financial assets	21,154,123
Agricultural assets	43,476
Investments in unconsolidated subsidiaries	331,574
Total investments	**22,028,960**
Property, plant and equipment	182,808
Intangible assets	584
Total assets	**27,672,322**
LIABILITIES	
Trade and other payables	338,644
Provisions	2,195
Taxation payable	116,944
Deferred Tax liability	181,294
Total liabilities	**639,077**
Net assets	**27,033,245**
EQUITY	
Retained surplus	12,100,679
Available-for-sale reserve	31,326
Land revaluation reserve	19,161
Contributed capital	14,882,079
Total public equity	**27,033,245**

Prospective Statement of Changes in Public Equity

FOR THE YEAR ENDING 30 JUNE 2015	$000
Balance at 30 June 2014	**25,156,935**
Profit for the year	1,856,934
Other comprehensive income	19,376
Total comprehensive income for the year	**1,876,310**
Fund capital contributions from the Crown	-
Capital contributions from the Crown in respect of funding the net cost of New Zealand Superannuation entitlements	11,590,323
Capital withdrawals by the Crown in respect of funding the net cost of New Zealand Superannuation entitlements	(11,590,323)
Balance at 30 June 2015	**27,033,245**

Prospective Statement of Cash Flows

FOR THE YEAR ENDING 30 JUNE 2015	$000
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash was provided from:	
Proceeds from the sale of investments	32,991,469
Dividends received	286,280
Interest received	346,313
Receipts from customers	40,168
Cash was applied to:	
Payment for the purchase of investments	(32,840,541)
Managers' fees	(25,730)
Payments to suppliers	(111,310)
Income tax paid	(894,845)
Net cash provided by/(used in) operating activities	**(208,196)**
CASH FLOWS FROM INVESTING ACTIVITIES	
Cash was applied to:	
Purchases of property, plant and equipment	(60,650)
Purchases of intangible assets	(700)
Net cash provided by/(used in) investing activities	**(61,350)**
CASH FLOW 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	**(269,546)**
Cash and cash equivalents at the beginning of the year	4,770,999
Effects of exchange rate changes on foreign currency cash	-
Cash and cash equivalents at the end of the year	**4,501,453**

Summary of significant accounting policies

These are the prospective financial statements of the New Zealand Superannuation Fund (Fund), 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 objective of the Fund is to reduce the tax burden of the cost of New Zealand Superannuation for future New Zealand taxpayers.

The Fund is managed and administered by the Guardians of New Zealand Superannuation (Guardians). The Guardians was established as a Crown entity by Section 48 of the Act and became operative from 30 August 2002. The Guardians is expected to manage the Fund in a commercial, prudent fashion comprising:

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

The Fund's master custodian is the Northern Trust Company.

Under Section 43 of the Act, the Crown is required to make capital contributions to the Fund for investment based on a percentage of Gross Domestic Product (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. No capital contributions were received during the current year, other than for superannuation entitlement payments.

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 prospective financial statements of the Fund have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP).

The prospective financial statements for the year ended 30 June 2015 were authorised for issue in accordance with a resolution of the Board of the Guardians of New Zealand Superannuation on 30 April 2014.

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 (NZD'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 Fund meets the definition of an investment entity as defined by NZ IFRS 10 and therefore has applied the exception to consolidation. As a result, its investments in subsidiaries are measured at fair value through profit and loss.

These separate prospective financial statements are the only prospective financial statements presented by the Fund.

The following particular accounting policies which materially affect the preparation of 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 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 Prospective 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 Prospective 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 prior to 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 Prospective Statement of Changes 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 prospective financial statements.

c) Income tax

In accordance with Section HR 4B of the Income Tax Act 2007, the income derived by the Fund is subject to New Zealand tax determined by using the rules applying to companies.

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

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 periods 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, the carry-forward of unused tax assets and unused tax losses can be utilised:

(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 which 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.

Summary of significant accounting policies (continued)

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) which have been enacted or substantively enacted at balance date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Fund 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 Fund intends to settle its current tax assets and liabilities on a net basis.

