Guardians of New Zealand Superannuation

STATEMENT OF INTENT

For the period commencing 1 July 2009 to 30 June 2014

NEW ZEALAND SUPERANNUATION FUND

Contents

1. Statement from the Board

On behalf of the Guardians of New Zealand Superannuation (the Guardians) we are pleased to present our Statement of Intent for the five-year period commencing 1 July 2009.

This Statement builds on the three-year plan we set out in last year's Statement of Intent. We have moved to a five-year forecast period as that is consistent with our belief that it is not possible to meaningfully evaluate our performance in managing the New Zealand Superannuation Fund (the Fund) over shorter periods.

We are acutely conscious that this Statement occurs against a background of profound global and economic volatility. Financial returns from investments of all types other than holdings in Government bonds have been severely impacted. Major financial institutions have failed or been brought under full or partial public ownership and property values have slumped. Accordingly we have dealt from the outset of this document with how the Fund thinks about and faces these conditions.

Changes to the Statement

We have already outlined why we have moved to a five-year forecast period for this statement. Additionally, in last year's Statement we set out two outcomes and a range of activities to support them. That continues to be the thrust of our organisational focus: however, following feedback from Audit NZ and incorporating the guidance provided in the State Services Commission's "Guidance and Requirements for Crown Entities Preparing the Statement of Intent", we have significantly restructured this year's Statement along the following lines:

- We describe the key outcome we seek to achieve as lowering the tax burden on future taxpayers of the cost of New Zealand Superannuation (NZS);
- We set out why we believe the Guardians can succeed in achieving that outcome;
- We outline the three principal outputs that we deliver to the Crown:
  - Determining an optimal mix of market exposures
  - Delivering a portfolio of passive market exposures
  - Adding returns through active management
- We set out the investment duty we have been given by the Crown, and within which we must operate in delivering our principal outputs;
- We describe how these outputs are fashioned and supported by our investment beliefs and organisational capacities; and,
- We provide clear metrics to measure our success against achieving our ultimate outcome and against the investment duty we have been given.

"We have moved to a five-year forecast period as that is consistent with our belief that it is not possible to meaningfully evaluate our performance in managing the New Zealand Superannuation Fund over shorter periods.

We trust that these changes will assist our stakeholders to understand the Fund's purpose and our operational focus.

Budget initiatives

We note that the Government has announced in the Budget for 2009 a reduction in contributions to the Fund. Full capital contributions are projected to resume from 2020 under current Treasury modelling, however this may change based on future Fiscal and Economic Updates.

We have taken the reduction in contributions into account in our Statement of Intent, in particular in assessing the size of the Fund and of our organization. We will continue to assess the impact of the decision during the course of the year.

The Board notes that at $12.5bn as at 30 April 2009 the Fund remains of significant size and has an extremely important job to do. The announcement makes no difference to the Board's collective will to add economic value and develop organisational characteristics that will ensure the Guardians' ongoing success. Our Statement of Intent reflects this.

Additionally, just prior to publication, the Guardians received a direction from the Minister of Finance. The direction states: *It is the Government's expectation, in relation to the Fund's performance, that opportunities that would enable the Guardians to increase the allocation of New Zealand assets in the Fund should be appropriately identified and considered by the Guardians*. We deal more with this direction in Section 4, however the Guardians will continue to examine a range of opportunities that enable us to comply with the direction and with our statutory duty to invest the Fund on a prudent, commercial basis. We will report how we are having regard to this Ministerial directive in our Annual Report.

DAVID MAY
Chairman
21 May 2009

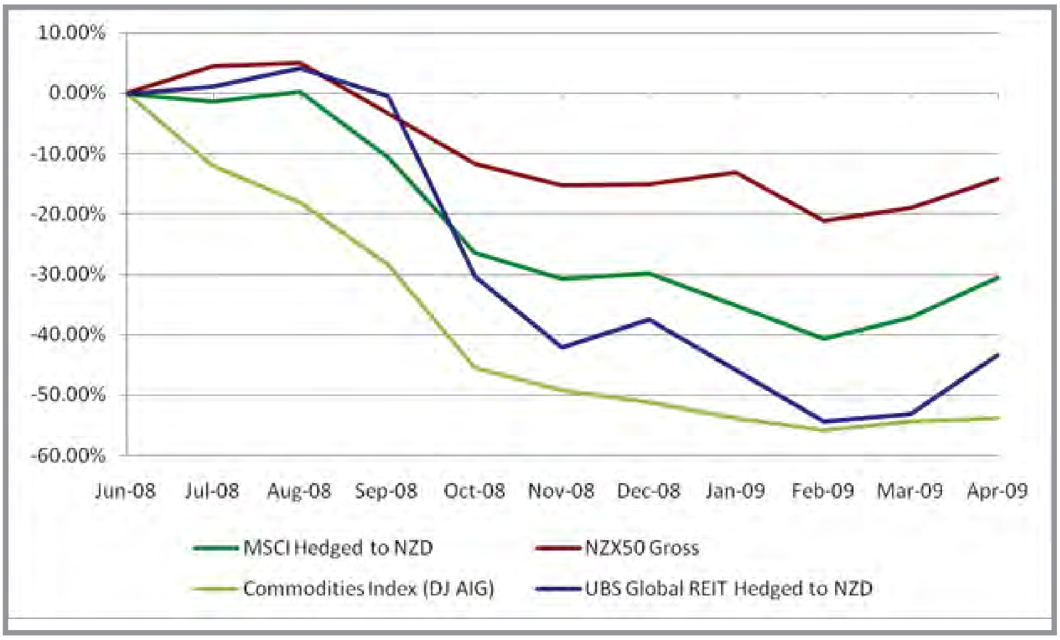
Sir DOUGLAS GRAHAM
Deputy Chairman
21 May 2009

2. Our operating environment

We are in the midst of the most profound global economic and financial crisis in a generation. After a period of sharply rising use of leverage across the financial and household sectors both are now in the midst of a significant deleveraging process as they attempt to repair the quality of their balance sheets. There is an ongoing concerted effort by governments and monetary authorities around the world to cushion the effects of this adjustment process.

Financial returns have been severely impacted. Since 1 July 2008, major stock markets have fallen, property values have fallen and commodities prices have slumped. Short-term interest rates are at their lowest levels in decades. Apart from holdings in Government bonds investors have seen almost every other broad class of investment assets fall in value. The extent to which asset prices behave in synch with one another has risen sharply.

