# STATEMENT OF INTENT

FOR THE PERIOD COMMENCING 1 JULY 2012 TO 30 JUNE 2017

NEW ZEALAND
SUPERANNUATION
FUND

Guardians of New Zealand Superannuation

# 2012

## Table of Contents

# 1.0 INTRODUCTION

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

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

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

This means New Zealand will have:

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

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

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

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

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

Together, the Fund and Guardians exist to 'smooth' the tax burden arising from the higher future cost of New Zealand Superannuation between generations of New Zealanders. The tax smoothing occurs through the Government making contributions to the Fund. At a future date - currently in the 2029/30 financial year – the Government will begin to withdraw money from the Fund to help to meet the cost, at that time, of New Zealand Superannuation.

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

> ***"Statistics New Zealand data projects that, between 2005 and 2050, the number of New Zealanders eligible to retire (aged 65+) will double."***

This is reflected in our Mission Statement: ***"Maximise the Fund's return over the long term, without undue risk, so as to reduce future New Zealanders' tax burden."***

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

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

We think of it this way:

1. The Fund is a special-purpose savings vehicle giving certainty that some of the future cost of New Zealand Superannuation is covered. The Fund is also expected to add to Crown wealth over the long term by earning more for the Government in investment returns than the Government would save in debt servicing. By doing this the Fund adds to Crown wealth, improves the ability of future Governments to meet increased superannuation commitments in the future, and ultimately reduces the tax burden on future New Zealand taxpayers of the cost of superannuation. That is the Fund's long-term outcome, and we discuss how we have framed it for shorter-term measurement in our Outcome Framework on page 5.

2. The Guardians are expected to manage the Fund according to a legislated mandate. The mandate requires us to manage the Fund in a commercial, prudent fashion comprising:

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

## 1.0 INTRODUCTION (continued)

In our Statement of Intent (SOI) we frame our output simply as 'managing the Fund' consistent with this mandate. This is also captured in the Outcome Framework on page 5.

### What other contextual considerations are important?

Firstly, as a result of the Global Financial Crisis, in the 2009 Budget the Government decided to reduce contributions to the Fund until the Crown operating balance returns to a level of surplus that is sufficient to resume contributions. At present the Treasury estimates this will be in the 2017/18 fiscal year.

Secondly, our activities and profile in New Zealand are important for a number of reasons. We have a Directive from the Minister of Finance requiring us to actively identify and consider opportunities to increase the allocation of New Zealand assets in the Fund, subject to our mandated duty to invest in a commercial, prudent fashion. From an investment perspective, we see New Zealand as a market we should have an advantage in; and it is an important part of our search for new opportunities. From an organisational perspective, it makes sense to work closely with other Crown Financial Institutions, and we see a significant benefit in ensuring our relationship with key domestic stakeholders is as transparent as possible.

Thirdly, we place a high priority on responsible investment, consistent with our mandate to adopt best practice portfolio management and avoid prejudice to New Zealand's reputation as a responsible member of the world community. We believe environmental, social and governance factors can impact on long-term financial performance. It is therefore important that our investment strategies take relevant regulatory, market, reputational and operational risks and opportunities into account. Environmental, social and governance considerations are integrated into investment decisions and our active voting and engagement programme encourages companies to apply good stewardship in these areas.

**Want to know more?**

If you are interested in further information about the reason why the Guardians and the Fund exist, more on the ageing population issue and how the Guardians and Fund are designed to respond to it, you can find it on our website www.nzsuperfund.co.nz.

# 2.0 BOARD STATEMENT

On behalf of the Guardians of New Zealand Superannuation we are pleased to present our Statement of Intent (SOI) for the five-year period commencing 1 July 2012.

We are mindful of the priority the Government currently is placing on fiscal prudence and on the need for the Guardians to demonstrate the long-term value provided for costs incurred. Pleasingly, our main global benchmarks show that we are a cost-efficient fund, a position we plan to maintain.

Our Statement of Intent takes this focus on fiscal prudence into account while setting out our strategic approach and objectives for the next five years. This year's Statement of Intent is consistent with the structure and content of the previous year's document, except for two key improvements:

1. We have taken a different approach to forecasting the Required Statement of Estimated Fund Returns, with the forecast now derived from market equilibrium levels taking a longer, 20 year view.
2. We have strengthened our strategic plan by adding a fifth objective, focusing on risk.

**Strategic Plan Objectives**

*1. Leadership in investment search, evaluation and selection*

We aim to operate an effective and efficient investment search, evaluation and selection process. Key work priorities include implementing the final tools required to support our investment framework, strengthening key parts of the process, seeking opportunities to remove complexity from the portfolio, enhancing communication across teams and increasing our structured focus on maximising value from our existing investments and managers.

Over the next few years, our work in this area will be fundamental to enhancing the long-term performance of the Fund.

*2. Significantly progress implementing value-add strategies*

We focus on adding value in a way that supports the delivery of our mission to maximise returns (net of cost) without undue risk. We therefore undertake active investment only when we believe it will reduce the Fund's risk levels, improve returns, or both; and are progressing a number of initiatives designed to minimise cost and maximise the efficiency of our operations.

*3. Collaboration with peers*

For a small, geographically isolated, fund like ours collaboration with peers across the world offers a range of strategic benefits. Building relationships with leading global peers has therefore been a key strategy over the last few years, and continues to be important.

The benefits of collaboration include leveraging these relationships to secure global and local opportunities for co-investment; exchange of best practice and knowledge; and cooperation in areas of joint interest, such as responsible investment.

*4. Building and maintaining a great team*

Giving effect to our Statement of Intent will require strong leadership; a shared understanding among staff of our purpose and values; and talented, committed people with access to quality data, systems and tools.

In particular, being able to attract, retain and develop high calibre people in what is a global, highly competitive market is vital to the performance of the Fund. As financial markets recover from the Global Financial Crisis, competition for good people from institutional investors, including peer funds, has intensified.

As a Crown entity, and mindful of the Minister of Finance's 2012 Letter of Expectations and the general Government focus on fiscal prudence, we strive for an employment offering which is reasonable in the New Zealand context and will deliver value in terms of Fund performance, relative to costs incurred. For example, our remuneration framework is benchmarked to relevant New Zealand salary comparisons using third-party data.

*5. Raising and embedding risk awareness*

Managing risk – financial, operational and reputational – is central to what we do. Over the last few years we have developed and refined our risk management policies, procedures, and other internal controls for application by our staff, external investment managers, and other expert service providers. We monitor internal compliance with our policies, procedures and relevant legislation, as well as compliance by external managers. Risk management is further supported by our Code of Conduct and conflict of interest procedures, defined roles and responsibilities, and individual and collective accountability processes.

## 2.0 BOARD STATEMENT (continued)

The next step, as we look to ensure that the Guardians' risk management is consistent with best practice around the world, is to further promote risk awareness and understanding across the team.

Risk taking must be based on appropriate and thorough assessments, and consistent with the Fund's overall risk appetite. This means ensuring risk functions are an integral part of our investment processes, and creating greater awareness across the organisation of the risk consequences of decisions, and potential mitigating factors. Over time, developing greater understanding and awareness of risk across the organisation will see each staff member able to articulate relevant risks in a consistent manner, appropriate to their level of responsibility.

Our Forecast Statement of Service Performance (FSSP) on page 15 contains further information about the Fund's strategic objectives and key activities for 2012-2017.

**Target Operating Model**

September 2012 will mark a decade since the Guardians' first Board meeting. Given this milestone, it is timely that a current focus for the Guardians is the development of a high-level view of the optimal future operating model for the organisation.

The target operating model project will assess where we should focus our investment search and selection to have the highest possible confidence of maximising return without undue risk. It will also determine how we are likely to source investment activity (deliver internally or outsource).

From this, the target operating model will outline how the various dimensions of our business (people, processes, information, technology) need to be designed to ensure we are able to efficiently and effectively deliver our mandate.

