Guardians of New Zealand Superannuation

STATEMENT OF INTENT

For the period commencing 1 July 2007 to 30 June 2010

NEW ZEALAND SUPERANNUATION FUND

1. Statement from the Board

Established under the New Zealand Superannuation and Retirement Income Act 2001 (the Act), the Guardians of New Zealand Superannuation (the Guardians) are a Crown entity which govern the New Zealand Superannuation Fund (the Fund).

The Crown Entities Act 2004 requires the Guardians to prepare an annual Statement of Intent. This is an opportunity for the Guardians to demonstrate how they set and plan to reach their objectives for the next three financial years, commencing 1 July 2007.

The Fund was created to assist future Governments meet the cost of providing retirement income to New Zealanders. Its mandate is set out in section 58(2) of the Act and requires that 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:

(a) best-practice portfolio management;

(b) maximising return without undue risk to the Fund as a whole; and

(c) avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

The legislation does not provide further guidance as to what these terms mean and it is left to the Guardians to decide. All decisions relating to the business of the Guardians are made under the authority of the Board of the Guardians (the Board), in accordance with section 53(1) of the Act.

The Guardians aspire to make all New Zealanders feel confident in their ability to manage the Fund and proud of its results. This implies developing the Fund into the country's most respected institutional investor and to be regarded as a centre of excellence internationally.

The Guardians adopt a transparent approach to business. Posted on its website is information on the Fund's history, management team, governance and legislation, and investment strategy and performance (see www.nzsuperfund.co.nz).

The Board accepts responsibility for the contents of this Statement of Intent, which aims to provide readers with an insight into the priorities and performance intentions of the Guardians.

DAVID MAY
Chairman

Sir DOUGLAS GRAHAM
Deputy Chairman

2. Background Information

(as required under s141(1)(a) of the Crown Entities Act)

The Guardians and the Fund were created by an Act of Parliament in October 2001. The first Guardians' Board meeting took place in September 2002. Having developed a corporate and investment structure and strategy, the Board appointed a Chief Executive in March 2003. A new Chief Executive Officer joined the Guardians in February 2007, with a total of 27 staff employed as at April 2007.

The initial Fund asset allocation was announced in August 2003, with the first financial contribution to the Fund received from the Government in September 2003 in the form of a portfolio of Treasury bills valued at $2.4 billion. The Fund's investment performance is calculated from this date.

The Fund today comprises a broadly diversified portfolio of assets. The majority of these assets are invested in public markets, with a growing proportion now being allocated to private markets. The Guardians have a long-term investment horizon, with no capital withdrawal allowed under the Act prior to 1 July 2020. The Fund's annualised return on investments since September 2003 is 14.85% as of 31 March 2007. This return is 8.45% above the risk-free rate.

Each financial year, Treasury must calculate the amount of required annual capital contributions to the Fund. They are calculated in accordance with a formula set out in section 43 of the Act. Based on estimates prepared by the Treasury, and forming part of its May 2007 Budget Economic and Fiscal Update, these are expected to average $2.2 billion per year over the next three financial years.

At the beginning of the financial year (FY) 2007/08, the Fund's assets are expected to be $12.8 billion. Over the next three financial years, the balance of the Fund (reflecting contributions from Government and expected investment income earned net of fees and after payment of tax) has been estimated by Treasury as follows:

AS AT 30 JUNE	BALANCE
2008	$16.0 billion
2009	$19.3 billion
2010	$22.9 billion

The nominal size of the Fund is presently around 8.0% of gross domestic product (GDP). Current estimates are that the Fund will peak at around 36.0% of GDP by 2035.

3. Nature and Scope of our Organisation

(as required under s141(1)(b) of the Crown Entities Act)

As outlined in the Statement from the Board (section 1), the Guardians are required to invest the Fund on a prudent, commercial basis and, in doing so, manage and administer it in a manner consistent with:

a) best-practice portfolio management;

b) maximising return without undue risk to the Fund as a whole; and

c) avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

The core task of the Guardians is to develop and execute an investment strategy that meets their mandate, and takes full advantage of the Fund's comparative advantages. The Fund's comparative advantages include its long-term investment horizon and its liquidity due to no capital withdrawals until at least 2020.

The Guardians' core investment beliefs are outlined in Box 1. These beliefs form the basis for the development of the investment strategy.

An important decision for the Guardians is the mix of markets and assets the Fund will on average be exposed to. This desired portfolio is expressed as the Guardians' Strategic Asset Allocation (SAA). The SAA is periodically reviewed and reflects the Fund's investment objectives and risk profile.

In return for taking investment risk, the Guardians seek adequate compensation. The Guardians have set an excess return expectation for their investment activity at 2.5% per annum above the risk-free rate. This return is measured over rolling 20-year periods, although rolling five-year periods provide useful intermediate targets.

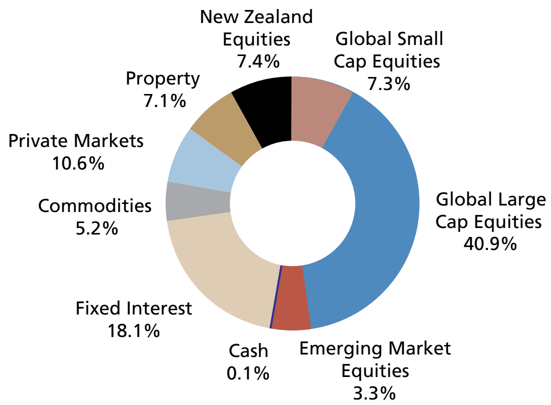
The actual investment activity (e.g. day-to-day stock selection and purchasing) is implemented through formal relationships with external service providers. Presently the Guardians have entered 35 investment manager relationships. In addition, the Guardians have a number of specialist advisory relationships covering investment strategy, research, private market and equity management, proxy voting, and portfolio monitoring for compliance with the Responsible Investment framework (discussed later on in this document). The business model of the Guardians is one of considerable outsourcing.

Box 1–The Guardians' Core Investment Beliefs

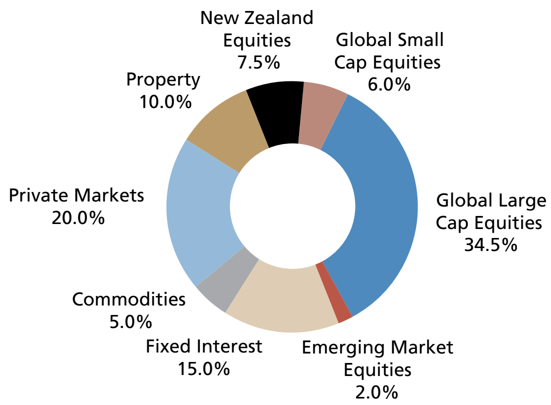
- It is important to be clear about the Fund's return objectives, risk tolerance and the timeframe over which the Guardians will measure results.
- Risk and return are strongly related, and diversification reduces total risk.
- Risk and return characteristics vary over time, and include both a random component and a partly predictable component based on current pricing compared to long-term averages. The longer the time horizon, the greater the predictable component.
- The Fund's long-term investment horizon, combined with the fact that no outflows are required until at least after 2020, means that the organisation is extremely well positioned to capture illiquidity premium.
- Different types of risks can be unbundled to make the portfolio more efficient. Examples include the separation of market risk (beta) and active risk (alpha), and the decoupling of foreign currency exposure and international assets.
- Investment opportunities must be examined on a risk-adjusted basis, post-expenses and foreign taxation, and excluding any benefit from leverage. Individual investments will be assessed on their expected impact upon the total portfolio, rather than the characteristics of the particular sector of transaction.
- There is value in pursuing excess returns in public markets. The Guardians will focus on the expected after-cost benefit on an investment.
- Principal-agent conflicts must be minimised in the Fund's relationship with investment managers. This can be done using financial incentives, transparency around related party transactions, and appropriate governance to promote investors' interests.
- Long-term financial performance can be affected by environmental, social, and governance (ESG) issues. The Guardians have encouraged and will continue to encourage the companies they invest in to meet international standards in these areas.

The current asset allocation and the Fund's longer-term target portfolio are illustrated below. The rationale behind this mix is set out in the 2005 SAA review, which is available on the Fund's website (www.nzsuperfund.co.nz).

Current Portfolio (as at 31/03/07)



Long-term Target Portfolio



Central to the Guardians' approach is the premise that diversification makes a portfolio more efficient. The combination of the Fund's long investment horizon, and no withdrawals for a very long period of time, means the Guardians are able to diversify the portfolio more widely than the average investor.

As can be seen from the asset allocation graphs, the Guardians are aiming to have at least one-third of the Fund's assets invested outside of public markets. The private market includes assets such as property, private equity, infrastructure, commodities, and timber. Presently, the Guardians have just over one-fifth of the Fund invested in such sectors.