Income tax relating to items of other comprehensive income is recognised in other comprehensive income.

d) Financial instruments

The Fund is party to financial instruments as part of its normal operations. These financial instruments include cash and cash equivalents, derivatives, investments (excluding agricultural assets), receivables and payables. All financial instruments are recognised in the Prospective Statement of Financial Position and all revenues and expenses in relation to financial instruments are recognised in the Prospective Statement of Comprehensive Income.

Financial assets and financial liabilities are recognised in the Prospective Statement of Financial Position when the Fund 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 which the Fund commits to purchase or sell the instrument. Derivatives are recognised on a trade date basis. The Fund offsets financial assets and financial liabilities when it has a current legally enforceable right to set off the recognised amounts and interests and intends to settle on a net basis.

Financial assets are derecognised when the rights to receive cash flows from the investments have expired or the Fund has transferred substantially all of the risks and rewards or ownership. The Fund derecognises a financial liability when the obligation under the liability is discharged, cancelled or has expired.

The Fund classifies its financial assets and financial liabilities into the following categories:

FINANCIAL ASSETS AND FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

Held for trading

All derivatives are classified as held for trading.

Fair value through profit or loss upon initial recognition

These include equity securities, other equity interests and debt instruments. These financial assets are designated upon initial recognition on the basis that they are part of a group of financial assets which are managed and have their performance evaluated on a fair value basis, in accordance with the risk management and investment strategies of the Fund.

AVAILABLE-FOR-SALE

These are unquoted equity instruments where fair value cannot be reliably measured, or where the instrument is not managed on a fair value basis.

LOANS AND RECEIVABLES

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Fund includes in this category amounts relating to cash, reverse repurchase agreements, cash pledged as collateral, unquoted debt instruments and other short-term receivables.

FINANCIAL LIABILITIES AT AMORTISED COST

This category includes all non-derivative financial liabilities. The Fund includes in this category amounts relating to cash collateral received, repurchase agreements and other short-term payables.

e) Investments

Investments are represented by the following: **KEY**

- Financial instruments at fair value through profit or loss (either designated at fair value through profit or loss or held for trading):
  - Equities **(i)**
  - Fixed income securities **(ii)**
  - Derivatives **(iii)**
  - Collective investment funds **(iv)**
  - Certain private equity investments **(v)**
  - Unlisted unit trusts **(vi)**
  - Insurance-linked investments **(vii)**
  - Unlisted debt instruments **(viii)**
- Available-for-sale financial instruments:
  - Certain private equity investments **(ix)**
  - Other available-for-sale investments **(x)**
- Loans and receivables: unlisted debt instruments **(xi)**
- Agricultural assets - forests and livestock (refer accounting policies (k) and (l))

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, e.g. trading commission, are expensed immediately in the Prospective Statement of Comprehensive Income.

Subsequent measurement

Subsequent to initial recognition, these investments are recorded at fair value and are classified into the category 'at fair value through profit or loss'. The Guardians manages and evaluates 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 Prospective Statement of Comprehensive Income.

Determination of fair value

Fair value is an estimate of the amount of consideration that would be agreed upon in an arm's 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 on the relevant exchange as of the close of business at balance date.

(ii) Highly liquid fixed income securities and equity-linked notes 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 income 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 which 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 quoted 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, including independent valuations, valuation models based on the price of recent investments, earnings multiples or discounted cash flows. Certain private equity investments are classified as available-for-sale. The accounting policy for these investments is outlined under (ix).

Summary of significant accounting policies (continued)

(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.

(viii) Unlisted debt instruments including fixed and floating rate instruments that form part of an investment into a private equity investment may be designated at fair value through profit or loss. These assets are valued by a suitably qualified independent valuer who ascribes an enterprise value to the entire private equity investment and apportions that value across the instruments held, including the debt instruments. Any unlisted debt instruments that are not designated at fair value through profit or loss are classified as loans and receivables and are carried at amortised cost. Refer to (xi) below.