While this is about establishing an ideal view of the Guardians in the medium-term (five years out), it is also founded on some key assumptions:

- We will continue to focus on adding value in a way that supports delivery of our mission to maximise returns (net of cost) without undue risk.
- We will continue to add value through active management, where we have a strong expectation of meaningful risk adjusted returns net of cost, as set out in our investment framework. As a result, we will achieve an appropriate balance between the costs of investing, which are generally known with a high degree of certainty, and the inherently uncertain expected risks and returns from investments.
- We will continue to build an operation that is agile and scalable, in anticipation of a resumption of Crown contributions in the 2017/18 fiscal year.
- We will operate as a standalone entity with a single mandate, but will continue to proactively seek synergies from sharing knowledge, approaches, and resources with other Crown Financial Institutions.

This work will help us concentrate our efforts on areas where we are most confident of maximising value and, by future-proofing the organisation, ensure we are prepared for the challenges the coming years will bring.

**David May**
Chairman
3 April 2012

# 3.0 OUTCOME FRAMEWORK

The Fund's **outcome** is reducing the tax burden on future New Zealand taxpayers arising from the cost of New Zealand Superannuation. This is a long-term outcome, the results of which will not be realised until around 2029/30, when withdrawals from the Fund will begin. In the shorter term, we focus on maximising return without undue risk, which facilitates the Fund's ultimate impact on New Zealanders' tax burden.

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

Managing the Fund involves work programmes covering:

- Investment
- Cost control
- Risk management
- Governance
- Organisational capability.

Under each work programme we have identified relevant Strategic Plan objectives and activities for 2012/13. Together these objectives and activities comprise our Forecast *Statement of Service Performance (FSSP)* – a key part of this document.

**Measurement**

We have set out on pages 6-13 short, medium and long-term qualitative and quantitative measurements for every level of our Outcome Framework. We will report on progress against each measure in our Statement of Service Performance (SSP) in Annual Reports from 2013 onward, depending on the time period of the goal.

### *What else influences the Fund's outcome?*

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

A broader picture of the internal and external influences on our management of the Fund and its performance can be found in the descriptions of our Values, Investment Beliefs, Mission and legislated mandate on www.nzsuperfund.co.nz.

### *Context*

On current Treasury projections the Government will begin capital withdrawals from the Fund in 2029/30.

**OUTCOME OF GUARDIANS OF NEW ZEALAND SUPERANNUATION: WHAT IS OUR GOAL?**

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

**OUTCOME OF GUARDIANS OF NEW ZEALAND SUPERANNUATION:**

WHAT SERVICES WILL WE PROVIDE TO MAKE A DIFFERENCE?

Managing the Fund

**WORK PROGRAMMES: WHAT ACTIVITIES CONTRIBUTE TO OUR OUTPUT?**

Investment – Cost control – Risk management – Governance – Organisational capability

**WHAT ARE THE STRATEGIC OBJECTIVES AND ACTIVITIES WITHIN OUR WORK PROGRAMME FOR 2012/13**

Forecast Statement of Service Performance (FSSP)

### 3.1 MEASURING PROGRESS

Setting targets in a five-year Statement of Intent for such a long-term outcome presents a challenge (internally, we use rolling 20-year periods to assess the performance of the Fund against our objective). To illustrate: at current policy settings, the Statement of Intent for the five years beginning 1 July 2025 will be the first to cover a period of actual withdrawals from the Fund.

However, we acknowledge that there is considerable interest in the Fund's progress. Accordingly, we have provided a set of short and medium-term measures so New Zealanders can track the Fund's progress.

**Using the tables**

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

*Measuring and reporting outcome*

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

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

We expect to comfortably outperform 90-day Treasury Bills by 2.5%, averaged over rolling 20-year periods. This expectation is based on the long-run equilibrium for each asset class within the Fund.

Predicting short-term financial market returns with useful accuracy over shorter periods is considerably more difficult. Making predictions with absolute confidence for a one-year period is impossible. While we provide such shorter horizon estimates for the purposes of our Strategic Tilting programme, we employ our equilibrium expectations of the Reference Portfolio as the basis for our one and five year expected outcomes in the SOI.

| Measure | 1-year expected outcome | 5-year expected outcome | 20-year expected outcome | Where reported | Explanation |
|---|---|---|---|---|---|
| **Reference Portfolio Returns relative to Treasury Bills (per annum)** | 2.5% p.a. | 2.5% p.a. | 2.5% p.a. | SSP, 2013 Annual Report (1 year)<br>SSP, 2017 Annual Report (5 years)<br>SSP, 2032 Annual Report (20 years) | The Fund is a pool of financial assets held by the Crown. As such, contributions to the Fund make no difference to net Crown assets/liabilities. However, contributions can impact the level of the Crown's gross debt.<br>Accordingly Treasury Bills, which are wholesale debt securities issued by the Crown, proxy the 'opportunity cost' to the Government of contributing capital to the Fund, instead of using the money to retire debt. This is because Treasury Bills represent the interest cost to the Government of raising debt.<br>Over time, the Fund is expected to earn more for the Government in investment returns than it would save in debt servicing i.e. it is expected to add to Crown wealth, putting future governments in a better position to meet increased superannuation commitments. |

### 3.1 MEASURING PROGRESS (continued)

| Measure | 1-year expected outcome | 5-year expected outcome | 20-year expected outcome | Where reported | Explanation |
|---|---|---|---|---|---|
| **Actual Fund returns relative to Reference Portfolio (per annum, net of costs)** | 1.1% p.a. | 1.2% p.a. | 1.3% p.a. | SSP, 2013 Annual Report (1 year)<br>SSP, 2017 Annual Report (5 years)<br>SSP, 2032 Annual Report (20 years) | The Reference Portfolio is our estimate of the best simple, low-cost, passive portfolio we could invest in to achieve our mandate – to maximise returns without undue risk. It therefore represents a benchmark against which we can measure our ability to add value with active investment strategies, which are more complex and more expensive to implement. These active investment strategies (such as strategic tilting and investing in private and/or illiquid assets) are consistent with our statutory duty regarding best-practice portfolio management, and are based on our investment beliefs and competitive advantages.<br>As we explain in detail on www.nzsuperfund.co.nz, there is a possibility of the actual Fund under-performing the Reference Portfolio. This is because active investment can be particularly affected by market volatility, especially in the short term.<br>Checks and balances are in place so that Board and management can examine sustained underperformance by the Fund relative to the Reference Portfolio and Treasury Bills. If necessary, changes can be made to particular investment strategies or to our overall investment approach. |

### 3.1 MEASURING PROGRESS (continued)

| Measure | 1-year expected outcome | 5-year expected outcome | 20-year expected outcome | Where reported | Explanation |
|---|---|---|---|---|---|
| **Expected worst case downside return** | -31% p.a. | -5% p.a. | -3% p.a. | SSP, 2013 Annual Report (1 year)<br>SSP, 2017 Annual Report (5 years)<br>SSP, 2032 Annual Report (20 years) | Our Act requires us to maximise returns without undue risk to the Fund as a whole. This is the trade-off all investors must consider and maximise. The term 'undue risk' is not defined in our Act; rather, it is up to us to interpret.<br>Accordingly, in establishing the Reference Portfolio we weigh up the amount of expected return per unit of risk that comes with different combinations of assets. The resulting combination of risk and return is that which we think best meets our statutory obligations.<br>Financial market returns are inherently volatile. In any given period actual returns will fall somewhere within a wide range of possible returns. For the estimated 'worst case' downside return we look at lowest percentile expected return (or a 1-in-100 event) for the period. If actual returns are worse than this, then either a rarer-than-expected event has occurred or we have taken more risk than we assumed. |

## 3.1 MEASURING PROGRESS (continued)

### *Measuring and reporting outputs*

Where goals are qualitative we have ensured that the relevant measurement is derived from a third party (independent surveys and the like).