The Guardians are also concentrating on their active management programme in public markets. While the risk attached to investing in different asset classes (i.e. market risk or "beta") will always dominate the Fund's total risk, they see value in the generation of additional, uncorrelated, returns from active management (or "alpha").

The long-term target portfolio represents the mix of investments to which the Fund is expected to evolve over the next 3–5 years. The actual mix of investments may vary at any point in time, due to factors such as the availability of investment opportunities and pricing of the respective assets.

In section 6 of this Statement of Intent, the Guardians set out the level of investment returns they expect to earn from the current asset mix.

4. The Guardians' Objectives over the Financial Years 2008–2010

(as required under s141(1)(c) and (d) of the Crown Entities Act)

MANAGING SUSTAINABLE GROWTH FOR THE FUND

The Guardians' business and Fund are at an important stage of their growth cycle. In a short period of time the Fund has grown into New Zealand's largest managed fund with investments across a wide range of public and private assets. This growth is set to continue at a rapid pace, and along with it the complexity involved in its management. In line with this development, the Guardians' focus for the year ahead and beyond is balanced between continuing to seek new investment opportunities that enhance the efficiency of the Fund, as well as invest in its business operations – including its people, systems, and processes.

Managing the Fund's growth on a sustainable basis to the aspired standards is the Guardians' key challenge.

In order to meet this challenge, the Guardians have identified their key priorities for the FY2007/08. Many of these priorities will continue to be implemented over the FY2009 and FY2010 also. The objective of these priorities is to best enable the Guardians to:

- identify, gain access to, and assess potential investments;
- manage the investment process, external relationships, and monitor and report in a cost-effective and operationally robust manner;
- attract and retain the necessary skilled people to undertake the business; and
- meet stakeholders' expectations of transparency and professionalism.

The order of these key priorities is not intended to reflect their relative importance.

4.1 Ensure that the Guardians' investment activities are able to respond appropriately to changing opportunities

The Guardians will assess the extent to which the Fund's asset mix should, if at all, respond to short-term changes in market pricing. The practical challenges include accurately assessing prospective returns from such strategies, assessing the appropriate magnitude of any such investments, and being able to undertake the investments in a timely, cost efficient, and disciplined manner.

The cost-benefit of the Guardians developing more in-house treasury capacity will also be explored. The Guardians' investment activities are growing in size and complexity. As such, an increasing portion of market exposure is obtained via foreign exchange, interest rate, and equity derivative transactions. These transactions can also be used to smooth short-term fluctuations in market prices, assist in maintaining benchmarks, and manage liquidity. As such, there may be advantages to centralising some of these functions.

4.2 Continue to broaden the Guardians' investments consistent with the Strategic Asset Allocation

The past three years have seen the Guardians continue to broaden the types of investments undertaken. Over the next few years the emphasis will be on continuing to diversify asset holdings, in particular into areas such as property and private markets, which includes private equity.

The Guardians will endeavour to build a diversified global property portfolio. Current investments include a holding in global listed Real Estate Investment Trusts and in unlisted New Zealand property. This mix can be expanded both by geography and by considering higher returning opportunities.

In terms of private equity, the Fund's exposure to date has been mainly via "fund of funds" vehicles. The Guardians will endeavour to augment this in time by selected exposure to high-quality funds. However, obtaining access to these funds is often difficult. Investment in these activities is contingent upon completing detailed sector strategies and business cases for each programme.

4.3 Maximise the Guardians' ability to attract, retain, motivate, and manage their people

The growing size and complexity of the Guardians' business will necessitate being able to attract, retain, train, and motivate the necessary people. The Guardians plan to increase staff numbers over coming years to meet their business objectives.

To manage this growth, the implementation of a human resource framework that includes all relevant policies and procedures will be necessary. The success of this framework in terms of appointments made and human capital development will be a determinant of the Guardians' business success, investment strategy, and business model in the medium term.

4.4 Complete the custodian transition project and assess new opportunities with the custodian for business efficiencies

The Guardians appointed Northern Trust Corporation as their new custodian in January 2007. The transition to Northern Trust is a complex and critical challenge, and will continue into the FY2007/08. A significant focus will be to ensure that the transition is sound and that the benefits of the transition are fully realised.

4.5 Review the Guardians' delegations, organisation, structure, policies, and procedures, to ensure they are best aligned to facilitate the Fund's activities

To improve the Fund's efficiency and ensure the ongoing integrity of investment decisions, a framework of more formalised policies and decision-making processes is being embedded into the business. This includes committee structures for business management and investment decisions, as well as ensuring there is full alignment of the Guardians' policies and procedures – from Board delegations through to individual job descriptions and performance assessments.

The organisation structure of the Guardians will also be reviewed to ensure it is capable of managing the planned growth in staff numbers, and the sustained growth in the Fund over coming years.

4.6 Develop and begin implementing a knowledge management framework that includes policies, procedures, and systems, which best meets the Guardians' business

Investment involves identifying opportunities, assessing these against the Fund's objectives, being able to execute the deal, and managing the asset and/or investment relationship on an ongoing basis. Knowledge management is critical to all of these tasks and the success of the Guardians' business. As the Fund grows in size and diversity, and the Guardians' staff numbers grow, so will the challenge of managing information flows.

Over the course of the next financial year, the Guardians' business processes will be mapped and documented, ensuring they are consistent with both best-practice internationally and the delegations, policies, and procedures of the Guardians. Systems will also be developed to manage investment information, including that which enables the Guardians to regularly reassess their conviction in a particular investment, and monitor investment managers on a cost-effective basis.

4.7 Undertake a review of the Guardians' vision and values to ensure they are consistent with the Guardians' strategic plan

The Guardians are approaching their fifth year in operation. It is thus timely to review the vision of the Guardians and ensure that it is consistent with achieving the mandate of best-practice portfolio management and supporting the reputation of New Zealand in the global community.

This review is also timely given the planned growth in staff numbers, to ensure that the values of the organisation are well identified, consistent with achieving the vision, and reflected in performance assessments. As such, a vision and values review process will occur over the course of FY2007/08.

4.8 Review and revise where necessary the Guardians' 'responsible investment' framework to ensure it remains consistent with the Guardians' mandate and policy and procedures

The Guardians have developed a responsible investment framework to assist them meet their legal mandate. As responsible investment is a rapidly evolving and complex area, the Guardians are committed to keeping this framework in line with best practice. The framework will form the basis for developing and implementing the responsible investment action plan for 2007/08. Any developments in this area will be communicated as appropriate, and investment/divestment or other corporate actions will be taken as appropriate.

4.9 Enhance the management and financial reporting framework for both the Guardians' executive and Board to ensure this best enables these parties to effectively discharge their duties

In line with the growth of the Fund and Guardians' staff, the monitoring and reporting to management and the Board must keep pace and facilitate effective decision making.

The Guardians are committed to reviewing all executive and Board reporting, to ensure sufficient coverage is being provided on all relevant portfolio, human resource, financial, operational, and legal matters. Costs are also a particularly important focus for the organisation. During 2007/08 the organisation will focus on understanding the key drivers of its costs, both internally and by comparison with peer organisations.

4.10 Review and implement a communications strategy

To manage the reputation of the Guardians consistent with its vision, the communications strategy is to be reviewed and implemented. The revised strategy will cover both internal and external communication issues, and aim to ensure that the organisation is well understood and able to address any risks.

The Guardians have also kept in mind their mandate when identifying their key priorities, as outlined in the Table below.

MANDATE	KEY PRIORITIES
Best-practice portfolio management	Priorities 1, 2, 4, 5, 6, 7, 9
Maximise return without undue risk to the Fund as a whole	Priorities 1, 2, 3
Avoiding prejudice to New Zealand's reputation as a responsible member of the world community	Priorities 8, 10

5. Judging the Guardians' Performance

(as required under s65 of the NZ Superannuation and Retirement Income Act)

The Guardians are focused on ensuring the achievement of their key priorities. In order to be able to measure progress on the priorities, performance indicators have been agreed to with the Board. These performance indicators are outlined below.

The Guardians have also identified risks to their performance and listed actions to manage these risks (see Box 2).

In February 2007 the Board agreed to a remuneration bonus scheme that includes both financial performance indicators related to the Fund's return, as well as non-financial performance indicators that relate in large part to the achievement of the key priorities.

The non-financial performance indicators come under three broad headings: Completion of the business plan objectives; Compliance with internal policies and procedures, and satisfactory internal and external audit results; and Satisfactory reporting and effective communications to key stakeholders.

The Board will monitor progress through reports at the monthly Board meetings and regular updates from management, and will report the Guardians' performance against these performance indicators at the end of the financial year as part of their Annual Report.