The following chart[1] shows the progress, since 1 June 2008, of a selection of the markets we monitor.



However sobering that picture, we nevertheless believe that several important factors should be taken into account with respect to the Fund.

First, it is important to recall that the Fund was created to reduce the tax burden on future taxpayers of the cost of New Zealand Superannuation/NZS. New Zealand has an ageing population. The number of retired people is expected to double by 2050, as is the expected cost of providing their superannuation.

Under the New Zealand Superannuation and Retirement Income Act 2001 (the Act), which established the Fund for this purpose, the first withdrawals to meet that obligation cannot be made until after 1 July 2020 and are not expected until after 2030.

We are in the midst of the most profound global economic and financial crisis in a generation.

1. Note that the Morgan Stanley Capital International (MSCI) is gross of dividends reinvested and grossed to NZD; the Commodities Index is a fully collateralised DJ AIG Commodities Index hedged to NZD; the actual description of the UBS Global REIT index is the UBS Global Investors Index and it is also hedged to NZD

This is the horizon we have in mind when we consider our investments. It is also the time period which we regard as genuinely significant with respect to Fund performance and returns. This is because that is when withdrawals will be made to help reduce the tax burden on future taxpayers of the future cost of NZS i.e. not before 2020 and the overwhelming majority well after 2030.

Second, in any market long-term investors are in a great position to benefit from investing over decades, more so than any individual. They can focus on the long-term and hence make investment decisions not available to many. They have the ability to ride out the tough patches and avoid forced, hasty divestments.

Right now, the earnings prospects for long-term investors have improved significantly. This is strongly positive for the Fund with the majority of its government contributions ahead. The global recession has seen asset prices fall and the rewards for accepting investment risk rise to historical levels. Historically, the best time for investment returns has followed significant downward corrections.

Right now, the earnings prospects for long-term investors have improved significantly.

This is a particularly important point for the Fund. We invest in such a way as to maximise the chances of succeeding in our purpose, of reducing the tax burden on future New Zealanders of the cost of NZS. What this means in terms of the Fund portfolio is that it is weighted toward growth assets (e.g. equity in companies), because they provide greater long-term rewards for their risk and so better assist the Fund to achieve its purpose. The SAA therefore has a high proportion of such assets.

Achieving our purpose will reduce future Governments' funding obligations arising from NZS commitments. We could invest a much larger part of the Fund in lower volatility asset classes such as cash or fixed income. However, doing so would limit the Fund's ability to meet its purpose, as the returns are less than for growth assets over the longer-term.

Thirdly, any current market snapshot is a historical view – it should not be mistaken for an expression of lack of confidence in the future. So, while economic dislocations are likely to persist for some time, at some point investors will begin to conclude that the gloomiest circumstances are already factored into pricing and confidence will return. Whether that turning point is next week, next month or next year is, now as always, impossible to determine. Perhaps it has already occurred.

It is with regard to these important factors that we invest the Fund over a horizon of decades and seek to ride out the short-term cycles of markets. During those times we may have to direct our short-term focus to a particular aspect of how we manage the Fund, but that does not materially alter the outcome we seek to achieve or the outputs we deliver.

3. What are we trying to achieve?

The policy aim

The Fund was established under the Act, and is a pool of financial assets that form part of the Government's core balance sheet. The Fund's purpose is to reduce the tax burden on future taxpayers of the cost of New Zealand Superannuation/NZS.

The Guardians are an autonomous Crown entity established under the Act. Our function is to invest, manage and administer the Fund.

The Act seeks to achieve the purpose of the Fund by 'smoothing' the tax burden between generations of the future cost of NZS, which, as we discuss later in this section, is expected to rise. It does this by providing for Government contributions to the Fund now – to be drawn on in the future – essentially pre-funding a portion of the future cost of NZS so that future taxpayers will not be required to meet that portion. The Act stipulates how contributions and later withdrawals are calculated.

Where do we come in?

Within the Guardians function of investing, managing and administering the Fund are two tasks. The first is to efficiently administer the Fund and the second is to grow it. Both activities are crucial to achieving the Fund's purpose of reducing the tax burden on future New Zealand taxpayers of the cost of New Zealand Superannuation/NZS.

The future cost of NZS, as a share of GDP, will be affected by a number of factors many of which are beyond the Guardians' control. These include changes in demographics, to the timing of entitlements, or in the rate at which the New Zealand economy grows. NZS is linked to the median nominal wage, implying the Fund's notional liabilities are linked to NZ-dollar inflation and economic growth.

The main factor that we can influence is the return on the Fund. How we allocate the Fund among asset classes is critical to this. We discuss this in detail in the following section however, in essence, we construct an asset allocation we regard as ideal to serve our purpose; we then replicate that allocation structure to the maximum extent possible with low-cost passive investments; and undertake active investment for the remainder in order to add further value.

This is consistent with the Fund's purpose and with the investment duties required of us by the Act. We discuss these in subsequent sections, however, the key duty in respect of our ability to influence the return on the Fund is "to maximise returns without undue risk."

When the intended purpose of the Fund is read in conjunction with that duty, it follows that the outcome to which we must ultimately aspire is to reduce the tax burden on future taxpayers of the cost of New Zealand Superannuation/NZS.

The outcome to which we must ultimately aspire is to reduce the tax burden on future taxpayers of the cost of New Zealand Superannuation.

Is it achievable?

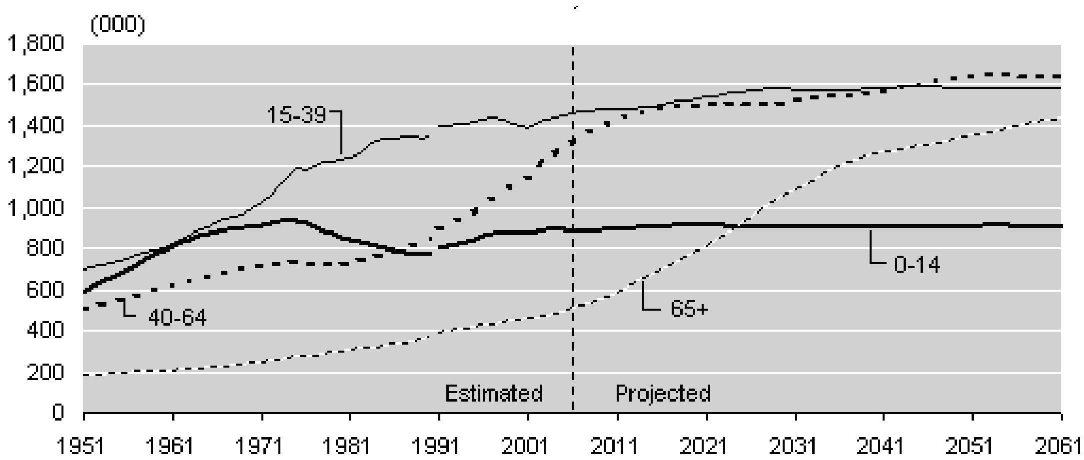
We believe it is. We can support this by graphically depicting:

- the demographic factors driving the projected increase in the future cost of NZS; and
- the Treasury funding model that makes it possible, given certain assumptions, to determine contributions (withdrawals) to (from) the Fund for many years into the future i.e. the smoothing effect.

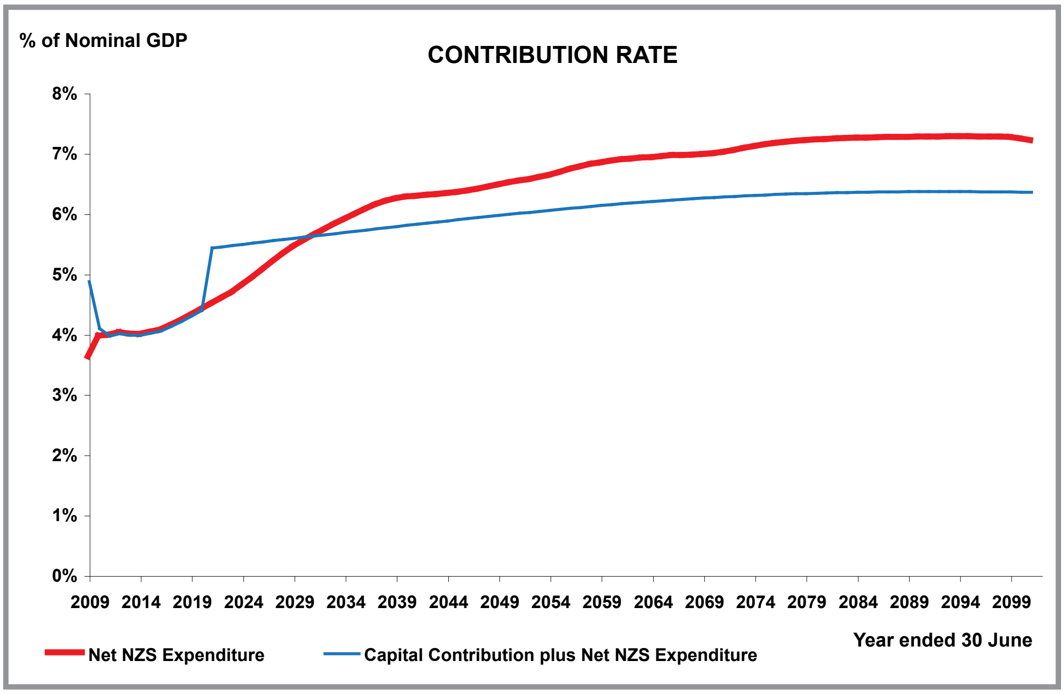
The Department of Statistics estimates and projections for New Zealand's ageing population are shown in the chart below. In summary, and using the 65+ line as our point of reference, the number of New Zealanders retiring is expected to double by 2050 and the associated cost of providing their NZS is also expected to double.

Population by Broad Age Group

1951 – 2061, series 5



Treasury Funding Model

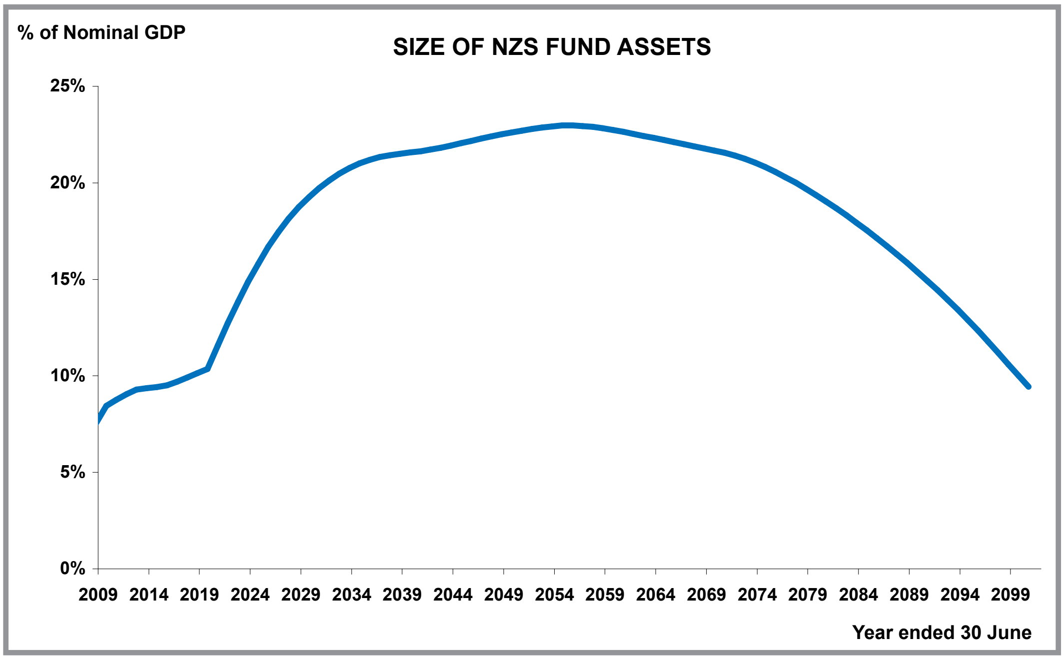


The above chart shows the projected smoothing effect of the Fund, which is how it delivers against its purpose. We note that the chart is based on Treasury projections current in 2009, but which are likely to change subject to future Fiscal and Economic Updates.