We have also identified specific activities we expect to achieve in the 2012/13 financial year and linked these to the work programme they sit under. These activities are drawn from the five-year objectives we have established within our Strategic Plan. We believe it is appropriate and efficient to align the goals and measurements we use for our Statement of Intent and our Strategic Plan.

Collectively, these activities form our Forecast Statement of Service Performance (FSSP), which is on page 15. The FSSP is a key part of each Statement of Intent and it draws together the priorities and activities from our Strategic Plan with the measurements, goals and reporting deadlines of our Statement of Intent. We reiterate this as part of our discussion of the FSSP.

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

### Investment programme

| Measure | 1-year expected outcome | 5-year expected outcome | 20-year expected outcome | Where reported |
|---|---|---|---|---|
| As per Outcome measures (because our outcome is fundamentally an investment outcome) | | | | |
| **Relevant FSSP activities in 2012/13?** | | | | **Where reported** |
| Yes. See Strategic Plan Objectives 1, 2 and 3 | | | | SSP, 2013 Annual Report |

### Cost Control Programme

| Measure | 1-year expected outcome | 5-year expected outcome | 20-year expected outcome | Where reported | Explanation |
|---|---|---|---|---|---|
| Costs relative to peers in CEM Benchmarking's investment management cost survey | Achieve/better rating of 'median cost, median value-adding' | | | SSP, 2013 Annual Report (1 year) SSP, 2017 Annual Report (5 years) SSP, 2032 Annual Report (20 years) | The Guardians participate in the most widely used and comprehensive financial benchmarking available globally – the annual cost structure benchmarking survey by CEM Benchmarking Inc. (CEM).<br>CEM assess the cost structure of the Fund against more than 300 funds from around the world, focussing on 20 with similar risk profiles that also use active management strategies.<br>Our goal for each CEM survey is for our costs to be consistent with our peers, while achieving a higher net-value-added rating.<br>The results of each CEM survey are published in our Annual Report and on www.nzsuperfund.co.nz. |
| **Relevant FSSP activities in 2012/13?** | | | | **Where reported** | |
| Yes. See Strategic Plan Objective 2 | | | | SSP, 2013 Annual Report | |

**Risk programme**

Note: 'worst-case downside return' also features as an Outcome measure.

| Measure | 1-year expected outcome | 5-year expected outcome | 20-year expected outcome | Where reported | Explanation |
|---|---|---|---|---|---|
| Expected worst case downside return | -31% p.a. | -5% p.a. | -3% p.a. | SSP, 2013 Annual Report (1 year) SSP, 2017 Annual Report (5 years) SSP, 2032 Annual Report (20 years) | Refer to page 8. |
| Transparency ratings over time | 10/10 SWF Institute, results as appropriate to other surveys | | | SSP, 2013 Annual Report (1 year) SSP, 2017 Annual Report (5 years) SSP, 2032 Annual Report (20 years) | There are not many third-party mechanisms rating the transparency of Sovereign Wealth Funds. One such rating is published quarterly by the San Francisco-based Sovereign Wealth Fund Institute. The rating is out of 10 and based on the Institute's view about what the average person would expect to find out, easily, about a Sovereign Wealth Fund. Our Fund has been rated 10 since the inception of the index and our target is simply to remain a 10. The Institute's website is www.swfinstitute.org.<br><br>Refer to www.nzsuperfund.govt.nz for the results of ad hoc transparency surveys by other organisations.<br>In general terms we aspire to a top-quartile or higher ranking, as appropriate, and will report on our performance if and when other relevant rating mechanisms are established. |

## 3.1 MEASURING PROGRESS (continued)

| Measure | 1-year expected outcome | 5-year expected outcome | 20-year expected outcome | Where reported | Explanation |
|---|---|---|---|---|---|
| Annual updating of response to 'Santiago Principles' | | Completed | | SSP, 2013 Annual Report (1 year) SSP, 2017 Annual Report (5 years) SSP, 2032 Annual Report (20 years) | The Santiago Principles are principles for best practice by Sovereign Wealth Funds, drawn up by the International Forum for Sovereign Wealth Funds (IFSWF), which was established under the auspices of the International Monetary Fund (IMF), and of which New Zealand is a member. For further information including copies of the Fund's annual review and response to the Principles, refer to www.nzsuperfund.govt.nz. |
| UNPRI Assessment over time | | Top quartile | | SSP, 2017 Annual Report (5 years) SSP, 2032 Annual Report (20 years) | We are committed to the United Nations Principles for Responsible Investment (UNPRI) as the international standard for best practice in responsible investment. Signatories are required to report on how they apply the principles and assesses the extent to which, and how effectively, UNPRI signatories are actually carrying out the principles in their investment activity. Achieving a top quartile rating is our aspiration. It is a moving target and requires a constant process of improvement in Responsible Investment policy and practice to maintain. We report on www.nzsuperfund.govt.nz about our performance under the UNPRI. Note: As UNPRI is undertaking a review of its assessment methodology no assessment will be undertaken in 2012/13. The next assessment will be undertaken in 2013/14. |

### 3.1 MEASURING PROGRESS (continued)

| Measure | 1-year expected outcome | 5-year expected outcome | 20-year expected outcome | Where reported | Explanation |
|---|---|---|---|---|---|
| Published records of voting, RI in Practice | | Published | | SSP, 2013 Annual Report (1 year) SSP, 2017 Annual Report (5 years) SSP, 2032 Annual Report (20 years) | We also provide a six-monthly report on voting across our equity portfolio. Our Annual Report contains a Responsible Investment section with detail on our engagement progamme, updates on integration of Responsible Investment requirements into the investment process and other industry-wide Responsible Investment initiatives. Our website provides additional information as required such as updating our list of companies excluded from the portfolio. These reports are available on www.nzsuperfund.govt.nz. |
| **Relevant FSSP activities in 2012/13?** | | | | **Where reported** | |
| Yes. See Strategic Plan Objectives 1 and 5 | | | | SSP, 2013 Annual Report | |

**Governance**

| Measure | 1-year expected outcome | 5-year expected outcome | 20-year expected outcome | Where reported | Explanation |
|---|---|---|---|---|---|
| Outcome of independent reviews | n/a done five yearly | Good review with review and our response published | Ongoing good reviews with the review and our response published | SSP, 2015 Annual Report (5 years) | An independent review of our governance of the Fund is required every five years. The terms of reference and funding for the review are provided by the Minister of Finance. The Fund has had two such reviews since inception; both are published on www.nzsuperfund.govt.nz. |
| **Relevant FSSP activities in 2012/13?** | | | | **Where reported** | |
| No (review is complete, not due again until 2014) | | | | n/a | |