Priority 1: Ensure that the Guardians' investment activities are able to respond appropriately to changing opportunities through

- Completing a business case assessing the net benefits of a more dynamic investment strategy.
- If viewed as appropriate, ensuring that suitable disciplines are put in place to manage such a strategy.
- Completing a business case as to the net benefits of in-house treasury capabilities, including foreign exchange, equities, and fixed interest.

Priority 2: Continue to broaden the Guardians' investments consistent with the Strategic Asset Allocation through

- Presenting a private equity market business strategy that includes an assessment of the net benefits.
- If viewed as appropriate, investing further in the resource capacity to participate in this market.*
- Developing a property market investment capacity and continuing to invest in identified opportunities.*

Priority 3: Maximise the Guardians' ability to attract, retain, motivate, and manage their people through

- Completing the implementation of a human resources framework that appropriately rewards people, develops their skills and knowledge, and also makes explicit the responsibility and accountability expected of employees.
- Successfully employing the resources required to sustain the Fund's growth.*

* The performance indicators identified with an asterisk will be multiple-year activities, with the work continuing into FY2009/10.

Priority 4: Complete the custodian transition project and assess new opportunities with the custodian for business efficiencies through

- Achieving management, audit, and Board sign-off for the transition project. Following the end of the physical transfer of assets, the transition project will be benchmarked against the objectives outlined in the project execution plan and will require formal internal and external audit sign-off.
- Completing an analysis of whether the objectives identified in the Custody Review Project have been satisfied.
- Completing a business case for accessing any further custodian capabilities and opportunities to gain new efficiencies outside the scope of the initial transition project.

Priority 5: Review the Guardians' delegations, organisation structure, policies, and procedures, to ensure they are best aligned to facilitate the Fund's activities through

- Obtaining internal acceptance and auditor agreement that the delegations, policies, and processes are adequate and aligned to the needs of the Guardians.*
- Establishing and introducing an organisation business model that is supported and controlled by formal policies and procedures that best facilitate the Guardians' business, including committees.

Priority 6: Develop and begin implementing a knowledge management framework that includes policies, procedures, and systems, which best meets the Guardians' business through

- Completing the development of the knowledge management framework and beginning its implementation, commencing with a document management system.*
- Initiating the development of an external relationship management system that improves the existing collaborative process for monitoring investment managers, enables better tracking of potential investment/investment relationships, and collates investment information centrally.*

Priority 7: Undertake a review of the Guardians' vision and values to ensure they are consistent with the Guardians' strategic plan through

- Completing a vision and values process that includes input from all Guardians' staff.
- Incorporating the resulting values in staff performance appraisals.
- Completing a comparative analysis study for the Guardians against other relevant international fund managers.

Priority 8: Review and revise where necessary the Guardians' 'responsible investment' framework to ensure it remains consistent with the Guardians' mandate and policy and procedures through

- Ensuring that the Statement of Investment Policies and Procedures is updated due to the rapidly evolving area that is responsible investment.*
- Ensuring relevant risk management systems are in place to monitor the portfolio and potential investments and undertaking any necessary actions such as to engage with firms or divest.
- Implementing a communications strategy to explain any evolution in the Guardians' responsible investment strategy.

---

* The performance indicators identified with an asterisk will be multiple-year activities, with the work continuing into FY2009/10.

Priority 9: Enhance the management and financial reporting framework for both the Guardians' executive and Board to ensure this best enables parties to effectively discharge their duties through

- Completing the development and implementation of management and financial reporting for the Guardians' executives.
- Implementing a standardised reporting template for the Board that comprehensively and efficiently highlights all relevant aspects of the Guardians' activities. This will be in the form of a "dashboard" type of report to provide visibility and commentary on the organisation's performance against both financial and non-financial performance targets.
- Enhancing the management and financial reporting framework for the Guardians' executive to provide improved visibility of performance by aligning and expanding reporting of actual versus budget costs at cost centre level based on the revised organisational structure.
- Completing the analysis of the benchmarking survey (CEM data) so as to ensure the Guardians' cost benchmarks are relevant and accurate.
- Improving forecasting and analysis of costs for the Fund in order to provide better visibility of performance against peers and to better understand the impact of economies of scale.*

Priority 10: Review and implement a communications strategy through

- Completing, communicating, and implementing the communications strategy (both internal and external). The Guardians will aim to communicate their objectives and results via appropriate, new channels and specific programmes to support transparency, accountability, and responsibility.
- Completing the business continuity and crisis management communications strategy. The Guardians will aim to identity a couple of key disaster scenarios, and develop and implement appropriate plans in case of market changes and reputational risks.

---

* The performance indicators identified with an asterisk will be multiple-year activities, with the work continuing into FY2009/10.

Box 2–Risks to the Performance of the Fund and Actions

(as required under s65 of the NZ Superannuation & Retirement Income Act)

The Guardians operate a holistic approach to risk management that identifies inherent and current risks.

The **inherent** risks which face the organisation include:

- the systemic collapse of financial market returns;
- inappropriate SAA or investment execution;
- activities that may prejudice New Zealand's reputation; and
- inadequate performance or failure of the custodian.

During FY2006/07, the Board reviewed the risk controls in place, and assessed the **current** risks. Five potential current risks that the Guardians face when managing the Fund's growth were identified:

- inadequate resource planning for the execution of the investment strategy;
- inadequate growth management practices;
- an inability to attract and retain capable staff;
- inadequate long-term investment performance; and
- ineffective processes and project management controls.

These current risks could directly impact the Guardians' performance if not managed appropriately.

The FY 2007/08 Key Priorities and the Performance Indicators directly address the current risks as outlined in the Table below.

RISKS	KEY PRIORITIES
Inadequate resources planning for the execution of the investment strategy	Priorities 3, 4, 5, 6, 8, 9
Inadequate growth management practices	Priorities 3, 4, 5, 6, 7, 9
An inability to attract and retain capable staff	Priorities 3, 5, 7, 10
Inadequate long-term investment performance	Priorities 1, 2, 10
Ineffective processes and project management controls	Priorities 4, 5, 6, 7, 8

6. Estimating Returns for the Fund

(as required under s65 of the NZ Superannuation and Retirement Income Act)

6.1 Estimating a Return for 2007/08

Section 65 of the New Zealand Superannuation and Retirement Income Act requires the Guardians to comment on their expectations about the performance of the Fund over the next financial year in sufficient detail to enable meaningful assessment against this at the end of the year. The Guardians believe the purpose of this requirement is to be encouraged to reflect their views about the current investment environment and its likely impact on earnings.

The Guardians have no particular confidence in predicting what might happen to returns in any near-term sense. However, as the investment horizon lengthens, this confidence improves – based on statistical analysis and 'mean-reversion' in asset prices.

Consistent with the strong investment returns over the last few years, the Guardians observe that most asset classes are presently highly priced. Therefore, it is likely that over the next decade the Fund will deliver a return lower than the long-term earning rates estimated in the SAA (See Box 3).

The Guardians' estimate for the next decade is made up as follows:

- ***The risk-free rate @ 5.2%***

  This is the Guardians' estimate of the yield on 90-day New Zealand Treasury bills measured fortnightly in line with contributions to the Fund. While there is no specific market mechanism for pricing in the future expected rate of return on such short-term securities, the pricing of longer-term Government debt provides useful information in this area.

  As of 31 March 2007, current bond yields reflect the expectations of finance market participants about future levels of interest rates, together with a premium for holding longer-term debt ('the term premium'). At the end of March 2007, the New Zealand 10-year bond yield was 5.7%. Separating the implied rate of return for cash from the term premium is a judgement, however some guidance is offered by considering average yield curve slopes over long periods both in New Zealand and abroad. Based on this analysis, the term premium for 10-year debt is estimated to be 0.5% which suggests the expected long-term cash rate is 5.2% p.a. In the Guardians' view, this is a reasonable expectation for the average level of risk-free return over the next 10 years.

- ***The reward for market risk (beta) @ 2.4%***

  The reward for market risk is defined as the margin between the risk-free rate and the return that would be generated if the portfolio was invested in line with the SAA and all of the Fund's investments performed in line with their benchmarks.

  The Guardians' modelling generates an expected return over the next 10 years of 2.4% (expressed as an annual compound rate for the period consistent with the way the Guardians report their returns). This 10-year estimate has a volatility of around 3.0% (i.e. a two-thirds probability of falling in the range of 0.6% below the risk-free rate to 5.4% above it.