AVAILABLE-FOR-SALE FINANCIAL INSTRUMENTS

(ix) Certain private equity investments 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 investments cannot be reliably measured where the entity's prospective 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, 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 in the Prospective Statement of Comprehensive Income.

(x) Other available-for-sale investments include investments in cooperative and processing companies. The Fund is required to hold these investments to facilitate farming investment operations. As such, the Fund is normally unable to sell these investments without disrupting farming investment operations. 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 in the Prospective Statement of Comprehensive Income.

LOANS AND RECEIVABLES

(xi) 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. Where such assets are not designated at fair value through profit or loss, these assets are carried at amortised cost using the effective interest rate method. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired.

IMPAIRMENT OF FINANCIAL INSTRUMENTS

The Fund assesses, at each reporting date, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an 'incurred loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

DERIVATIVES

The Fund enters into a variety of derivative financial instruments to manage its exposure to foreign currency risk and interest rate risk and to 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 Fund.

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 interest rate swaps is determined using a model, with the key input being interest rates.

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

The fair value of volatility swaps is determined using a discounted cash flow model with the key input being the volatility curve.

The fair value of futures contracts is calculated as 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 or total return swaps (commodity, equity, bond, 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 that 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 other 'over-the-counter' (OTC) swaps is determined using a model, with the key inputs being the expected future cash flows under the swap contract.

The fair value of options is calculated using a Black-Scholes option valuation model or, where the option is traded on an exchange, the exchange price is used to value the option.

'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 Fund immediately recognises the difference between the transaction price and fair value (a 'day 1' gain or loss) in profit or loss in the Prospective Statement of Comprehensive Income. In cases where the fair value is determined using data that 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 instrument.

f) Repurchase and reverse repurchase agreements

Securities sold under agreement to repurchase at a fixed price or at the sale price plus a lender's return at a specified future date are not derecognised from the Prospective Statement of Financial Position as the Fund retains substantially all the risks and rewards of ownership. The corresponding cash received is recognised in the Prospective 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 Fund. 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 Prospective Statement of Financial Position. The consideration paid, including accrued interest, is recorded separately in the Prospective Statement of Financial Position as an investment, reflecting the transaction's economic substance as a loan by the Fund. 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.

Summary of significant accounting policies (continued)

g) Investment entity

The Fund meets the definition of an investment entity as the following conditions exist:

- The Fund obtains and manages funds for the purpose of providing its investor with investment management services;
- The Fund has committed to its investor that its business purpose is to invest funds solely for returns from capital appreciation and investment income;
- The Fund measures and evaluates the performance of substantially all of its investments on a fair value basis;
- The Fund has more than one investment; and
- The Fund has documented exit strategies for its investments.

Although the Fund does not meet all of the typical characteristics of an investment entity (namely, the Fund does not have multiple investors, its investor is not an unrelated party and it does not have ownership interests in the form of equity), management believe the Fund is an investment entity because it has been specifically established as an investment vehicle; it has a diversified investment portfolio with best practice investment policies and procedures in place; it invests funds for the purpose of maximizing returns; and has elected to fair value the majority of its investments where feasible for the purposes of its prospective financial statements.

h) Subsidiaries

Subsidiaries are those entities (including structured entities) that are controlled by the Fund. The Fund controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. The Fund re-assesses whether or not it controls an entity if facts and circumstances indicate that there are changes to one or more of the elements of control.

The Fund's subsidiaries are measured at fair value through profit and loss in accordance with NZ IAS 39 Financial Instruments: Recognition and Measurement.

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.

The Fund's investments in associates are measured at fair value through profit and loss in accordance with NZ IAS 39 Financial Instruments: Recognition and Measurement.

j) Investments in joint ventures

A joint arrangement is a contractual arrangement whereby the Guardians and other parties undertake an economic activity that is subject to joint control. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

A joint operation is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. The Fund does not have any interests in joint operations.

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture.

The considerations made in determining joint control are similar to those necessary to determine control over subsidiaries.

The Fund's investments in joint ventures are measured at fair value through profit and loss in accordance with NZ IAS 39: Financial Instruments: Recognition and Measurement.

k) Forests

Forest assets are predominantly standing trees. These are recognised in the Prospective 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 profit or loss in the Prospective 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 is 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 is recorded at fair value less estimated point-of-sale costs.