3.1 MEASURING PROGRESS (continued)

### Organisational capability

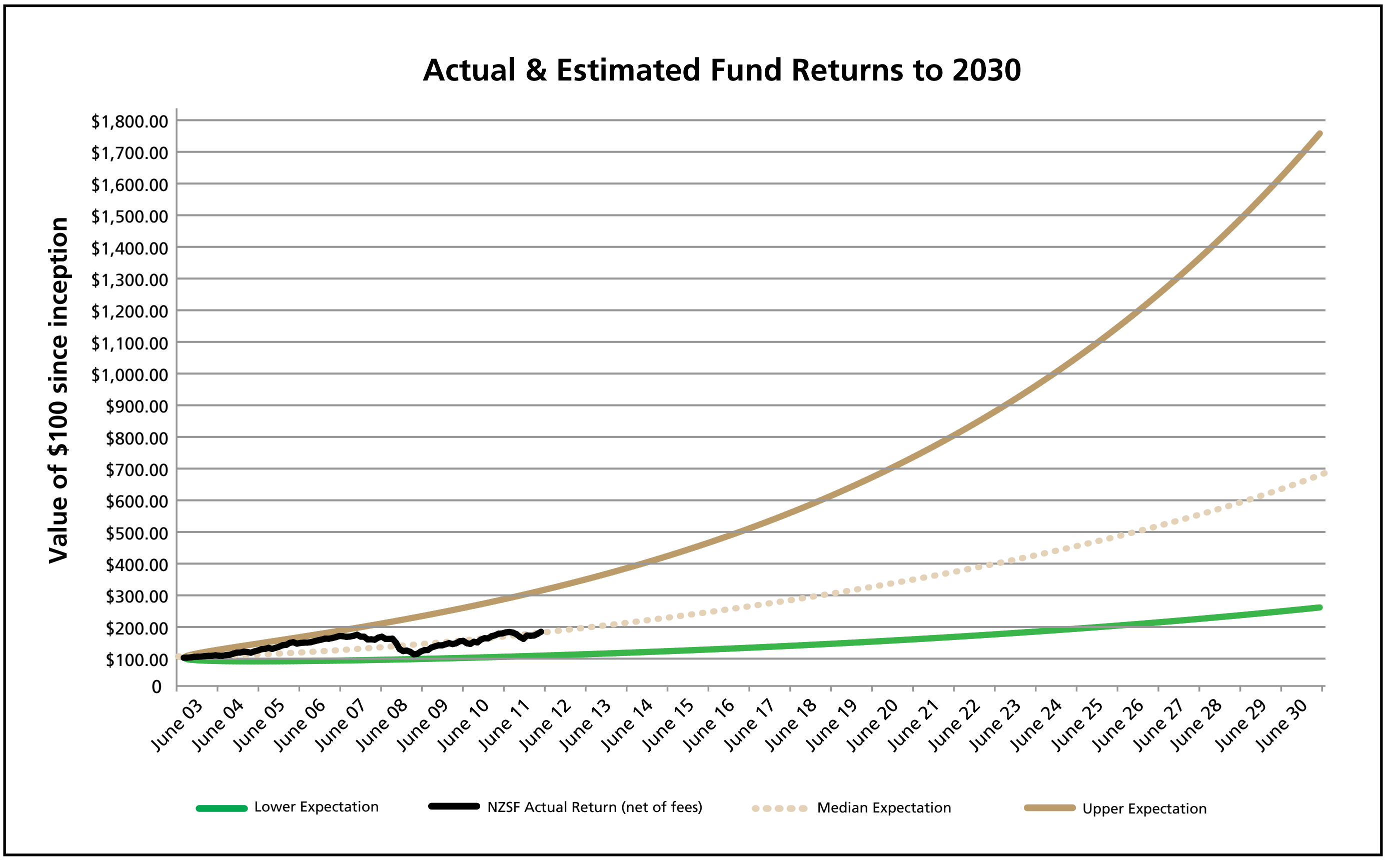
| Measure | 1-year expected outcome | 5-year expected outcome | 20-year expected outcome | Where reported | Explanation |
|---|---|---|---|---|---|
| Key person risks identified and covered | Board approval received for our assessment of key person risk and our plans to mitigate that risk<br>3-6 month cover in place for all critical roles and key people. | | | SSP, 2013 Annual Report (1 year)<br>SSP, 2017 Annual Report (5 years)<br>SSP, 2032 Annual Report (20 years) | This measure is essentially an indicator of how well we attract and retain the best people, in line with the Guardians' and the Fund's objectives. |
| Key performance indicators achieved | Staff members achieve their personal key performance indicators. | | | SSP, 2013 Annual Report (1 year)<br>SSP, 2017 Annual Report (5 years)<br>SSP, 2032 Annual Report (20 years) | Each staff member is assigned KPIs to work towards, including desirable behaviours and the achievement of key projects. KPIs are closely linked to organisational strategy, objectives and values, and are therefore a measure of the extent to which our people are contributing to the Fund achieving its purpose. |
| **Relevant FSSP activities in 2012/13?** | | | | **Where reported** | |
| Yes. See Strategic Plan Objectives 3, 4 and 5 | | | | SSP, 2013 Annual Report | |

### A short way into a long-term purpose

This graph plots actual and estimated Fund performance relative to our expectation that the Fund should outperform the risk-free rate of return (as measured by 90-day Treasury Bills) by 2.5% p.a., averaged over rolling 20 year periods. It shows expected returns through to 2030, when the first withdrawals are projected to take place.

As well as demonstrating that the Fund is still in its early days relative to its long term purpose, the graph illustrates how, because of its weighting to growth assets, the Fund can experience large short-term movements. These shifts must be seen in the context of the long-term purpose of the Fund.

Upper, median and lower performance expectations, within a 95% confidence level, are shown. For the period the Fund has been invested these expectations are based on the actual risk-free rate of return. For future periods, our projections are based on the current risk-free rate of return.



# 4.0 FORECAST STATEMENT OF SERVICE PERFORMANCE (FSSP)

Our FSSP frames our single output as managing the Fund. As set out in our Outcome Framework, that output comprises five work programmes covering expected investment returns; risk management; cost control; governance and organisational development. For each work programme we have set performance measures which, collectively, are performance measures for our output.

The FSSP sets out:

- objectives for the 2012-17 period as set out in our Strategic Plan together with some detail about what achieving these objectives would look like
- key activities occurring in 2012/13 financial year (we detail a selection of these on pages 17-19)
- the Statement of Intent work programme(s) toward which each strategic objective and key activity contributes, together with a reference back to the table setting out how each programme is measured and where and when it is reported (typically, in the Statement of Service Performance in the Annual Report).

It is worth noting that this year's FSSP adds a fifth strategic objective for 2012-2017: raising and embedding risk awareness.

The forecasted revenue to be received by the Guardians from the Fund and through parliamentary appropriation as detailed in the prospective statement of comprehensive income (page 25), supplemented by expenses to be met directly by the Fund, will be used for the following strategic initiatives to ultimately achieve the outcome of the Fund.

## 4.0 FORECAST STATEMENT OF SERVICE PERFORMANCE (continued)

| Focus of Strategic Plan | | | Where reflected in SOI |
|---|---|---|---|
| **Strategic Plan Objectives for 2012-2017** | **What does success look like in 2017?** | **Key activities for 2012/13** | **Relevant work programme(s), measurements & reporting** |
| 1. Leadership in investment search, evaluation and selection | • Single view across a wide range of opportunities<br>• Higher reliance on internal capability to identify opportunities<br>• Opportunistic investing in structured and consistent way<br>• Broad assessment of access points<br>• Systematic monitoring of strategies and managers | • Develop more consistent valuation models across main asset classes<br>• Continue Responsible Investment Strategy | **Investment:**<br>• Actual Fund returns relative to Reference Portfolio (page 7)<br>**Risk:**<br>• UNPRI top quartile (page 11) |
| 2. Significantly progress implementing value-add strategies | • Fully implemented investment strategies<br>• Adding value net of costs to the reference portfolio<br>• Improving the Sharpe ratio (see www.nzsuperfund.co.nz for a definition)<br>• Maximising cost efficiency and effectiveness | • Enhancing strategic tilting<br>• Introduce manager segmentation / strengthen relationship management<br>• Accessing opportunities in the most efficient and effective manner | **Investment:**<br>• Actual Fund returns relative to Reference Portfolio (page 7)<br>**Cost control:**<br>• Costs relative to peers in CEM Survey (page 9) |
| 3. Collaborate with peers | • Co-investments alongside peers<br>• Regular bilateral exchange of best practice alongside wider effectiveness and efficiency benchmarking<br>• Active membership of global forums that exercise influence | • Relationship management and seeking co-investment opportunities | **Investment:**<br>• Actual Fund returns relative to Reference Portfolio (page 7)<br>**Cost control:**<br>• Costs relative to peers in CEM Survey (page 9)<br>**Risk:**<br>• Transparency ratings (page 10)<br>• UNPRI over time (page 11) |
| 4. Building and maintaining a Great Team | • Best practice across governance, enterprise risk management, and IT<br>• Strong leadership, strong culture and values, focus on talent development and retention | • Strengthen talent management<br>• Continue to implement culture development programme | **Organisational capability:**<br>• Board approval for key person risk plans (page 13)<br>• 3-6 month cover in place for all critical roles and key people (page 13)<br>**Cost control:**<br>• Costs relative to peers in CEM Survey (page 9) |
| 5. Raising and embedding risk-awareness | • Risk taking is well aligned with risk appetite<br>• High organisational awareness of risk consequences of decisions and potential mitigants<br>• Each staff member is able to articulate relevant risks in a consistent manner appropriate to their level of responsibility | • Align Fund risk reporting with investment strategy<br>• Risk Management Benchmarking (CEM Global Leaders) | **Risk:**<br>• Expected worst case downside return p.a. (page 8) |

## 4.1 HIGHLIGHTS OF KEY ACTIVITIES FOR 2012/13

This section provides commentary for some of the key activities for 2012/13 that we have put against the work programmes in the FSSP.