6.1 Estimating a Return for 2007/08 (contd)

- ***The reward for active management (alpha) @ 0.5%***

  The return from active management is, in theory, independent of the performance of underlying markets. Accordingly, the Guardians' estimate of the contribution of active management (alpha) to total returns is not reduced by current market pricing in the way that their estimate of beta is. Not all of their publicly traded assets are actively managed. Presently the Guardians take almost no active risk in their fixed interest portfolio and a component of their equities and listed property assets is passively managed. The estimate for alpha needs to reflect this. In addition, it is very difficult to distinguish the alpha and beta in private market assets like timber and private equity. These issues aside, the Guardians estimate the total return across the portfolio will be lifted by 0.5% from active management.

  This means the estimated nominal average return over the next 10 years is 8.1% p.a.

  It is very important to note there is considerable uncertainty around this mid-point estimate. This is illustrated by the Guardians' assumption that they have a two-thirds probability of falling in the range of 5.1% p.a. to 11.1% p.a. and a 95.0% probability of falling in the range of 2.0% to 14.3%.

  This estimate for total nominal average return is close to the estimate from last year but lower than in previous years. In 2003/04 the Guardians' estimate was 9.2% p.a. This was lowered to 9.0% in 2004/05, 8.65% in 2005/06 and 8.2% in 2006/07. The fall in expected returns from the initial expectations in 2003/04 reflects the subsequent fall in the 10-year Government bond yields and very strong equity and property markets over this period, that have compressed their expectations of future earnings.

6.2 How does performance to date compare with the Guardians' earlier forecasts?

In the approximately four years since the Guardians began investing, the excess return over the risk-free rate has been 8.4% (i.e. annualised returns of 14.8% against the risk-free rate of 6.4% for the same period). The Guardians had previously estimated the average expected excess return would be around 3.5% over this period. What does this say about the Fund's forecasting framework?

Despite the significant difference between recent returns and the Fund's estimated average, it is within a two-thirds probability range. Over this period the expected volatility (standard deviation) around the average is approximately 5.5% (down from 10.0% for a single year). This means that with an average expected excess return of 3.5%, the result had a two-thirds probability of being within a range of around 2.0% below the risk free rate to 9.0% above it.

Can the level of excess returns the Guardians have achieved to date be maintained? The Guardians estimate that continuing to generate more than 6.0% p.a. above the risk-free rate over the next 10 years has a probability of only 15.0%.

Indeed, looking beyond the current period of rapid growth, the Guardians anticipate returns in the asset markets to become more unstable and decline. Therefore, the Guardians are continually focused on improving the mix of assets in the Fund to boost returns, and in identifying highly skilled investment managers to add value from active management. The Guardians do think it is important, however, to ensure that readers are realistic about the likely long-term returns for the level of risk the Guardians are taking.

6.2 How does performance to date compare to the Guardians' earlier forecasts? (contd)

The model set up by Treasury to calculate contributions to the Fund, and to estimate its balance, assumes a long-term earning rate of 8.6% (pre-tax but post-fees). This lies within a +/-1 percentage point range of the Guardians' current estimate (7.1% to 9.1%). A link to the Treasury model is on the Fund's website (www.nzsuperfund.co.nz).

Box 3–Estimating the Expected Return for the Fund

Returns on the Fund's assets are expected to come from three sources:

- **The risk-free component:** This is the return on short-term sovereign debt, a proxy for the return attainable with little or no investment risk.
- **Reward for market risk (beta):** The long investment horizon of the Fund, and the lack of need for short-term liquidity, means that the Fund can be invested outside the risk-free markets in the expectation that adequate reward will be received to compensate for the risk involved. The size of the risk premium varies with different types of assets. The SAA reflects the Guardians' view of the most efficient combination of market risk premia (often referred to as 'beta').
- **Reward for active management risk (alpha):** While the combination of market risk exposures is expected to make the main contribution to the Fund's return, the exploitation of market inefficiencies to generate returns from security selection (often referred to as 'alpha' or active risk) is also expected to be relevant. While this has traditionally been achieved by allowing portfolio managers to take positions away from the relevant index exposure in a given asset class, the Guardians are increasingly seeking to capture additional returns through retaining firms' trading decisions that do not expose the Fund to the underlying market exposure.

It must be noted that in some asset classes, the absence of a benchmark for the sector as a whole makes it difficult to clearly distinguish between the return offered by the market (beta) and the excess return from portfolio managers' skill (alpha). This applies to most assets in the unlisted, or private, markets. In these cases, excess returns for active management are often measured with reference to the most appropriate listed equity or debt market proxy plus a margin for the illiquidity or risk.

Box 3–Estimating the Expected Return for the Fund (CONTD)

Estimating returns over varying periods of time: An appropriate starting point for estimating future returns is the long-term risk and review modelling set out in detail in the Guardians' March 2005 'Strategic Asset Allocation Review' (SAA Review), available on the Fund's website (www.nzsuperfund.co.nz). This review considered expected returns and risks over a 30-year horizon. Over a single year, there is much greater variability than over the long-term and a single year estimate is simply the mid-point of a very wide range.

To illustrate, in the SAA Review, the Guardians observed that the expected return over a single year is the risk-free rate plus 4.0% (that is an excess return of 4.0%). The annual standard deviation of this excess return (a measure of volatility) is 10.0%. This means the margins around the expected mid-point of the risk-free rate plus 4.0% are very wide. Indeed, it implies that in two years out of three, the annual return will fall in a range of 6.0% below the risk-free rate to 14.0% above it. In one year out of 20, the annual return would be expected to fall outside a much wider range of 16.0% below the risk-free rate to 24.0% above it.

Lengthening the period for estimating returns produces a much more useful result. For example, the SAA Review notes that the estimated average excess return for a 30-year period is 3.75% but the standard deviation drops from 10.0% to 1.9%. This implies a two-thirds probability that the average return will fall within a range of 1.85% to 5.65% above the risk-free rate. Over the same period, the probability of the Fund's returns exceeding the risk-free rate is approximately 98.0% and the probability of generating an excess return above the risk-free rate of more than 2.5% p.a. is approximately 75.0%.

7. Managing the Organisational Health

(as required under s141(1)(e) of the Crown Entities Act)

7.1 Governance

The Board of the Guardians of New Zealand Superannuation is the governing body of the Fund: it has the authority to "undertake any activity … or enter into any transaction" in order "to manage and administer the Fund". The Board has the power to delegate any of the functions or powers it has to a committee of the Board, or any person, but may not delegate the power to grant a power of attorney or the power to appoint investment managers and custodians.

The Board has developed a Code of Conduct for both itself and management. This covers a diverse range of circumstances and sets minimum standards of behaviour. There is also a commitment to professional development for Board and staff members to ensure the organisation keeps up with emerging best-practice trends.

For the 2007/08 year, the Board intends to operate four Board Committees:

- **Audit and Risk Committee:** Oversees the financial reporting of the Fund, internal and external audit of the Fund, the internal risk management framework and its application, compliance (including tax compliance), the accuracy of key financial statements, and other governance systems.
- **Responsible Investing Committee:** Oversees the implementation of the ethical investment policy (under s61(d) of the Act) and the policy for the exercise of voting rights (under s61(i) of the Act).
- **Employee Policy and Remuneration Committee:** Oversees the development of employment and remuneration policies.
- **Private Markets Committee:** Considers private equity opportunities on an 'as required' basis.

While ultimate responsibility rests with the Board, the objective of the committees is to assist and advise the Board.

7.2 Management structure

The Board has a formal delegation agreement with the Chief Executive Officer who, with the Board's approval, has further delegated some powers to other staff members.

The Guardians are committed to investing in a talented and committed team of people. At the commencement of the 2007/08 year, there will be the equivalent of 30.5 full-time employees. The Board has recognised that the level of internal resources in the organisation needs to increase to effectively respond to the investment opportunities available to the Fund and to manage the business challenges. Therefore, the Guardians expect to see 10 additional staff recruited over the 2007/08 year.

The internal/external service provision cost-effectiveness will also be assessed and monitored. The appointment of legal, tax, human resource, and other expertise in-house should see some external service provision costs plateau or decline.

Over a longer-time horizon, the Guardians may also see a shift in the ratio of outsourced service costs to insourced costs. This ratio will depend on the Guardians' organisational structure and business model.