The red line shows the projected cost of NZS absent the existence of the Fund. The blue line shows the projected cost after allowing for contributions into (withdrawals from) the Fund. The difference between the two lines shows the amount of the projected contribution (withdrawal) in any one year. This data can be used to demonstrate some of the actual impact of the Fund in dollar terms. For the period 30 June 2031 to 30 June 2100 (encompassed by this graph and reflecting the first 70 years of withdrawals from the Fund under the new Treasury model), the present value of the money paid out of the Fund which would otherwise have to be funded by future NZ taxpayers is approximately $41.3 billion.

Based on the latest Treasury funding model, capital contributions are expected to resume in 2020 and continue until the fiscal year ending June 2031. Under the Act no withdrawals can be made from the Fund until after 1 July 2020. For the purposes of this statement we have assumed that after the $250 million signaled for the Fund in 2009/10 there will be no contributions in the following four years.

Even in the absence of capital contributions, we expect the Fund to continue to grow through returns on its investments.



The size of the Fund in real terms (that is, its size in relation to future GDP) is more important to our ability to serve our purpose than is the contribution rate. The above chart shows the projected growth of the Fund in those terms. Again, we note that the chart is based on Treasury projections current in 2009, but which are likely to change subject to future Fiscal and Economic Updates.

As can be seen the Fund peaks at just under 23% of GDP in the early 2050s. To put that into perspective of today's dollars, 23% of GDP equates to about $41bn.

Although expressing the Fund's size in share of GDP terms is the right way to think about it over very long terms, in the shorter term (including the period covered by this Statement) we talk of the Fund in nominal terms. By the end of the period covered by this Statement the Fund is projected to grow to $20bn.

We believe that these three graphs together clearly depict the public policy issue underpinning the establishment of the Guardians and the Fund; the clear alignment between the Funds' structure and its purpose; and why the Guardians' focus is on the longer-term.

4. Our outputs – what we intend to deliver to reach our achievement

By virtue of our enabling legislation the outputs we deliver are quite straightforward. We have one role (manage the Fund) and we have one client (the Crown).

There is a myriad of ways in which the Fund could be managed. Given the universe of potential investments we could make for the Fund, the number of permutations of assets actually held and the weights they are held in is, to all intents and purposes, infinite. In the following sections we describe why we manage the Fund in the way we do.

In our last Statement of Intent we talked about ensuring we delivered a "cost effective, fit-for-purpose, portfolio". That remains our focus. In this Statement, though, we describe that in terms of three closely interrelated principal outputs:

1. determining an optimal mix of market exposures consistent with our investment duty;
2. identify an equivalent portfolio of "passive" market exposures for the Fund; and,
3. modifying the "passive" market exposure portfolio through a variety of active-management strategies.

Determining an optimal mix of market exposures

The first step before investing is to determine an optimal mix of market exposures. We call this the Strategic Asset Allocation or SAA. We design the SAA to maximise our chances of achieving our purpose. As we've discussed in earlier sections, this means that the SAA is skewed toward growth assets as they are the best match for future NZS costs. Investments of this nature also tend to result in short-term volatility, as we have indeed seen. However they deliver longer-term rewards for the risk[2] taken.

The sponsor's (the Crown's) risk tolerance is not specified in the Act. Instead, Ministers have accepted the risk tolerance of the portfolio through their successive acceptances, since the Fund's inception, of our SAA.

We believe our risk tolerance is best expressed in terms of our expected return – outperforming NZ 90-day Treasury Bills over the long term – as risk tolerance is fundamental to the process which produces that point of reference. We deal with this more in Section 7.

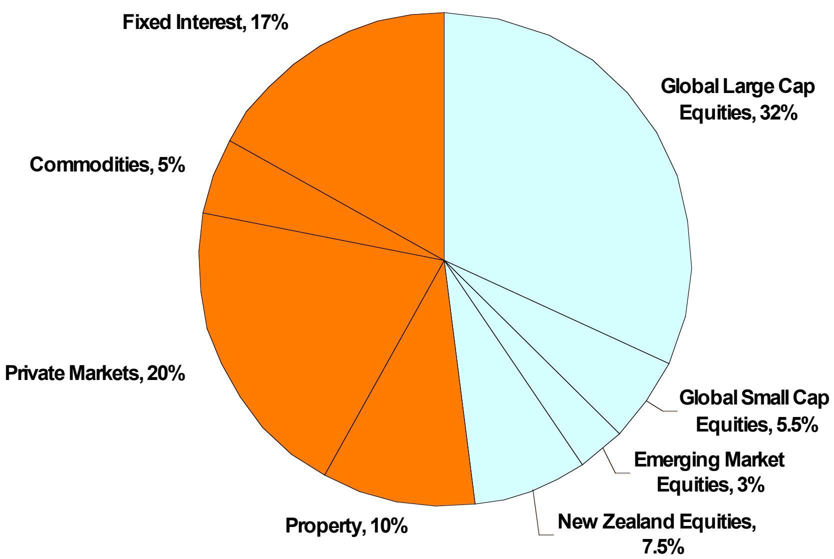
Reducing the tax burden on future taxpayers of the cost of NZS improves the net wealth of the Crown. From that starting point we can consider a range of optimal SAAs and the effect they have on future net wealth. By optimal we mean a SAA that delivers the highest expected return per unit of risk.

2. Except where otherwise specified, when we talk about risk we are talking about variability in asset prices and the Fund's value and returns.

Key determinants of our SAA are the nature of expected future NZS costs, the timing of future withdrawals from the Fund, our limited liquidity requirements, and the desirable risk characteristics of the asset choice. Given that the Fund is part of the core Crown balance sheet, we aim to maximise investment returns measured before New Zealand tax but after foreign tax and expenses.

Our current SAA is illustrated below. The rationale behind this selection of assets is set out in earlier in this section and also in the 2007 review, which is available on the Fund's website (www.nzsuperfund.co.nz).

STRATEGIC ASSET ALLOCATION



The private markets category includes alternative investments and investment vehicles such as timber, private equity, and infrastructure.

Our SAA and investment approach is such that the Fund has exposure to market factors from which we expect the Fund to gain a return in excess of the risk-free rate on average over time. We increase the Fund's portfolio efficiency (i.e. increase the return per unit of risk) by diversifying the Fund across and within various asset classes. We also have exposure to alternative asset classes other than listed equities, where we believe these can further diversify our market exposures and add to total portfolio returns.

The Fund comprises a broadly diversified portfolio of financial assets. The majority of those are in publicly listed equity markets, although a growing proportion is invested in private markets. This implies that we have a deliberately high exposure to growth assets whose returns, while potentially volatile in the short term, provide longer-term economic reward for taking risk.