Our work on the target operating model, which is described in the Board Statement on page 4 and is a high priority for the year, encompasses all the work programmes and strategic plan objectives.

| | |
|---|---|
| **Work programme** | Investment programme; Cost control and risk management programme |
| **Strategic plan objective** | Leadership in investment search, evaluation and selection |
| **Highlighted activity** | Continue responsible investment strategy |

The Fund will undertake further work in 2012/13 to integrate environmental, social and governance risk and return considerations into portfolio construction, opportunity prioritisation and investment conviction. Specific initiatives include applying Responsible Investment ratings to managers and investment portfolios.

We have introduced an updated engagement process to guide how we respond to potential or actual breaches of the Fund's environmental, social and governance standards by companies. This process, which will be refined during the year, will see more companies removed from the Fund's investment universe for breaches of standards, and will help concentrate resources on a focus list of companies where engagement can be most effective.

| | |
|---|---|
| **Work programme** | Investment programme |
| **Strategic plan objective** | Significantly progress implementing value-add strategies |
| **Highlighted activity** | Enhancing strategic tilting |

The Fund will begin 2012/13 well placed to introduce a new level of sophistication to its strategic tilting activities, with the essential tools and frameworks in place, and experience gained from executing tilts over the last few years. Work to both broaden the scope of our strategic tilting activities, and make them more granular, will be a focus for the year.

Strategic tilting is the process of altering asset allocation weights as expected returns change over time. While the Fund has a long-term default reference portfolio, we aim to take advantage of extreme market movements based on the belief that investment returns will revert to mean expectations over time.

As an investment strategy, strategic tilting is well suited to the Fund because it requires a long-term perspective and an ability to weather short-term volatility in returns. Tilts are also managed internally and are relatively inexpensive to execute. We therefore expect strategic tilting to be a significant contributor to the value our active investment activity adds to the Fund over time.

| | |
|---|---|
| **Work programme** | Investment programme |
| **Strategic plan objective** | Significantly progress implementing value-add strategies |
| **Highlighted activity** | Manager segmentation |

The Fund is currently working with more than 40 managers and peer funds across the Private Equity, Private Real Estate and Active Returns sectors. A key piece of work for 2012/13 is to develop a more structured relationship management approach to ensure we are getting the most from these relationships.

The main goals of the approach are to ensure we have good manager coverage of our opportunities; and to transfer knowledge from managers to the Fund, helping us to:

- identify new investment opportunities;
- inform/test existing investment opportunities; and
- continually develop our internal capabilities.

We also expect the enhanced approach to better identify where we have gaps in our manager pool (i.e. we have no managers, or the managers

## 4.1 HIGHLIGHTS OF KEY ACTIVITIES FOR 2012/13 (continued)

accessing the opportunity cannot completely meet our market intelligence requirements).

We believe this approach will help us add value to the Fund by improving our market intelligence, increasing our knowledge and understanding of key managers, and identifying gaps and opportunities within the overall manager pool.

| | |
|---|---|
| **Work programme** | Cost control programme |
| **Strategic plan objective** | Significantly progress implementing value-add strategies |
| **Highlighted activity** | Accessing opportunities in the most efficient and effective manner |

One of our investment beliefs is that managing fees and costs, and ensuring efficient implementation, can prevent unnecessary cost. As noted in the Board Statement above, our main benchmarks show that we are a cost efficient fund. We remain focused on ensuring we are doing everything we can to operate effectively and efficiently, and on identifying opportunities for improvement.

In addition to the focus we have described above on strategic tilting and manager segmentation (both of these initiatives will help drive lower costs) key activities include:

- Embedding the cost allocation tool that was developed in 2011/12, to ensure our cost base is well aligned to the opportunities that we have the greatest confidence will add value to the Fund;
- Exploring other opportunities to reduce cost, such as whether particular investment activities are managed in-house or out-sourced;
- Driving efficiency in our operations, including exploring opportunities for further process automation and improving the culture of the organisation, enabling us to operate as effectively as possible across teams; and
- Only undertaking active investments where we have a high degree of confidence that we can add value to the Fund.

| | |
|---|---|
| **Work programme** | Organisational capability programme; Investment programme |
| **Strategic plan objective** | Collaborate with peers |
| **Highlighted activity** | Relationship management and seeking of co-investment opportunities |

Collaborating with peers remains very important to us for a number of reasons. The relationships assist us with building our own organisational capability, overcoming some of the challenges of geographic isolation, and delivering investment strategies (especially by providing co-investment opportunities).

Key activities over the next 12-24 months including working towards peer relationships executing co-investments, introducing a new investment relationship management system, continuing bilateral discussions and formal benchmarking, and working closely with other Crown Financial Institutions to identify and explore further areas of cooperation, for example in sharing our responsible investment capability.

| | |
|---|---|
| **Work programme** | Organisational capability programme |
| **Strategic plan objective** | Building and maintaining a great team |
| **Highlighted activity** | Strengthen talent management |

The Fund aims to foster and develop strong leadership; to have a strong culture and shared values; and to ensure all staff members are working to clear and defined objectives in line with our strategic plan.

Strengthening our talent management practices and looking for innovative ways in which we can attract, develop and retain the best people is therefore an important work-stream for 2012/13.

Specific initiatives include preparing development plans for all key talent, including succession

### 4.1 HIGHLIGHTS OF KEY ACTIVITIES FOR 2012/13 (continued)

planning options; and using secondments with peer funds to provide new learning opportunities and knowledge transfer. Leadership capability and organisational culture inventories will also be undertaken in 2012/13.

| | |
|---|---|
| **Work programme** | Risk programme |
| **Strategic plan objective** | Raising and embedding risk awareness |
| **Highlighted activity** | Participate in CEM Global Leaders Risk Management benchmarking |

Managing financial, operational and reputational risk is of fundamental importance to the Fund. We are therefore constantly seeking to ensure that our risk management is best practice. A key activity for 2012/13 will be our participation in CEM's Global Leaders Risk Management benchmarking survey, a new initiative that we have been actively involved in developing. This exercise will give us an independent evaluation of how our risk management practices compare to similar (albeit larger) funds around the world. The survey results will also enable us to identify areas for improvement and set specific performance targets to be reported against in future years.

Dashboard-style management and Board reporting of risk measures will also be introduced during 2012/13.

## 4.2 REQUIRED STATEMENT OF ESTIMATED FUND RETURNS

We are legally required to outline our expectations for the performance of the Fund over the next financial year. Predicting short-term financial market returns with any useful accuracy over such a near-term horizon is, however, impossible. We therefore show our long-term, or equilibrium expectations for the Reference Portfolio Return.

To that we add our expectations of returns from added-value activities to arrive at the mid-point for the Actual Fund.