7.2 Management Structure (contd)

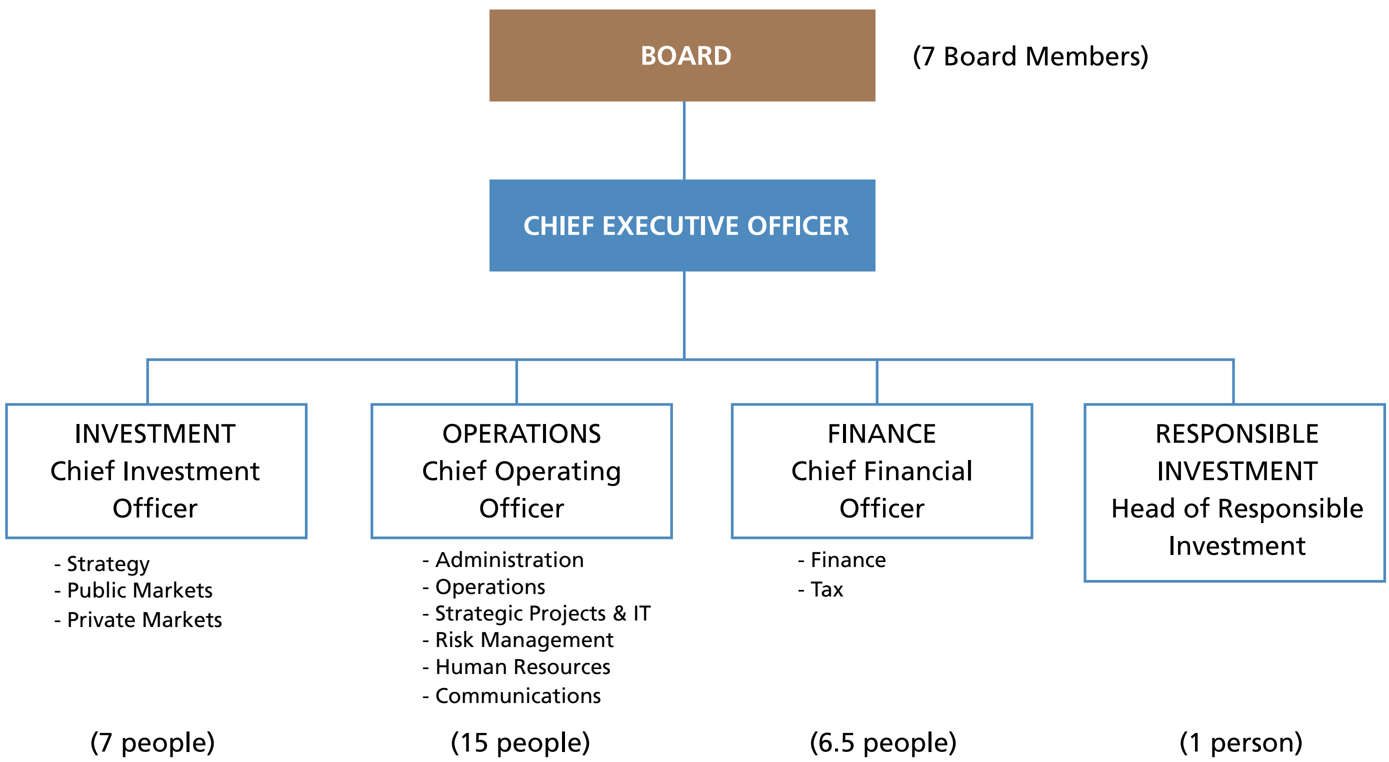
As mentioned in section 5, two of the Guardians' key priorities are to maximise their ability to attract, retain, motivate and manage their team; and to review their vision and values. Both key priorities aim to position the Guardians as an employer of choice.

The management team is fully accountable to the Board for all aspects of the Fund's investment and business performance, and for compliance and control. The chart below provides a snapshot of the organisation's structure as at May 2007. It is estimated as of 1 July 2007, the total staff will be 30.5 (as mentioned in brackets below).

The delegations from the Board to the CEO, and from the CEO to executives, is done by position. However, much of the business of the Guardians is conducted through internal executive committees. These committees include the:

- **Management Committee:** Dealing with the business operations of the Guardians;
- **Investment Committee:** Advising on the investment decisions of the Guardians;
- **Portfolio Committee:** Advising on the performance of the Fund and the Guardians' service providers; and
- **Communications Committee:** Advising on all internal and external communication issues.

The committees have a dedicated executive chairman and secretary and meet regularly. The Guardians' risk management framework (including policies and procedures) maps into these committee structures. The role of the committees is to ensure all key business decisions are robust and appropriately reported and acted upon.



8. Reporting to the Minister Of Finance

(as required under s141(1)(g) of the Crown Entities Act)

The Board provides a quarterly report on the progress of the Fund to the Minister of Finance in addition to its public disclosure on its website (www.nzsuperfund.co.nz).

The legislation clearly gives the Board of the Guardians responsibility for setting the investment strategy for the Fund. Accordingly, the Board would not expect to consult the Minister of Finance on the development or implementation of strategy. From time to time, exemptions from restrictions in broader public sector legislation have been sought and granted from the Minister. Examples include the ability to operate offshore bank accounts to hold Crown assets as part of the portfolio and to use derivatives as part of the investment strategy.

The Minister of Finance may, after consultation with the Board, give directions regarding the Government's expectations as to the Fund's performance, including the Government's expectations as to risk and return. The Act notes that such a direction must be in writing, signed and dated, and not be inconsistent with the Guardians' duty to invest the Fund on a prudent commercial basis. The Guardians must have regard to any such direction and must notify the Minister how they propose to do this as well as report any such directions in their Annual Report.

No directions from the Minister of Finance have been received by the Board to date.

9. Process for Meeting Requirement not to Acquire a Substantial Interest in Another Entity

(as required under s141(1)(h) of the Crown Entities Act)

Section 59 of the Act prohibits the Fund from taking a controlling interest in any other entity. Section 100 of the Crown Entities Act carries a similar restriction.

The Guardians are very conscious of this obligation. The investment guidelines with managers place strict limits around the proportion of a company's market capitalisation each manager can own. The Guardians actively monitor the proportion of issued market securities that the Fund owns through its investment managers to ensure they are not deemed to hold a controlling interest. The Guardians also ensure that, where the threshold for notifying the market of change in their holding in a company is reached, they do this promptly.

From time to time, opportunities to purchase privately traded assets carry associated obligations to take over operating entities specific to that asset. In these cases, the Guardians need to balance the benefit to the Fund of progressing with the transaction against the restriction on taking control of the operating entity.

In the past, the Guardians have had the opportunity to purchase timberland estates which came with existing commercial obligations. Their approach is to continue to consider transactions, and if some investment merits are identified, they will aim to change the ownership structure of the operating entities "as soon as practicable" as is required under the Act. The Guardians seek and follow professional legal and taxation advice on these transactions and ensure that the Minister of Finance is kept informed.

10. Financial Projections for the 2007/08 Year

(as required under s142 of the Crown Entities Act)

Preparation of prospective financial statements

The Guardians have prepared prospective financial statements for both the Guardians (in their role as manager and administrator of the Fund) and for the Fund itself.

They are required to include these prospective financial statements in their Statement of Intent in order to comply with s142 of the Crown Entities Act. 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 31 May 2007. 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.

Transition to IFRS

The year ending 30 June 2008 will be the first year in which financial statements are prepared in accordance with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS").

On conversion to NZ IFRS, the Fund identified two transition adjustments. These related to a movement of the portfolio to bid pricing (as required by NZ IAS 39) and the associated deferred tax impact (as required by NZ IAS 12). The total of these adjustments was posted as a debit to retained earnings totalling $9 million.

On conversion to NZ IFRS the Guardians identified one transition adjustment. This was a reclassification in the balance sheet of computer software from property, plant, and equipment to intangible assets – $47,000 at cost.

Cost allocation model

The expenses of the Guardians are made up of Board-related costs, internal staff and associated costs (e.g. salaries, recruitment, travel, and professional development), office accommodation/services, and limited professional fees (e.g. audit and legal costs for the Guardians but not audit/advisory/legal costs relating to Fund transactions).

Section 52 of the New Zealand Superannuation and Retirement Income Act states that the expenses of the Guardians must be met out of money appropriated by Parliament for that purpose. Section 41(2)(b) provides for money to be paid out of the Fund to meet any obligation that is directly related to the operation of the Fund. The costs of investment managers and custodians are also met directly from the Fund.

Cost allocation model (contd)

Over the past few years there has been considerable discussion over the most appropriate treatment of costs incurred by the Guardians. During 2005/06, agreement on how these would be met was reached with Treasury and the Office of the Auditor General following a review of legal advice and analysis of the experience of similar institutions abroad. This was subsequently endorsed by the Minister of Finance.

Under this approach, those costs incurred by the Guardians in their role as a Crown entity (principally governance, performance reporting, and stakeholder communication) are met from Parliamentary appropriation. These expenses amount to $1.56 million p.a. (GST exclusive). The existing parliamentary appropriation is $1.53 million p.a. (GST exclusive). The difference will be met from expenditure being less than the level of appropriation in the year ended 30 June 2007.

The costs incurred in the establishment and implementation of investment policy, the management of the organisation's outsourced back office, and the financial and risk management of Fund assets are recovered from the Fund. This is the majority of the Guardians' activities with most staff allocated to these roles. The cost of these employees (together with related expenses like office services, travel, professional development) amounts to $17.26 million.