Our SAA represents the mix of investments to which the Fund aspires. However, our actual mix of investments may vary at any point in time, due to factors such as the availability of investment opportunities and pricing of the respective assets. We use a system of proxies to keep the overall risk of the SAA consistent with our desired asset mix.

We announced our initial SAA in August 2003, and we started investing the Fund in September 2003. We have updated the SAA twice: most recently in December 2007 (refer to our website www.nzsuperfund.co.nz). We will undertake the next review of our SAA late in calendar 2009.

We employ a team of investment specialists to concentrate on this work. While the SAA varies little through time there is a range of complex questions to address to further improve its efficiency. In addition the underlying assumptions behind the SAA are subject to ongoing review and the theoretical underpinnings of this work are constantly evolving.

We have a deliberately high exposure to growth assets whose returns, while potentially volatile in the short term, provide longer-term economic reward for taking risk.

Delivering a portfolio of passive market exposures

Having determined the SAA, we next determine what is the lowest-cost way of implementing it. In general terms broad market exposures can be obtained very inexpensively: however, not all the desired exposures in our SAA can be obtained that way. In particular, there is no generic exposure to replicate part or all of the Fund's private market exposures. Accordingly it is not possible to fully implement the SAA, and to generate the returns necessary to meet our purpose, with 100% passive exposures.

To overcome that limitation we construct a hypothetical portfolio of exposures that can be easily derived and that most closely match the risk profile of our SAA. We call this the "passive" portfolio because portfolios that aim only to replicate market exposures (and not attempt to add value through security selection) are called "passive".

In practice our desired private markets exposures are replaced in this hypothetical portfolio by exposures to publicly traded securities markets. We call these public market replacements for private market exposures "proxies".

We implement some market exposures in a passive fashion because we think that is not just the lowest cost but also the most efficient way of doing so. In most markets there is a variety of ways we can do this, whether through index funds, futures contracts or over-the-counter derivatives contracts. Our focus is on ensuring we choose the most efficient option. Some of this is done in-house and some by external managers on our behalf.

If we stopped at the passive portfolio our organisational structure would be quite different to what it is now. We could implement the passive portfolio with a significantly smaller team. In practice, though, the passive portfolio remains a largely hypothetical construct. The Fund's actual mix of assets differs from the passive portfolio because we believe we can derive additional returns by actively deviating from that.

Adding returns through active management

It is to the third leg of our outputs that we devote most organisational resource either directly or indirectly. Directly through the selection of investment managers or assets: indirectly through the various processes that are required to support and monitor such selections. It is in this area that our investment beliefs come most sharply into play.

We strive to add value relative to the passive portfolio in a number of ways:

- By investing in private markets. The SAA targets 20% in private markets which include a diverse set of assets ranging from timber to private equity to infrastructure. Most of our investing in private markets is undertaken by external managers on our behalf. Private markets investing is complex and the barriers to entry to the best assets and best managers are relatively high. Individual transactions must be assessed on their merit and often involve complex legal arrangements and have particular tax structures. Investing in private markets exploits our long time horizon and high tolerance for illiquidity..
- Through active manager selection. In public markets we identify managers who we believe can add value, over and above a passive benchmark, through active security selection. In some cases these managers will be constrained to select securities from a narrowly defined universe (New Zealand listed equities managers are a case in point) and may hold more or less of a particular security than that in a passive market portfolio. In other cases the managers are less constrained and may select from a broader universe. Some managers are "market-neutral" so called because they hold both positive and negative exposures to securities and markets with the intention of removing the market exposure from their portfolio while benefitting from anomalies and inefficiencies. More explanation of how we select investment managers can be found on our website.
- Through strategic tilting. This is a new addition to our value-adding armoury, one that has been under development for some time and that exploits our belief that returns from asset classes are partially predictable over the long term. Strategic tilting involves developing a robust integrated framework for projecting the expected returns from certain asset classes and then tilting to or away from our SAA target weights when those expected returns are extraordinarily high or low. Because we are looking for extraordinary price signals, strategic tilts will be implemented relatively infrequently. All decisions relating to strategic tilting are made in-house.

"In public markets we identify managers who we believe can add value, over and above a passive benchmark, through active security selection.

- Through looking for implementation efficiencies. There are a number of hidden costs when investing. These include the impact on securities prices when we invest or divest – this is particularly relevant in relatively small markets like New Zealand. We are developing a Treasury unit to manage a number of our in-house investment activities and that unit will also be responsible for identifying implementation gains that can be secured.

Our investment staff are always considering new ways in which we can add value to the Fund. Some of these will have positive but very small impacts. Others have the potential to make more significant contributions. Included in this latter work are such themes as whether there are more efficient market exposures than those represented by traditional market capitalisation-weighted indices and whether it is possible to exploit long-run macro-economic or geopolitical themes.

In addition to this specifically value adding work we also actively deviate from the passive portfolio by making decisions in line with our Responsible Investment Policy a copy of which can be found on our website. To date the most visible face of this policy has been the various securities we have excluded from the Fund's allowable universe. Those securities cover such activities as tobacco, whaling, cluster munitions and nuclear explosives manufacture and nuclear testing.

In the period covered by this Statement we will aim to:

a) Identify additional opportunities in markets including New Zealand, which allow us to capture the prevailing increased liquidity premium;

b) Identify additional ways to adapt our SAA to capture strategic tilting opportunities and to embed further resilience to stress-testing;

c) Improve the efficiency of our investment management through revenue and cost efficiencies (in large part related to liquidity management) and assessing the appropriate hurdle for active management in selected areas, and;

d) Identify positive environmental investment themes, to add value.

Ministerial direction on investment in New Zealand

As discussed in the Board Statement, just prior to publication of the SOI we received a direction from the Minister, which states: It is the Government's expectation, in relation to the Fund's performance, that opportunities that would enable the Guardians to increase the allocation of New Zealand assets in the Fund should be appropriately identified and considered by the Guardians.

The Guardians will examine a range of direct investment opportunities that allow us to comply with the direction and with our statutory obligation to invest on a prudent, commercial basis. We will report our progress against the direction in ensuing Statements of Intent and in our Annual Report.