Finally, we estimate a range of possible Fund returns for 2012/13, given our assumed volatility of market returns. Using this approach we have estimated as follows:

| Component of Return | Explanation |
|---|---|
| Risk-free rate **6.0%** | Our estimate of the equilibrium return on 90-day Treasury Bills. |
| **PLUS** Excess return after costs (which is the reward for taking market risk above cash or the riskfree rate) **2.5%** | We define the reward for market risk as the margin between the risk-free rate and the return that would be generated on the Reference Portfolio (after assumed costs of 0.3%). Although the estimates of market risk vary over time, we provide the equilibrium, or long-term, expectation of the rewards for market risk on the Reference Portfolio.<br>Our estimate of the reward for market risk has a very wide range over a one-year horizon, although this range tightens over longer horizons. Around the mid-point the 90% probability range is around +/- 20% for one year, +/- 8% for five years and +/- 3.5% for 20 years. |
| **PLUS** Reward for value-adding activities **1.1%** | Our estimation of the return from the investment activities we undertake to add value. We summarise those activities as part of the explanation of the Reference Portfolio on page 7. |
| **EQUALS 9.6%** | **The mid-point of our estimated range for the Fund return over 2012/13 is 9.6%.** This estimate is higher than the corresponding estimate of 9.2% in the 2011/12 SOI. |

# 5.0 CONSULTATION AND REPORTING TO THE MINISTER

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

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

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

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

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

As part of the 2009 Budget we received a direction from the Minister on investing in New Zealand. The wording of the direction and our response, and progress response on it; are publicly available on www.nzsuperfund.co.nz.

In common with other Crown entities we also receive from the Minister an annual Letter of Expectations, setting out the Minister's general requirements for prudent expenditure and the importance of achieving value for costs incurred, given the broader economic and fiscal environment.

A copy of the 2012/13 letter and our response can be found on www.nzsuperfund.co.nz

# 6.0 ACQUISITIONS

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

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

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

### *Seeking a change to Section 59*

We note that we are working with Treasury officials on potential changes to the Section 59 restriction. The intention of the changes is to permit more effective structuring of the investments we make for the Fund. We also believe that the changes will put us in a better position to make progress against the Minister of Finance's Directive.

# 7.0 FINANCIAL PROJECTIONS FOR 2012/13

### *Cost Allocation Model*

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

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

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

All operating costs, irrespective of whether they are sourced from appropriations or Fund assets, are consolidated in the financial statements of the Guardians and subject to the reporting and disclosure obligations of the Crown Entities Act (2004).

We have prepared prospective financial statements for the Fund. The estimates assume that earnings will be broadly in line with the medium-term estimate (i.e. 9.6% p.a. after costs but before New Zealand tax). Some costs are fixed (e.g. audit costs) and can be easily estimated, but the majority are variable (i.e. base and performance fees paid to investment managers or transaction fees paid to the custodian). We have prepared estimates of these variable costs based on our expectations of the Fund over the year.

### *Expected total cost of managing the Fund in 2012/13*

The forecast cost of managing the Fund in 2012/13 – excluding performance fees – is $125.1 million or 0.64% of expected average funds under management. This is lower than forecast in the previous SOI ($128.3 million or 0.67%). Of this amount the Guardians' expenses are $30.9 million (of which $0.53 million are Board expenses met by Parliamentary Appropriation), amounting to 0.16% of expected average funds under management.

Performance fees are only paid when investment managers outperform their benchmarks and so they are better described as an offset against returns than a cost. However, if we include forecast performance fees, the forecast cost of managing the Fund in 2012/13 is $154.0 million or 0.79% of expected average funds under management. This is slightly higher than forecast in the previous SOI ($149.6 million or 0.78%).

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

### *Expected total cost of managing the Fund from 2012/13 to 2016/17*

We forecast that total costs (excluding performance fees) will decrease from 0.64% to 0.57% of expected average funds under management over the five-year period covered by this SOI. This compares favourably to actual costs (excluding performance fees) over the last five years, which have averaged 0.72% of average funds under management.

If we include forecast performance fees, costs over this period are projected to decrease from 0.79% to 0.75% of expected average funds under management.

# 8.0 PROSPECTIVE FINANCIAL STATEMENTS

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

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

The Guardians of New Zealand Superannuation Board authorised the issue of these prospective financial statements at its 3 April 2012 meeting. 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 in the intent of the Board to update these prospective financial statements subsequent to presentation.

## Guardians of New Zealand Superannuation and Group

**Prospective Statement of Comprehensive Income**

For the year ending 30 June 2013

| | $000 |
|---|---|
| Revenue from parliamentary appropriation | 528 |
| Revenue from New Zealand Superannuation Fund | 30,274 |
| Other income | 80 |
| **Total revenue** | **30,882** |
| Board-related expenses | (686) |
| Employee remuneration and related expenses | (24,581) |
| Depreciation | - |
| Other expenses | (5,615) |
| **Total expenses** | **(30,882)** |
| **Net surplus/(deficit)** | **-** |
| Other comprehensive income | - |
| **Total comprehensive income for the year** | **-** |

## Guardians of New Zealand Superannuation and Group

**Prospective Statement of Financial Position**

As at 30 June 2013

| | $000 |
|---|---|
| **Assets** | |
| **Current assets** | |
| Cash and cash equivalents | 898 |
| Trade and other receivables | 5,964 |
| **Non-current assets** | |
| Property, plant, and equipment | - |
| **Total assets** | **6,862** |
| | |
| **Liabilities** | |
| **Current liabilities** | |
| Trade and other payables | (779) |
| Accrued employee benefits | (4,812) |
| Lease incentive | (75) |
| **Non-current liabilities** | |
| Lease incentive | (696) |
| **Total liabilities** | **(6,362)** |
| | |
| **Net assets** | **500** |
| | |
| **Equity** | |
| Accumulated surplus | - |
| General equity reserve | 500 |
| **Total public equity** | **500** |

## Guardians of New Zealand Superannuation and Group

**Prospective Statement of Changes in Public Equity**

For the year ending 30 June 2013

| | $000 |
|---|---|
| **Balance at 30 June 2012** | **500** |
| Profit for the year | - |
| Other comprehensive income | - |
| **Total recognised revenue and expense for the year** | **-** |
| **Balance at 30 June 2013** | **500** |

## Guardians of New Zealand Superannuation and Group

**Prospective Statement of Cash Flows**

For the year ending 30 June 2013

| | $000 |
|---|---|
| **Cash flows from operating activities** | |
| Cash was provided from: | |
| Receipts from the Crown | 528 |
| Receipts from New Zealand Superannuation Fund | 28,457 |
| Other income | 60 |
| Interest received | 57 |
| Goods and Services Tax | 647 |
| Cash was applied to: | |
| Payments to suppliers | (4,669) |
| Payments to employees | (24,581) |
| **Net cash provided by/(used in) operating activities** | **499** |
| | |
| **Net increase in cash and cash equivalents** | |
| Cash and cash equivalents at the beginning of the year | 399 |
| **Cash and cash equivalents at the end of the year** | **898** |

# Guardians of New Zealand Superannuation and Group

## Summary of Significant Accounting Policies

### GENERAL INFORMATION

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

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

### STATEMENT OF COMPLIANCE

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

The prospective financial statements of the Guardians of New Zealand Superannuation and Subsidiaries (Group) for the year ended 30 June 2013 were authorised for issue at the 3 April 2012 meeting of the Board of Guardians of New Zealand Superannuation.

### BASIS OF PREPARATION

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

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

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

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

#### (a) Consolidation of subsidiaries

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

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

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

The results of any subsidiaries that become or cease to be part of the Group during the year are consolidated from the date that control commenced or until the date that control ceased.