Together this means that the total costs of the Guardians in 2007/08 are expected to be $18.82 million (GST exclusive). This is equivalent to 0.13% of expected average Fund assets over 2007/08.

The Guardians see this model for the treatment of expenses as very appropriate. It places full responsibility for managing both the structure of the investment programme, and the operating costs, on the Guardians. Investment returns will be measured after all operating costs, including all Guardians' expenses, are taken into account. All operating costs, irrespective of whether they are sourced from appropriation or Fund assets, will be consolidated in the financial statements of the Guardians and subject to the reporting and disclosure obligations of the Crown Entities Act.

The Guardians have also prepared prospective financial statements for the Fund. They have assumed that earnings will be broadly in line with their medium-term estimate (i.e. 8.1% p.a. after costs but before New Zealand tax). Some costs are fixed (e.g. audit costs and most advisory services) and can be fairly 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.

GUARDIANS OF NEW ZEALAND SUPERANNUATION AND GROUP

Prospective Income Statement for the year ending 30 June 2008

	$000
Revenue from parliamentary appropriation	1,537
Revenue from New Zealand Superannuation Fund	10,711
Other income	92
Total revenue	**12,340**
Board-related expenses	(431)
Employee remuneration	(8,886)
Depreciation	(102)
Other expenses	(2,852)
Total expenses	**(12,271)**
Net surplus/(Deficit)	**69**

GUARDIANS OF NEW ZEALAND SUPERANNUATION AND GROUP

Prospective Balance Sheet
As at 30 June 2008

	$000
Assets	
Cash and cash equivalents	1,215
Trade and other receivables	1,854
Intangible assets	10
Property, plant, and equipment	50
Total assets	**3,129**
Liabilities	
Trade and other payables	2,525
Total liabilities	**2,525**
Net assets	**604**
Equity	
Accumulated surplus	104
General funds	500
Total public equity	**604**

GUARDIANS OF NEW ZEALAND SUPERANNUATION AND GROUP

Prospective Statement of Changes in Public Equity For the year ending 30 June 2008

	$000
Balance at 30 June 2007	**535**
Profit for the period	69
Total recognised revenue and expense for the period	**69**
Balance at 30 June 2008	**604**

GUARDIANS OF NEW ZEALAND SUPERANNUATION AND GROUP

Prospective Statement of Cash Flows
For the year ending 30 June 2008

	$000
Cash flows from operating activities	
Cash was provided from:	
Receipts from the Crown	1,729
Receipts from New Zealand Superannuation Fund	10,714
Interest received	92
Cash was applied to:	
Payments to suppliers	(4,209)
Payments to employees	(7,171)
Goods and Services Tax	(1,107)
Net cash provided by/(used in) operating activities	**48**
Net increase in cash and cash equivalents	**48**
Cash and cash equivalents at the beginning of the year	1,167
Cash and cash equivalents at the end of the year	**1,215**

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 ("the Guardians"), a Crown entity in terms of the Crown Entities Act 2004.

The Guardians' primary purpose is to manage and administer the New Zealand Superannuation Fund ("the Fund"). It is domiciled in New Zealand and the address of its principal place of business is AMP Centre, 29 Customs Street West, Auckland.

STATEMENT OF COMPLIANCE

The Guardians are a public benefit entity. The prospective 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").

The prospective financial statements of the Guardians of New Zealand Superannuation and Subsidiaries for the year ended 30 June 2008 were authorised for issue in accordance with a resolution of the Board of Guardians on 7 May 2007.

BASIS OF PREPARATION

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

The prospective financial statements have been prepared on an historical cost basis and 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.

This is the first set of prospective financial statements prepared based on NZ IFRS.

The following particular accounting policies which materially affect the measurements in the prospective income statement and prospective balance sheet have been applied:

(a) Budget figures

The budget was approved by the Board of Guardians at the beginning of the year. The budget figures have been prepared in accordance with NZ GAAP, using accounting policies that are consistent with those adopted by the Guardians for the preparation of the financial statements.

(b) Consolidation of Subsidiaries

The consolidated financial statements comprise the Guardians of New Zealand Superannuation and their subsidiaries ("the Group").

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.

(b) Consolidation of Subsidiaries (contd)

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-company transactions, balances, and unrealised profits are eliminated on consolidation.

(c) Revenue

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:

Rendering of services

The Group primarily derives revenue through the provision of outputs to the Crown and to the New Zealand Superannuation Fund, and also derives income from its investments. Revenue is recognised by reference to the stage of completion of outputs provided.

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

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

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.

(d) 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.

Commitments and contingencies are disclosed exclusive of GST.

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.

(e) Taxation

The Guardians are a public authority in terms of the Income Tax Act 1994 and consequently are exempt from income tax.

(f) Accounts receivable

Accounts receivable are stated at their expected realisable value after providing for doubtful and uncollectable debts.

(g) Investments

Investments are recognised and derecognised on trade date where purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at cost, inclusive of transaction costs.

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

(h) 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 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.

Impairment

All items of property, plant, and equipment are assessed for indicators 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 income statement.

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.

Intended for sale

Items of property, plant, and equipment withdrawn from use and intended for sale are recorded at the lower of carrying amount and net market value.

Disposal

On disposal or permanent withdrawal of an item of property, plant, and equipment the difference between the disposal proceeds (if any) and the carrying amount is recognised in the income statement.

(i) 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
Leasehold improvements	3–6 years

The cost of leasehold improvements is capitalised and depreciated over the unexpired period of the lease or the estimated remaining useful lives of the improvements, whichever is shorter.

(j) Intangible assets

Computer software that does not form an integral part of the related hardware is a finite life intangible asset. Intangible assets are recorded at cost less accumulated amortisation and impairment. Amortisation is charged on a straight-line basis over the estimated useful life of 3 years. The estimated useful life and amortisation method is reviewed at the end of each annual reporting period.

(k) Employee benefits

Employee benefits that the Guardians expect to be settled within 12 months of balance date are measured at nominal values based on the accrued entitlements at current rates of pay.

These include salaries and wages accrued up to balance date, annual leave earned to, but not yet taken, at balance date, retiring and long service leave entitlements expected to be settled within 12 months, and sick leave.

The Guardians recognise a liability for sick leave to the extent that absences in the coming year are expected to be greater than the sick leave entitlements earned in the coming year. The amount is calculated based on the unused sick leave entitlement that can be carried forward at balance date, to the extent that the Guardians anticipate they will be used by staff to cover those future absences.

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.

The Guardians recognise a liability and an expense for bonuses where contractually obliged or where there is a past practice that has created a constructive obligation.

(l) Operating leases

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 a liability. The aggregate benefits of incentives are recognised as a reduction of rental expense on a straight-line basis over the period of the lease.

(m) Foreign currency transactions

Transactions denominated in foreign currencies are initially recorded in the functional currency using the exchange rate in effect at the transaction date.

Monetary items receivable or payable in a foreign currency are retranslated at the exchange rate in effect at balance date at the closing rate.

Exchange differences on foreign exchange balances are recognised in the income statement.

(n) Financial instruments

The Group is party to financial instruments as part of its normal operations. These financial instruments include bank accounts, short-term deposits, receivables, and payables. All financial instruments are recognised in the balance sheet and all revenues and expenses in relation to financial instruments are recognised in the income statement.

Financial assets and financial liabilities are recognised in the balance sheet 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 separate accounting policy, all financial instruments are shown at their estimated fair value.

(o) Provisions

Provisions are recognised when the consolidated entity has a present obligation, 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.

(p) Statement of cash flows

Cash and cash equivalents means cash balances on hand, held in bank accounts, demand deposits and other highly liquid investments in which the Group invests as part of its day-to-day cash management.

Operating activities include all activities other than investing and financing activities. The cash inflows include all receipts from the sale of goods and services 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 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.

(q) Equity

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

Changes in Accounting Policies

There have been no changes in accounting policies. All policies have been applied on a basis consistent with previous years.

GUARDIANS OF NEW ZEALAND SUPERANNUATION AND GROUP

Explanation of Transition to NZ IFRS

Under NZ IFRS 1: *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards,* the opening balance sheet is prepared in accordance with the accounting policies effective at the date of its first complete set of NZ IFRS financial statements, being 30 June 2008.

The accounting policies detailed above may need to be adjusted when applied to the first complete NZ IFRS financial statements to reflect the effects of both changes in financial reporting requirements arising from new or revised standards or interpretations subsequent to the date of the special purpose audit report on the opening balance sheet, or changes in the Guardians' circumstances or operations.