We note that we have some competitive advantage in making direct investments in New Zealand assets, arising from the Fund's scale, long horizon, liquidity, location and Crown ownership. In addition, the Guardians are already involved in New Zealand private equity, property, and passive equity/derivative management – all of which generate deal identification, relevant external relationships, and necessitate us retaining internal skills that can be used in direct investment assessments (i.e., leveraging our skills).

However these investment decisions must include consideration of the specific risks of investing locally. These risks include country and asset concentration, liquidity management, legal and operational issues. We must ensure that New Zealand investment decisions are pursued consistent with best-practice portfolio management, with maximising the returns without undue risk to the Fund as a whole and without prejudice to New Zealand's reputation in the global community.

5. Our investment duty

The Crown has given us a set of parameters, collectively our investment duty, within which we must operate in delivering our outcome of reducing the burden on future taxpayers of the cost of New Zealand Superannuation/NZS.

Accordingly, our performance must be measured not only against the outputs we have set out above, but these parameters. If the outputs are the desired services we provide in reaching our goal, our investment duty sets out the desired behaviours.

Our Act stipulates that we must invest the Fund on a prudent, commercial basis and, in doing so, manage and administer it in a manner consistent with:

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

The terms "best-practice", "maximising return without undue risk" and "avoiding prejudice …" are not defined in the Act. That interpretation is crucial both to the decisions we make in respect of the Fund and to how we structure the Guardians to implement those decisions. We examine this further in the following section.

There are few limitations on how we invest the Fund. We may appoint, on terms and conditions we think fit, one or more persons to invest the Fund.

Except with the Minister of Finance's approval, we may not: borrow money in respect of the Fund; mortgage or charge any of the property of the Fund as security; nor hold any financial instrument that places or may place a liability or contingent liability on the Fund or the Crown. We must use our best endeavours to ensure that the Fund does not control, or be in a position where it is required to seek control of, another entity.

We must have regard to any lawful directions from the Minister of Finance regarding the Government's expectations as to the Fund's performance, including the Government's expectations as to risk and return. We must report in our Annual Report how we are having, or have had, regard to such directions.

We are required to establish and adhere to investment policies, standards and procedures for the Fund that are consistent with our investment duty and we must review those at least annually. These are set out in our Statement of Investment Practices, Standards and Procedures on our website.

"Our Act stipulates that we must invest the Fund on a prudent, commercial basis.

6. What organisational capabilities can we draw upon to succeed?

We manage the Fund based on an investment philosophy and drawing on our organisational capabilities in such a way as to reduce the tax burden on future taxpayers of the cost of New Zealand Superannuation/NZS while acting consistently with the statutory investment duty set out above.

Both our philosophy and organisational capabilities are important because they fundamentally shape the decisions we make. Other investors will hold their own belief sets (explicitly or implicitly stated) and those will drive their investment choices.

As we outlined in Section 2, the Fund's purpose means that we have long time horizons for choosing, managing and measuring the success of our investments. This is reflected within our values and investment philosophy, and within our overall mission statement. These are set out below.

"The Fund's purpose means that we have long time horizons for choosing, managing and measuring the success of our investments.

Our Values

We have developed, and are embedding a set of organisational values. These are:

- Inclusiveness: We combine diverse skills, and seek relevant views and rigorous analysis, in a supportive environment.
- Innovative: We encourage initiative taking and continuous learning, and drive timely decisions
- Integrity: We behave consistently with a transparent and commercial manner for the long-term benefit of the Fund

Our Investment Philosophy

The Fund benefits from a number of important endowments directly relevant to our investment philosophy. Our long investment horizon and liquidity put us in an excellent position to make and benefit from investment decisions not available to many, while having an ability to deal with harsher market and economic conditions without having to revert to forced sales. Our sovereign status means that our activities can be funded at the cheapest rate, with tax benefits for the New Zealand Government on local investment.

The combination of these factors optimises our chances of investment success.

Our resultant investment philosophy (which is underpinned by a set of related investment beliefs, set out in Appendix 1) is set out on the following page.

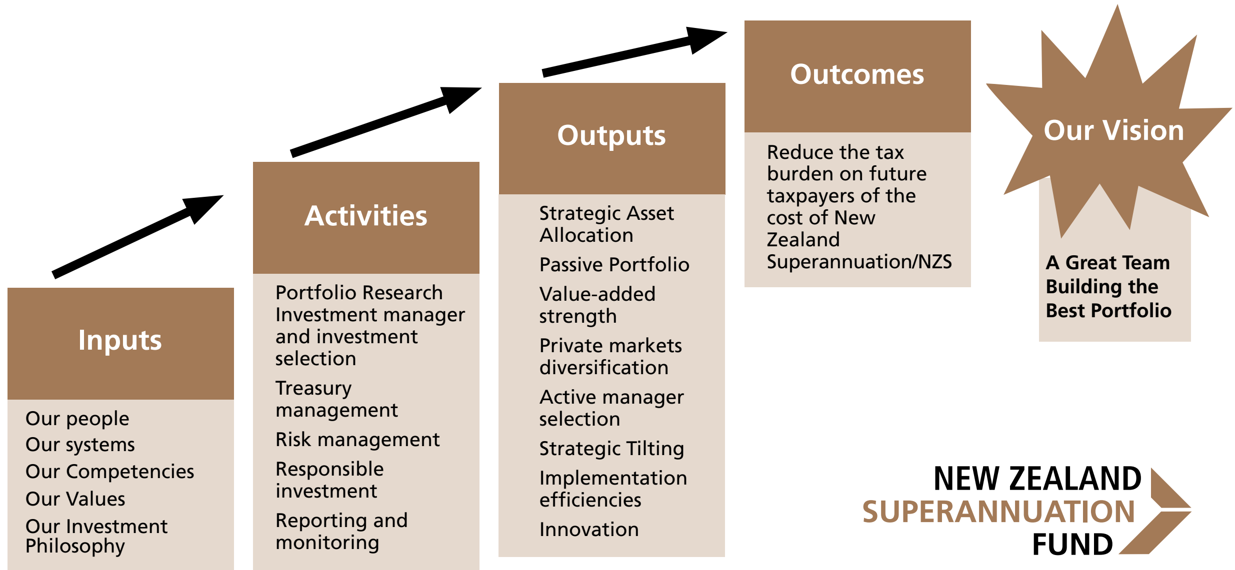
Our investment philosophy

- We are a long-term investor that is building the best (i.e., most cost-effective and fit for purpose) portfolio.
- When building the portfolio we un-bundle risk and accept only those risks that enhance our overall portfolio efficiency.
- We invest in a manner that best exploits a liquidity premium, and we put effort and resource into in seeking excess (alpha) return only where we have a competitive advantage and core competencies.
- When outsourcing, we manage principal-agent risks through contracts and appropriate fees and incentives.
- When allocating capital, we are fully aware of all financial and opportunity costs and we monitor all activities against relevant benchmarks.
- We act as a responsible investor, promoting positive environmental, social and governance behaviour as a shareholder, and we look to be rewarded for this effort.
- We behave consistent with our values in relentless pursuit of our vision.