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

#### (b) Revenue and income

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

**Rendering of services**

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

*New Zealand Superannuation Fund reimbursement of costs:*

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

*Crown appropriations:*

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

*Other service revenue:*

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

**Interest**

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

## Guardians of New Zealand Superannuation and Group

### Summary of Significant Accounting Policies (continued)

**(c) Goods and Services Tax (GST)**

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

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

**(d) Taxation**

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

**(e) Receivables**

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

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

**(f) Subsidiaries**

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

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

*Initial recording*

All items of property, plant and equipment are initially recognised at cost. Cost includes the value of consideration exchanged, or fair value in the case of donated or subsidised assets, and those 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.

*Subsequent measurement*

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

*Disposal*

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

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

*Impairment*

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

Where the carrying amount is assessed to be greater than its recoverable amount, the item is written down to its recoverable amount. The write-down is recognised in the statement of comprehensive income.

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

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

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

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

*Held for sale*

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

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

**(h) Depreciation**

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

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

| | |
|---|---|
| Office equipment | 3 years |
| Computer equipment | 1–3 years |

**(i) Intangible assets**

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

**(j) Employee benefits**

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

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

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

**(k) Operating leases**

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Leases where the lessor effectively retains substantially all the risks and benefits of ownership of the leased items are classified as operating leases. Operating lease expenses are recognised on a straight-line basis over the period of the lease.

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

**(l) Foreign currency transactions**

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

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

## Guardians of New Zealand Superannuation and Group

### Summary of Significant Accounting Policies (continued)

#### (m) Financial instruments

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

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

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

#### (n) Provisions

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

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that recovery will be received and the amount of the receivable can be measured reliably.

#### (o) Payables

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

#### (p) Equity

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

#### (q) Statement of cash flows

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

*Operating activities* include all activities other than investing and financing activities. The cash inflows include all receipts from the sale of goods and services, interest and other sources of revenue that support the Group's operating activities. Cash outflows include payments made to employees, suppliers and for taxes.

*Investing activities* are those activities relating to the acquisition, holding and disposal of current and non-current securities and any other non-current assets.

*Financing activities* are those activities relating to changes in equity and debt capital structure of the Group and those activities relating to the cost of servicing the Group's equity capital.

*Cash and cash equivalents* 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.

#### (r) Changes in accounting policies

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

#### (s) Critical accounting estimates and assumptions

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

*Employee entitlements - long-term portion of incentive*

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

## SIGNIFICANT ASSUMPTIONS ADOPTED IN THE PREPARATION OF PROSPECTIVE FINANCIAL STATEMENTS

The Guardians' forecast assumes that headcount for the Guardians will remain stable (at 83.8) from 30 June 2012 until 30 June 2017. This is consistent with the projections contained in the Guardians' annual strategic plan.

In the event that the Guardians' headcount varies from this assumption, actual results may vary materially from the forecast. Any variance in actual headcount is likely to result in a material variance in expenses, resulting in a corresponding variance in the revenue received from the Fund.

The estimates of Fund performance used in the calculation of the long-term portion of the incentive liability are 9.6% total Fund return, including 1.1% value-add, consistent with the Required Statement of Estimated Fund Returns on page 20. Should the actual Fund performance vary from these estimates, this will impact the calculation of the incentive liability, affecting the employee benefits expense in the statement of comprehensive income, the carrying amount of the incentive liability in the statement of financial position and the corresponding revenue receivable from the Fund.

## New Zealand Superannuation Fund and Group

**Prospective Statement of Comprehensive Income**

For the year ending 30 June 2013

| | $000 |
|---|---|
| **Income** | |
| Interest income | 329,103 |
| Dividend income | 188,562 |
| Timber & milk sales | 44,928 |
| Fair value changes in investments at fair value through profit or loss | 1,258,725 |
| Net foreign exchange gain / (loss) | - |
| Share of profit of investments accounted for using the equity method | 68,040 |
| **Net operating income / (loss)** | **1,889,358** |
| **Expenses** | |
| Timber expenses | (10,843) |
| Farm expenses | (14,923) |
| Depreciation and amortisation | (3,106) |
| Managers' fees – base | (42,919) |
| Managers' fees – performance | (28,918) |
| Custody fees | (5,181) |
| Other expenses | (47,508) |
| **Profit / (loss) for the year before income tax expense** | **1,735,960** |
| Income tax expense | (425,166) |
| **Profit / (loss) for the year after income tax expense** | **1,310,794** |
| **Other comprehensive income** | |
| Net fair value gains on available-for-sale financial assets | 10,400 |
| Gain on revaluation of property, plant, and equipment | 22,060 |
| **Other comprehensive income for the year, net of tax** | **32,460** |
| **Total comprehensive income for the year** | **1,343,254** |

## New Zealand Superannuation Fund and Group

**Prospective Statement of Financial Position**

As at 30 June 2013

| | $000 |
|---|---|
| **Assets** | |
| Cash and cash equivalents | 3,115,937 |
| Inventory | 1,105 |
| Investments | |
| Derivative financial instrument assets | 1,031,172 |
| Other financial assets | 14,123,917 |
| Investments accounted for using the equity method | 915,586 |
| Timber investments - forests | 153,756 |
| **Total investments** | **16,224,431** |
| | |
| Trade and other receivables | 884,696 |
| Property, plant, and equipment | 249,729 |
| **Total assets** | **20,475,898** |
| | |
| **Liabilities** | |
| Trade and other payables | (103,877) |
| Provisions | (26,483) |
| Taxation Payable | (83,888) |
| Deferred Tax Liability | (141,242) |
| **Total liabilities** | **(355,490)** |
| | |
| **Net assets** | **20,120,408** |
| | |
| **Equity** | |
| Retained surplus | 5,177,395 |
| Available-for-sale reserve | 26,798 |
| Land revaluation reserve | 34,136 |
| Contributed capital | 14,882,079 |
| **Total public equity** | **20,120,408** |

## New Zealand Superannuation Fund and Group

**Prospective Statement of Changes in Public Equity**

For the year ending 30 June 2013

| | $000 |
|---|---|
| **Balance at 30 June 2012** | **18,777,154** |
| Profit for the year | 1,310,794 |
| Other comprehensive income | 32,460 |
| **Total comprehensive income for the year** | **1,343,254** |
| Fund capital contributions from the Crown | - |
| Capital contributions from the Crown in respect of funding the net cost of New Zealand superannuation entitlements | 10,242,827 |
| Capital withdrawals by the Crown in respect of funding the net cost of New Zealand superannuation entitlements | (10,242,827) |
| **Balance at 30 June 2013** | **20,120,408** |

## New Zealand Superannuation Fund and Group

**Prospective Statement of Cash Flows**

For the year ending 30 June 2013

| | $000 |
|---|---|
| **Cash flows from operating activities** | |
| Cash was provided from: | |
| Dividends received | 339,523 |
| Interest received | 311,939 |
| Receipts from customers | 45,216 |
| Cash was applied to: | |
| Managers' fees | (78,183) |
| Payments to suppliers | (90,082) |
| Income tax paid | (369,335) |
| GST paid | - |
| **Net cash provided by/(used in) operating activities** | **159,078** |
| | |
| **Cash flows from investing activities** | |
| Cash was provided from: | |
| Proceeds from the sale of investments | 20,142,110 |
| Disposal of property, plant, and equipment | 48,933 |
| Cash was applied to: | |
| Payment for the purchase of investments | (20,355,069) |
| Purchases of property, plant, and equipment | (118,900) |
| Purchases of intangible assets | (500) |
| **Net cash provided by/(used in) investing activities** | **(283,426)** |
| | |
| **Cash flows from financing activities** | |
| Cash was provided from: | |
| Capital contributions from the Crown | - |
| **Net cash provided by/(used in) financing activities** | - |
| | |
| **Net increase/decrease in cash and cash equivalents** | **(124,348)** |
| Cash and cash equivalents at the beginning of the year | 3,240,285 |
| Effects of exchange rate changes on foreign currency cash | **-** |
| **Cash and cash equivalents at the end of the year** | **3,115,937** |

## New Zealand Superannuation Fund and Group

### Summary of Significant Accounting Policies

#### GENERAL INFORMATION

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

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

Under section 43 of the Act, the Crown is required to make capital contributions to the Fund for investment based on a percentage of GDP as set out in the Act. Capital contributions are made by the Crown into the Fund on a fortnightly basis for the purpose of investment and funding the net cost of New Zealand superannuation entitlements. Under section 44 of the Act, the Crown is entitled to contribute lesser amounts than calculated using the formula under section 43 of the Act.