Changes in the value of livestock are recognised in profit or loss in the Prospective 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 subsequently 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 and those expenses directly attributable to bringing the item to working condition for its intended use.

SUBSEQUENT MEASUREMENT

Subsequent to initial recognition, plant and machinery, office equipment, computer equipment, motor vehicles and office fit-outs are stated at cost less accumulated depreciation and any impairment in value.

Land, land improvements and buildings are measured at fair value less accumulated depreciation on land improvements and buildings and any impairment losses recognised after the date of revaluation. 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, land improvements and buildings 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 profit or loss, in which case the increase is credited to profit or loss to the extent of the decrease previously charged.

A decrease in carrying amount arising on the revaluation of land, land improvements and buildings is charged as an expense in profit or loss 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, land improvements and buildings are performed with sufficient regularity (at least every three years) 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 surplus.

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 profit or loss in the year in which the item is derecognised.

IMPAIRMENT

All items of property, plant and equipment are assessed for indicators of impairment at each balance date. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

Summary of significant accounting policies (continued)

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 profit or loss in the Prospective Statement of Comprehensive Income unless it relates to land and buildings, 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 which would have been determined had no impairment loss been recognised for the item in prior years. A reversal of an impairment loss is recognised in the Prospective Statement of Comprehensive Income immediately unless it relates to land and buildings, 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 pre-tax 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 of major classes of assets have been estimated as follows:

Land improvements	15 - 50 years
Buildings	25 - 50 years
Plant and machinery	3 - 17 years
Office equipment	3 years
Computer equipment	3 years
Motor vehicles	5 - 12 years
Office fit-out	12 years

The cost of office fit-out is capitalised and depreciated over the unexpired period of the lease (held by the Guardians) or the estimated remaining useful lives of the improvements, whichever is shorter.

q) Intangible assets

SOFTWARE

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 three years. The estimated useful life and amortisation method is reviewed at the end of each annual reporting period.

CARBON CREDITS

Allocations of New Zealand Units (NZU) and/or other carbon credits are initially recognised at fair value where they have been received, or where the Fund is reasonably certain that they will be received, and there is a market-determined price. Other changes in the quantity of carbon credits are recognised as an operating gain or loss based on the fair value at the time of the transaction.

Subsequent to initial recognition, the carbon credits are measured at fair value at the date of revaluation less any subsequent accumulated impairment losses. Fair value for this purpose is determined by reference to an active market. If the carbon credits cannot be revalued because there is no active market, the carbon credits shall be carried at the amount initially recorded less any impairment losses. The carbon credits are assessed to have indefinite useful lives and as such are not amortised but are tested annually for impairment. An impairment loss is recognised when the carbon credits' carrying amount exceeds their recoverable amount. Recoverable amount is the higher of the carbon credits' fair value less costs to sell or value in use.

r) Assets held for sale

Assets and disposal groups classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell. Assets and disposal groups are held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as having been met only when the sale is highly probable and the asset or disposal group is available for immediate sale in its present condition. Management must be committed to the sale, which is expected to qualify for recognition as a completed sale within one year from the date of classification.

Property, plant and equipment are not depreciated once classified as held for sale.

s) 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.

Where there are contingent lease payments, which are assessed to be closely related to the host lease contract, they are recognised as an expense as they arise.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as deferred income in the Prospective 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.

t) Payables

Short-term payables are not interest bearing. They are initially recognised at fair value and subsequently at amortised cost.

u) Provisions

Provisions are recognised when the Fund has a present obligation as a result of a past event, the future sacrifice of economic benefits is probable and when 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.

v) Income recognition

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

INTEREST

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

DIVIDENDS

Dividend income is recognised when the shareholder's rights to receive payment has been established, normally the ex-dividend date. Where the Fund has elected to receive dividends in the form of additional shares rather than cash, the amount of the cash dividend foregone is recognised as income. Any excess in the value of shares received over the amount of cash dividend foregone is recognised as a gain in the Prospective Statement of Comprehensive Income.