Under NZ IFRS, only a complete set of financial statements together with comparative financial information and explanatory notes, can provide a fair presentation of the company's financial position, results of operations, and cash flows in accordance with NZ IFRS.

GUARDIANS OF NEW ZEALAND SUPERANNUATION AND GROUP

Significant Assumptions Adopted in the Preparation of Prospective Financial Statements

The forecast numbers above are based on the key assumption that headcount for the Guardians will increase from 30.5 to 40.5 full-time equivalent employees.

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 above forecasts. Any variance in actual headcount is likely to result in a material reduction of expenses, resulting in a surplus.

NEW ZEALAND SUPERANNUATION FUND

Prospective Income Statement for the year ending 30 June 2008

	$000
Revenue	1,209,881
Share of profit/(loss) of investments accounted for using the equity method	29,523
Other income	30,678
Expenses	
Manager fees	(74,228)
Custody fees	(6,500)
GNZS▲ operating expenses	(11,902)
Other expenses	(23,139)
Profit for the period before income tax expense	**1,154,313**
Income tax expense	(199,831)
Profit for the period after income tax expense	**954,482**

▲ GNZS: Guardians of New Zealand Superannuation

NEW ZEALAND SUPERANNUATION FUND

Prospective Balance Sheet
As at 30 June 2008

	$000
Assets	
Investments	
Cash and cash equivalents	260,497
Investments – financial assets	15,295,096
Timber investments – forest and land	449,106
Total investments	**16,004,699**
Trade and other receivables	75,593
Property, plant, and equipment	71,150
Total assets	**16,151,442**
Liabilities	
Trade and other payables	135,468
Deferred tax liability	141,029
Total liabilities	**276,497**
Net assets	**15,874,945**
Equity	
Retained surplus	3,498,584
Foreign currency translation reserve	(14,385)
Land revaluation reserve	4,883
Contributed capital	12,385,863
Total public equity	**15,874,945**

NEW ZEALAND SUPERANNUATION FUND

Prospective Statement of Changes in Public Equity
For the year ending 30 June 2008

	$000
Balance at 30 June 2007	**12,821,687**
Gain/(loss) on revaluation of timber investments – land	-
Net income for the period recognised directly in equity	**-**
Profit for the period	954,482
Fund capital contributions from the Crown	2,098,776
Balance at 30 June 2008	**15,874,945**

NEW ZEALAND SUPERANNUATION FUND

Prospective Statement of Cash Flows
For the year ending 30 June 2008

	$000
Cash flows from operating activities	
Cash was provided from:	
Dividends received	340,249
Interest received	153,547
Receipts from customers	30,678
Cash was applied to:	
Manager fees	(68,784)
Payments to suppliers	(42,034)
Income tax paid	(270,346)
Net cash provided by/(used in) operating activities	**143,310**
Cash flows from investing activities	
Cash was provided from:	
Proceeds from the sale of investments	11,969,981
Cash was applied to:	
Payment for the purchase of investments	(14,210,678)
Net cash provided by/(used in) investing activities	**(2,240,697)**
Cash flows from financing activities	
Cash was provided from:	
Capital contributions from the Crown	2,098,776
Net cash provided by/(used in) financing activities	**2,098,776**
Net increase/decrease in cash and cash equivalents	**1,389**
Cash and cash equivalents at the beginning of the year	259,108
Effects of exchange rate changes on foreign currency cash	-
Cash and cash equivalents at the end of the year	**260,497**

NEW ZEALAND SUPERANNUATION FUND
Summary of Accounting Policies

GENERAL INFORMATION

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

The Fund is managed and administered by the Guardians of New Zealand Superannuation ("the Guardians"). The Guardians were established as a new Crown entity by section 48 of the New Zealand Superannuation and Retirement Income Act 2001 and became operative from 30 August 2002.

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 ("superannuation entitlements").

The Fund is domiciled in New Zealand and the address of its principal place of business is AMP Centre, 29 Customs Street West, Auckland.

STATEMENT OF COMPLIANCE

The Fund is a profit-oriented entity. The prospective 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"). Compliance with NZ IFRS ensures that the financial statements comply with International Financial Reporting Standards ("IFRS").

The prospective financial statements of the Fund for the year ended 30 June 2008 were authorised for issue in accordance with a resolution of the Board of Guardians on 7 May 2007.

BASIS OF PREPARATION

The prospective financial statements have been prepared in accordance with the New Zealand Superannuation and Retirement Income Act 2001 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.

This is the first set of financial statements prepared based on NZ IFRS.

The following particular accounting policies which materially affect the measurements in the prospective income statement and prospective balance sheet have been applied:

(a) Budget figures

The budget was approved by the Board of Guardians at the beginning of the year. The budget figures have been prepared in accordance with NZ GAAP, using accounting policies that are consistent with those adopted by the Fund.

(b) 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 movements 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 movements in public equity.

(c) 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 1 July 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 financial statements.

(d) Income tax

In accordance with section 76 of the Act the Fund 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 1994.

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 by the balance sheet date. Current tax for current and prior periods is recognised as a liability or asset to the extent that it is unpaid (or refundable).

(d) Income tax

Deferred income tax is provided on all temporary differences at the balance sheet 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:

- except for a deferred income tax liability arising from the initial recognition of goodwill;
- 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
- 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:

- 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
- 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 the balance sheet date. The measurement of deferred tax liabilities and assets reflects the tax consequences of 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 recognised directly in equity is recognised in equity and not in the income statement.

(e) Financial instruments

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

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

(i) Investments

Investments are initially recognised at fair value on a trade date basis. Transaction costs, for example trading commission, are expensed immediately in the income statement. Subsequent to initial recognition, investments are recorded at fair value and are classified into the category "at fair value through profit or loss" except for certain private equity investments which are classified as "available for sale" as outlined below. The Fund manages and evaluates the performance of investments classified as "at fair value through profit or loss" on a fair value basis in accordance with its investment strategy and information about the investments is provided internally on this basis to the Fund's key management personnel. Changes in fair value are recognised in the income statement.

Instruments classified as fair value through profit or loss

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:

- Fixed interest securities are valued at the last quoted bid price on the relevant exchange as of the close of business at balance date.
- Listed securities are stated at the last bid price as quoted on the relevant exchange as of the close of business at balance date.
- Investments in listed unit trusts are stated at the last quoted bid price as quoted on the relevant exchange as of the close of business at balance date.
- Investments in unlisted unit trusts are stated at the last bid price of the unit or security as provided by the investment managers or administrators at balance date.
- Private equity investments are valued on the basis of independent valuations utilising valuation models based on the price of recent investments, earnings multiples or discounted cash flows. For certain private equity investments, where no reliable fair value can be estimated using such techniques, these are initially designated as "available for sale" and are carried at cost less any provision for impairment as outlined below.
- Investments in multi-strategy funds (unlisted open-ended investment funds) are stated at the last bid price of the unit or security as provided by the investment managers or administrators at balance date.

(e) Financial instruments (contd)

Investments classified as "available for sale"

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 above and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments are measured at cost. Transaction costs are included in the cost of the investment.

(ii) Derivatives

The Fund enters into a variety of derivative financial instruments to manage its exposure to foreign currency risk, including forward foreign exchange contracts, and achieve exposure to assets and asset classes, including futures contracts, equity swaps, and over-the-counter commodity swaps. The use of financial derivatives is governed by the Fund's Statement of Investment Policies, Standards, and Procedures approved by the Guardians, which provides written principles on the use of derivatives by the Fund.

Derivatives are recorded at fair value. Fair values are determined using valuation models and broker quotations.

The fair value of derivatives that are not exchange-traded is estimated at the amount that the Fund would receive or pay to terminate the contract at the balance sheet date using discounted cash flow analysis or option pricing models taking into account current market conditions and the current creditworthiness of the counterparties.

The fair value of all forward foreign exchange contracts is determined as a net present value of estimated future cash flows, discounted at appropriate market rates as at balance date. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

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

The fair value of commodity swaps is determined using broker quotations. Commodity swaps are settled net in cash.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not measured at fair value with changes in fair value recognised in profit or loss.

(iii) Receivables

Short-term receivables are stated at their estimated realisable value.

(iv) Payables

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

(f) Investment properties

Initially, investment properties are measured at cost including transaction costs.

Subsequent to initial recognition, investment properties are stated at fair value.

Gains or losses arising from changes in the fair values of investment properties are included in the income statement in the year in which they arise.

Investment properties are derecognised when they have either been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal.

Any gains or losses on the derecognition of an investment property are recognised in the income statement in the year of derecognition.

The fair value of investment properties is determined using accepted industry valuation methods, such as discounted cash flows and comparable purchase transactions. In the first year of ownership, cost is generally considered to be an appropriate estimate of fair value unless there is evidence of a significant change in value.