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

#### STATEMENT OF COMPLIANCE

The Fund is a profit-oriented entity. The 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), as appropriate for profit-oriented entities. The prospective financial statements also comply with International Financial Reporting Standards (IFRS).

The prospective financial statements for the year ended 30 June 2013 were authorised for issue at the 3 April 2012 meeting of the Board of the Guardians of New Zealand Superannuation.

#### BASIS OF PREPARATION

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

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

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

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

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

**(a) Capital contributions**

**(i) Fund capital contributions**

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

**(ii) Superannuation entitlement payments**

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

**(b) Capital withdrawals**

**(i) Fund capital withdrawals**

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

**(ii) Superannuation entitlement payments**

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

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

**(c) Income tax**

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

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

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

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

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

- 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 balance date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority

## New Zealand Superannuation Fund and Group

### Summary of Significant Accounting Policies (continued)

and the Group intends to settle its current tax assets and liabilities on a net basis.

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

**(d) Financial instruments**

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

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

**(e) Investments**

Investments are represented by the following:

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

**Financial instruments at fair value through profit or loss**

*Initial recording*

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

*Subsequent measurement*

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

*Determination of fair value*

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

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

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

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

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

v. Certain private equity investments (unlisted investment funds and unlisted equity investments), which are designated at fair value through profit or loss, are valued at the last price of the unit or security as provided by the investment managers or administrators at balance date. The price is based on the fair value of underlying net assets of the private equity investment. Fair value is determined using a variety of methods, including independent valuations, valuation models based on the price of recent investments, earnings multiples or discounted cash flows. Certain private equity investments are classified as available-for-sale. The accounting policy for these investments is outlined under viii).

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

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

### Available-for-sale financial instruments

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

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

## New Zealand Superannuation Fund and Group

### Summary of Significant Accounting Policies (continued)

impaired, at which time the cumulative gain or loss previously reported in reserves is reclassified to profit or loss.

#### Loans and receivables

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

#### Derivatives

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

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

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

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

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

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

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

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

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

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

The fair value of other 'over-the-counter' (OTC) swaps is determined using a model, with the key inputs being the expected future cash flows under the swap contract.

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

#### 'Day 1' gains and losses

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

#### (f) Securities lending

Securities lending transactions are collateralised by securities or cash. The transfer of the securities to counterparties is only reflected on the statement of financial position if the risks and rewards of ownership are also transferred. Collateral advanced by the borrower in the form of readily marketable securities (non-cash) is held in escrow by a third-party agent. Recourse to those securities is only available in the event of default by the borrower and, as such, the non-cash collateral is not recognised in the statement of financial position. Collateral advanced by the borrower in the form of cash is recognised in the statement of financial position as an asset, along with a corresponding liability to repay the cash collateral to the borrower, once the securities have been returned.

**(g) Repurchase and reverse repurchase agreements**

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

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

**(h) Consolidation of subsidiaries**

Subsidiaries are those entities that are controlled by the Fund.

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

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

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

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

**(i) Investments in associates**

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

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

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

## New Zealand Superannuation Fund and Group

### Summary of Significant Accounting Policies (continued)

#### (j) Investments in joint ventures

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

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

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

#### (k) Forests

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

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

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

#### (l) Livestock

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

Changes in the value of livestock are recognised in profit or loss in the statement of comprehensive income.

#### (m) Inventory

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

#### (n) Receivables

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

#### (o) Property, plant, and equipment

*Initial recording*

All items of property, plant and equipment are initially recognised at cost. Cost includes the value of consideration exchanged, 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 and buildings are measured at fair value less accumulated depreciation on buildings and any impairment losses recognised after the date of revaluation. Fair value is determined on the basis of an independent valuation prepared by external valuation experts, based on discounted cash flows or capitalisation of net income (as appropriate).

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

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

Independent valuations of land and buildings are performed with sufficient regularity (at least every three years) to ensure that the carrying amount does not differ materially from the asset's fair value at balance date.

*Disposal*

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

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

Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of an item) is included in profit or loss in the year the item is derecognised.

*Impairment*

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

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

Where an impairment loss subsequently reverses, the carrying amount of the item is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the item in prior years. A reversal of an impairment loss is recognised in the statement of comprehensive income immediately unless it relates to land and buildings, in which case it is treated as a revaluation increase.

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

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

**(p) Depreciation**

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

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

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

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

**(q) Intangible assets**

*Software*

Software and licences are finite life intangibles and are recorded at cost less accumulated amortisation and

## New Zealand Superannuation Fund and Group

### Summary of Significant Accounting Policies (continued)

impairment. Amortisation is charged on a straight-line basis over their estimated useful lives of 3 years. The estimated useful life and amortisation method is reviewed at the end of each annual reporting period.

*Carbon credits*

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

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

*Operating leases*

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Leases where the lessor effectively retains substantially all the risks and benefits of ownership of the leased items are classified as operating leases. Operating lease expenses are recognised on a straight-line basis over the period of the lease.

Where there are contingent lease payments, the contingent rental is recognised as an expense when the value can be reliably estimated.

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

#### (r) Payables

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

#### (s) Provisions

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

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that recovery will be received and the amount of the receivable can be measured reliably.

#### (t) Income recognition

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

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

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

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

Securities lending fees are recognised as earned.

**(u) Foreign currency transactions**

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

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

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

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

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

On disposal of a foreign operation, the accumulated amount of the exchange differences taken to the foreign currency translation reserve that relate to the foreign operation is transferred out of the foreign currency translation reserve and recognised as income or expense in the statement of comprehensive income.

**(w) Statement of cash flows**

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

*Operating activities* include all transactions and other events that are not investing or financing activities.

*Investing activities* are those activities relating to the acquisition, holding and disposal of property, plant and equipment and intangible assets.

*Financing activities* are those activities relating to capital contributions and to payments of superannuation entitlements (from 2020). As the current funding by the Crown of superannuation entitlements flows directly from the Treasury to the Ministry of Social Development it is not considered cash flow of the Group and is accordingly not recorded in the statement of cash flows.

*Cash and cash equivalents*

Cash and cash equivalents 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.

**(x) Goods and Services Tax (GST)**

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

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

**(y) Changes in accounting policies**

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

**(z) Significant estimates and judgments**

In preparing these prospective financial statements, estimates and judgments have been made concerning the future. These estimates and judgments may differ from the subsequent actual results. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

## New Zealand Superannuation Fund and Group

### Summary of Significant Accounting Policies (continued)

The estimates and judgments that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are detailed within each accounting policy above.

**SIGNIFICANT ASSUMPTIONS ADOPTED IN THE PREPARATION OF PROSPECTIVE FINANCIAL STATEMENTS**

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

Investment returns for the forecast period are based on internal modelling, consistent with the Required Statement of Estimated Fund Returns on page 20.

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

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

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

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

NEW ZEALAND SUPERANNUATION FUND

## Directory

**NEW ZEALAND SUPERANNUATION FUND**
PO Box 106 607
Auckland 1143

Level 12
21 Queen Street
Auckland 1010

Phone: +64 9 300 6980

Fax: +64 9 300 6981

enquiries@nzsuperfund.co.nz

www.nzsuperfund.co.nz

NEW ZEALAND
SUPERANNUATION
FUND