"We are a long-term investor that is building the best portfolio.

Below we have set out how our Investment Philosophy and Values are incorporated within our Mission: To manage the Fund in a manner that best enables future governments to provide retirement incomes to New Zealanders.

Our Mission: To manage the Fund in a manner that best enables future governments to provide retirement incomes to New Zealanders



Our Competencies: Quality decisions; Specific knowledge; Employer of choice; Innovative;
Our Values: Integrity; Inclusiveness; Innovation;
Our endowments: The Fund's sovereign status, liquidity profile, investment horizon and breadth of mandate;
Our investment philosophy: Comes from matching our endowments with our investment beliefs

Our organisational capabilities

In managing the Fund we undertake portfolio research, selection of external investment managers, in-house asset management, portfolio oversight and operational, administrative and financial support.

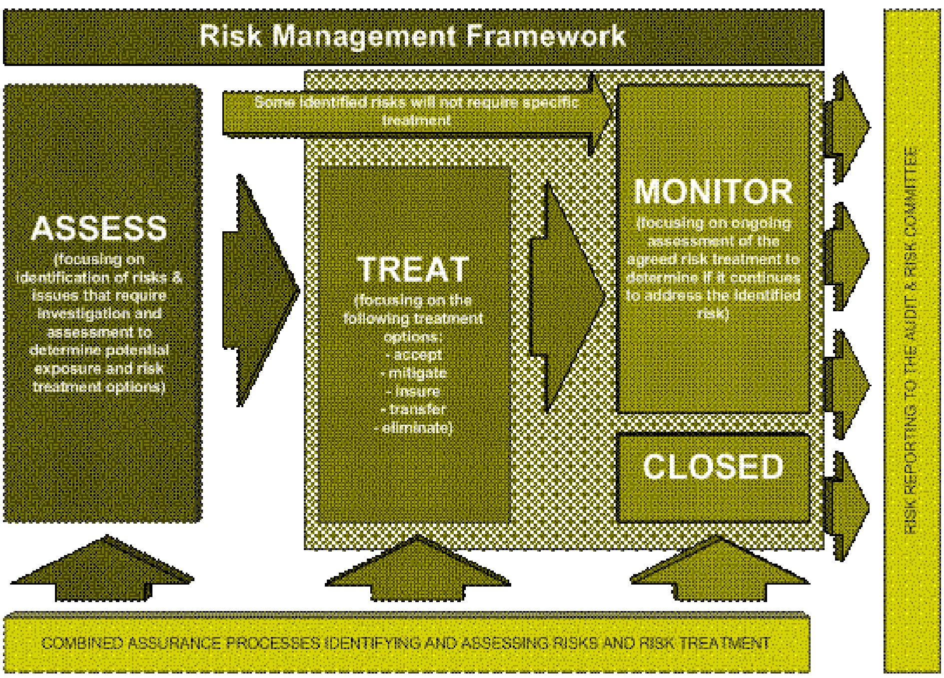
A key discipline is risk management. Our approach to this involves the Board, our staff and our external partners.

We have developed risk management policies, procedures, and other internal controls for application by our staff, external investment managers, and other expert service providers. We monitor compliance with the relevant policies and procedures as well as compliance by external managers.

Risk management is further supported by our Code of Conduct including conflict of interest procedures, defined roles and responsibilities and individual and collective accountability processes. Our five major risk categories are:

- Investment risk: The risk inherent in achieving investment goals and objectives, including market, credit, and liquidity risk.
- Strategic risk: The risk that we make inappropriate strategic choices or are unable to successfully implement selected strategies.
- Legislative and regulatory risk: The risk of loss due to non-compliance with actual or proposed laws, rules and regulations and prescribed industry practices.
- Operational risk: The risk of loss from inadequate or failed internal processes, people or systems, or from external factors.
- Reputation risk: Risk of loss of reputation or credibility due to internal or external factors.

The below diagram sets out our risk- management framework.



Our Board

The Board is responsible for organisational governance. Amongst other things it approves the Guardians' business plans, the SAA and high-level asset class specific strategies (for example how we approach private equity investing). It monitors the organisation's performance against each of these. Under our Act there are certain things that the Board cannot delegate. These include the power to appoint external managers and the custodian. Board members are appointed for an initial term of up to five years.

The Board operates three standing Board committees to assist in the fulfillment of its obligations. While ultimate responsibility rests with the Board, the objective of the committees is to assist and advise the Board.

- The Audit and Risk Committee – responsible for overseeing the financial reporting, audit, risk management, compliance and other governance systems.
- The Responsible Investment Committee – responsible for developing and implementing policy, standards and procedures in relation to responsible investing, including encouraging best practice corporate governance by investee companies.
- The Employee Policy and Remuneration Committee – responsible for overseeing employment and remuneration policies to ensure the human resources policies and practices of the organisation are appropriate and consistent with its statutory obligations.

From time to time the Board may establish specific sub committees to address a particular matter or for a particular purpose. Such sub committees may have certain decision making powers delegated to them by the Board and will report back to the Board in a manner consistent with the function of the particular sub committee.

Our Management

Our organisational structure can be found in Appendix 2.

Management oversight is provided through four teams:

- The Leadership Team – responsible for overseeing implementation of the Guardians organisational strategy and monitoring organisational risks.
- The Investment Committee – responsible for evaluating new investment initiatives including proposed changes to the SAA, manager selection and direct investment selection.
- The Risk and Portfolio Monitoring Committee – responsible for monitoring the Fund's compliance with the SAA and detailed mandate rules governing each part of the Fund managed by external managers and the internal team.
- The Communications Committee – responsible for overseeing our communications including the production of this Statement, the Annual Report and responses to official requests.