(g) Forest assets

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

The valuation of the Fund's forest assets is based on discounted cash-flow models. The yearly 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.

(h) 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, the Fund's associates are either 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*) or are equity accounted in accordance with *NZ IAS-28 Investments in Associates*.

(i) Investments in joint ventures

Jointly controlled entities are those entities in which the Fund shares control. Joint control is the contractually agreed sharing of control where the strategic financial and operating decisions require the unanimous consent of the parties sharing control. The Fund's jointly controlled entities are accounted for in accordance with *NZ IAS-39 Financial Instruments: Recognition and Measurement* as investments designated at fair value through profit or loss and, therefore, in accordance with paragraph 1 of *NZ IAS-31 Investment in Joint Ventures,* equity accounting is not required.

(j) 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 profit or loss, in which case the increase is credited to the income statement to the extent of the decrease previously charged.

A decrease in carrying amount arising on the revaluation of land 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.

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

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 the balance sheet 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.

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 income statement 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 financial performance unless it relates to land in which case it is treated as a revaluation decrease.

(j) Property, plant, and equipment (contd)

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 income statement 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.

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.

(k) 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:

Office equipment	3 years
Computer equipment	3 years
Leasehold improvements	6 years

The cost of leasehold improvements is capitalised and depreciated over the unexpired period of the lease or the estimated remaining useful lives of the improvements, whichever is shorter.

(l) Income recognition

Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

(l) Income recognition (contd)

Dividend income is recognised when the shareholders rights to receive payment have 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 income statement.

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.

Stock-lending fees and underwriting commission are recognised as earned.

(m) 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 in the income statement. Realised foreign currency gains and losses represent gains and losses upon sale of investments that relate to foreign exchange movements in assets, and gains and losses upon settlement of forward foreign exchange contracts. Unrealised foreign exchange gains and losses represent the translation of foreign dominated assets and liabilities, including forward foreign exchange contracts.

(n) 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 period, 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 movements 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 and to any monetary liability or forward foreign exchange contract designated as a hedge of that operation are transferred out of the foreign currency translation reserve and recognised in the income statement when the gain or loss on disposal of the foreign operation is recognised.

(o) 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 investments. Investments include securities not falling within the definition of cash, including cash flows from the settlement of forward foreign exchange contracts.

Financing activities are those activities relating to capital contributions and to payments of superannuation entitlements (from 2020). As the current funding of superannuation entitlements by the Crown 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 statement of cash flows.

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

(p) 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.

NEW ZEALAND SUPERANNUATION FUND

Explanation of Transition to NZ IFRS

Under NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards*, the opening statement of financial position is prepared in accordance with the accounting policies effective at the date of its first complete set of NZ IFRS financial statements, being 30 June 2008.

The accounting policies detailed above may need to be adjusted when applied to the first complete NZ IFRS financial statements to reflect the effects of both changes in financial reporting requirements arising from new or revised standards or interpretations subsequent to the date of the special purpose audit report on the opening balance sheet, or changes in the Fund's circumstances or operations.

Under NZ IFRS, only a complete set of financial statements together with comparative financial information and explanatory notes, can provide a fair presentation of the company's financial position, results of operations, and cash flows in accordance with NZ IFRS.

NEW ZEALAND SUPERANNUATION FUND

Significant Assumptions Adopted in the Preparation of Prospective Financial Statements

Capital contributions from the Crown are determined using the Treasury's fund forecast model which in turn relies on a number of macroeconomic and government budgetary factors.

Investment returns for the forecast period are based on internal modelling of 10-year returns.

The distribution of investments between various categories is driven by the Fund's SAA.

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

Material differences between the forecast and actual results 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.

APPENDIX – GLOSSARY

Crown entity: A type of organisation that forms part of New Zealand's state sector, which is managed consistent with the requirements of the Crown Entities Act 2004.

Guardians of New Zealand Superannuation (Guardians): An autonomous Crown entity which manages, administers, and invests the New Zealand Superannuation Fund (established under the New Zealand Superannuation and Retirement Income Act 2001).

Board of the Guardians of New Zealand Superannuation (Board): A body responsible for setting the investment policies of the New Zealand Superannuation Fund and for overseeing its operations. The Board must consist of at least five, but not more than seven members appointed by the Governor-General on the recommendations of the Minister of Finance (established under the New Zealand Superannuation and Retirement Income Act 2001).

New Zealand Superannuation Fund (Fund): A Crown-owned fund financed by capital contributions from the Crown, to assist future Governments to meet the cost of providing retirement income to New Zealanders (established under the New Zealand Superannuation and Retirement Income Act 2001).

The glossary of terms relates to the Guardians' organisation, to the investment strategies, activities, and performance of the New Zealand Superannuation Fund specifically, and to investing generally.

Active management: An investing strategy that seeks returns in excess of a specified benchmark.

Active return: Return relative to a benchmark. If a portfolio's return is 5.0%, and the benchmark's return is 3.0%, then the portfolio's active return is 2.0%.

Alpha: That part of a portfolio's return not explained by market factors. Alpha is the result of manager skill applied through active management.

Assets: Anything owned that has value and is measurable in terms of money.

Asset classes: Categories of assets, such as shares, bonds, real estate.

Asset mix: The proportion of assets held in the portfolio in percentage terms.

Benchmark: A standard against which the performance of a security, index, or investor can be measured.

Beta: A measure of a security's or a portfolio's volatility, or systematic risk, in comparison to the market as a whole.

Bond: A debt investment with which the investor loans money to an entity (company or government) that borrows the funds for a defined period of time at a specified interest rate.

Commodities: Tangible products, such as metals, crude oil, or grain.

Custodian: An independent organisation entrusted with holding investments and settling transactions on behalf of the owner. The custodian maintains the financial records for the investments and may perform other services (such as performance measurement, mandate compliance, etc) for the owner as well.

Environmental issues: Issues relating to the natural environment including resource use, pollution, climate change, energy use, ecology and nature conservation that affect or are affected by companies and their operations.

Equities: Securities that signify ownership in a corporation and represent a claim on part of the corporation's assets and earnings.

Fixed interest securities: Fixed interest securities generate a predictable stream of interest, and include bonds, bank bills, floating rate notes, and negotiable certificates of deposit.

Fund manager (aka Asset manager): Invests and manages the assets of others.

Governance issues: Issues relating to corporate governance or business ethics relevant to companies and their shareholders, boards, managers and employees.

Investment: An asset or item that is purchased with the hope it will generate income or appreciate in the future.

Investment horizon: The period of time over which money is to be invested (e.g. 1 year, 20 years).

Portfolio: A group of investments, such as shares and bonds, held by an investor.

Private equity: When equity capital is made available to companies or investors, but not quoted on a stock market. The funds raised through private equity can be used to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen a company's balance sheet.

Private market: A market where capital is raised by specific agreement between investors. The terms of each transaction are negotiated separately, and usually remain private and are not disclosed to third parties. These markets tend to transact infrequently, so prices are not readily observable. Private markets can encompass collective vehicles, including both open and closed end funds, as well as directly owned investments. Almost all private equity falls under this definition, but private markets also includes many investments in other areas, such as real estate, infrastructure and timber.

Proxy: A formal document signed by a shareholder to authorize another shareholder, or commonly the company's management, to vote the holder's shares at the annual meeting.

Public market: Any financial market, open to most or all investors, where securities or related derivatives are traded. This would include, for example any recognized stock exchange, most bond, currency and futures markets. It will also extend to over-the-counter markets where related derivative products are transacted. Public markets usually include a governing body, prescribed rules, regulations and form in which transactions are conducted.

Responsible investment: The integration of environmental, social, and governance considerations into investment management processes and ownership practices.

Return: The gain or loss on an investment in a particular period, consisting of income (such as interest, dividends, or rent), plus capital gains or capital losses. The return is usually expressed as a percentage.

Risk: The chance of something happening that will have an impact upon objectives. Risk can have both positive (upside risk) and negative (downside risk) consequences. For investments it is the chance that an investment's actual return will be different than expected – either higher or lower than expected.

Risk management: The culture, processes, and structures that are directed towards realising potential opportunities, whilst managing adverse effects.

Shareholder: Any person, company, or other institution that owns at least one share in a company. A shareholder may also be referred to as a stockholder.

Strategic Asset Allocation (SAA): The division of assets within an investment portfolio with regards to the long-term view of the risk and return profile of those asset classes, and how to best achieve the portfolio's long-term objectives.

Swaps: Agreements between counterparties to exchange (swap) cash flows of their respective notional obligations so as to manage cash flows more effectively.

Voting Right: The right of a stockholder to vote on matters of corporate policy as well as on who is to compose the Board of Directors.

Yield: The annual rate of return on an investment expressed as a percentage.