SALE OF GOODS

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

w) 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 separately in profit or loss in the Prospective Statement of Comprehensive Income.

Summary of significant accounting policies (continued)

x) Prospective Statement of Cash Flows

The following are the definitions of the terms used in the Prospective 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 Fund and is accordingly not recorded in the Prospective Statement of Cash Flows.

Cash and cash equivalents includes cash balances on hand, cash held in bank accounts, demand deposits and other highly liquid investments with an original maturity of three months or less, which have an insignificant risk of change in fair value.

y) 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 Prospective Statement of Cash Flows on a gross basis. The GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority, is classified as operating cash flows.

z) Changes in accounting policies

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

aa) Significant estimates and judgements

In preparing these prospective financial statements, estimates and judgements have been made concerning the future. These estimates and judgements may differ from the subsequent actual results. Estimates and judgements 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 judgements that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are:

Assessment as an investment entity

Management has concluded that the Fund meets the definition of an Investment Entity as outlined in the Summary of Significant Accounting Policies. These conclusions will be reassessed on an annual basis, if any of the criteria or characteristics change.

Assessment of control, joint control or significant influence

The Fund holds investments in a number of entities that are not considered subsidiaries even though its ownership interest exceeds 50%. Management has concluded that the Fund has no power to direct the relevant activities of these entities and therefore it does not have control of these entities.

The Fund also holds investments in a number of entities that are not considered associates even though its ownership interest exceeds 20%. Management have concluded that the Fund has no power to participate in the financial and operating policy decisions of these entities and therefore it does not have significant influence over these entities.

The Fund holds a 37.3% interest in Datacom Group Limited. Under a Shareholder's Agreement, there are a number of key operating and financial activities that require approval in writing by the Fund, as well as the majority shareholder. As a consequence, it is management's view that the Fund and the major shareholder have collective or joint control of Datacom Group Limited and therefore the investment in Datacom Group Limited is treated by the Fund as a joint arrangement.

The Fund classifies its joint arrangements as joint ventures because the contractual agreements provide the parties with rights to the net assets of the joint arrangements.

Assessment of investments in structured entities

The Fund has assessed which of its investments should be classified as investments in structured entities. In doing so, the Fund has considered voting rights and other similar rights afforded to investors as well as any contractual arrangements in place with these investments.

Management have concluded that certain of its investments meet the definition of a structured entity because:

- The voting rights in the investments are not the dominant factor in deciding who controls the investment;
- The investments have narrow and well-defined objectives to provide investment opportunities to investors.

Determination of fair value of investments

(i) Fixed income securities where the fair value is determined by a pricing vendor.

The vendor uses models that utilise inputs including loan level data, prepayment and default assumptions and benchmark prices for similar securities. Management mitigates the risk of pricing errors by only selecting reputable pricing vendors and by periodically calibrating prices against observed market data.

(ii) Private equity, collective investment fund and unlisted unit trust investments.

Managers and administrators may either use their own models or may engage independent valuers who use models to obtain the fair value of these investments. In addition management may also directly appoint independent valuers to obtain the fair value of certain investments where this information is unable to be provided by a manager or administrator. Model inputs may include the price of recent transactions, earnings multiples or discounted cash flows.

(iii) Derivatives where the fair value is determined by a pricing vendor, broker or counterparty.

The pricing vendor, broker or counterparty uses models to price derivatives where the inputs may include current and forward exchange rates, estimates of cash flows, interest rates, futures prices, default rates, credit spreads, volatility curves, indicative prices for similar assets and discount rates. Management mitigates the risk of pricing errors by only selecting reputable vendors, brokers and counterparties and by periodically calibrating prices against observed market data.

Determination of fair value of land, land improvements and buildings

Valuations of land, land improvements and buildings are provided by an independent valuer who uses a discounted cash flow model, recent transactions or capitalisation of net income model (as appropriate).

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:

(i) investment markets generate returns at a level that is greater or lesser than the rate assumed in this forecast; and

(ii) foreign currency movements.

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