Our organisational focus is on enhancing the quality of the outputs described in the previous section. We have undertaken a number of business activities to achieve this, most of which will be developed and implemented over a number of years. The principal activities are:

- identifying, assessing and rigorously applying opportunities to improve the Fund's investment performance through raising performance hurdles on expected alpha, driving further cost-effectiveness from beta exposures
- a global benchmarking study that identifies our peer group and the features and benchmarks the Guardians should develop;
- embedding a holistic framework for the allocation of capital that ensures all investments meet our investment objectives and remain consistent with our operational model;
- enhancing our derivative risk managing capabilities; and
- developing specific knowledge of key asset classes and regions.

The activities we will be undertaking also include developing and maintaining our core competencies (as described in the next section), developing and protecting intellectual property and investment networks (including completing our Information Technology (IT) architecture and application development) and embedding our risk management framework. We will also complete the implementation of our human resources framework.

Our organisational health

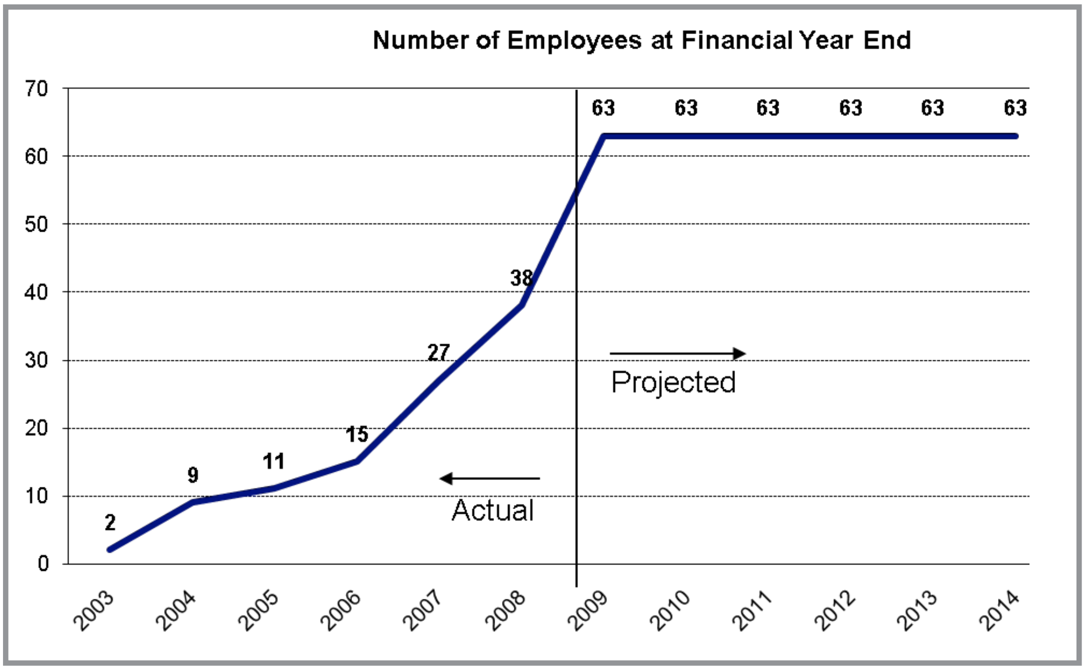
As at 30 April 2009 we employed 50 full-time and three part-time staff. Our principal office, where the majority of our staff work, is in Auckland. We have a smaller office in Wellington.

Our staff numbers are estimated to grow to around 63 by June 2010, where we anticipate they will peak – consistent with our long-term operational model. Even at this peak, the Guardians will be a small organisation relative to our global peers, and will remain highly dependent on outsourced service providers.

The growth in our staff numbers is focused largely around delivering against our purpose, in the areas of investment strategy and implementation (i.e., in the Portfolio Strategy, Private and Public Markets, and the Treasury business units). The final headcount will be in part dependent on the economics of managing certain Fund assets internally versus the alternative of managing them in equivalent fashion through external managers. Any decision to bring activities in-house will continue to be compared to the most cost-effective outsourced alternative that meets the service standards we require.

> **The growth in our staff numbers is focused largely around delivering against our purpose.**

The following chart shows the evolution of our full-time equivalent headcount since our first Annual Report in 2003.



Since our last Statement of Intent we have put considerable effort into bedding down a relatively new Leadership Team and we have started the process of orienting the organisation in line with our vision and values. To attract and retain staff we need to complete the implementation of our human resources framework, key element of which include embedding frameworks for attracting, retaining and developing high-performing staff.

We believe we are in a relatively unique position as an employer and investor in New Zealand, and that this is a strength we can exploit. Our sovereign status, and the Fund's liquidity profile, investment horizon and breadth are all endowments that we can capitalise on. However, many of these endowments are shared by similar investment organisations globally. Hence, we need to identify and use our competitive advantages when managing the Fund.

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We believe we are in a relatively unique position as an employer and investor in New Zealand.

When investing, we compete for access to the financial and real assets that best enable us to reduce the tax burden for future New Zealand taxpayers of the future costs of NZS; access to the best investment managers and investments; and the resources we need to manage the Fund on a sustainable basis, in particular people. In doing so, we compete against the passive investment alternative to the assets we select; other investors seeking the same assets; other funds seeking access to the best investment managers; and other employers seeking similar talent.

In order to be successful we need to build on and exploit a number of core competencies:

- high quality and timely decision making;
- specific knowledge (e.g., of certain asset classes, geographies, and investor relationships);
- a strong position in New Zealand as an employer in this field;
- an ability to learn and constantly innovate in order to be an early adopter of investments.

Such competencies will best enable us to leverage off the endowments described and make the maximum contribution towards achieving our investment objectives.

7. Measurement – how we determine success

In this section we will provide detailed commentary against each of our measurements and then chart their interrelationships with each other and with our desired ultimate outcome.

Measurement against Outputs

As a reminder, our three key outputs are as follows:

1. determining an optimal mix of market exposures consistent with our investment duty;
2. delivering a portfolio of "passive" market exposures for the Fund; and,
3. modifying the "passive" market exposure portfolio through a variety of active-management strategies.

At the highest level and with our ultimate outcome in mind, what matters is the long-term return to the Fund net of all costs and foreign taxes[4]. This is because the Fund's purpose is to reduce the tax burden on future taxpayers of the cost of NZS. As we have described the part of that we can have some influence over is the Fund's return.

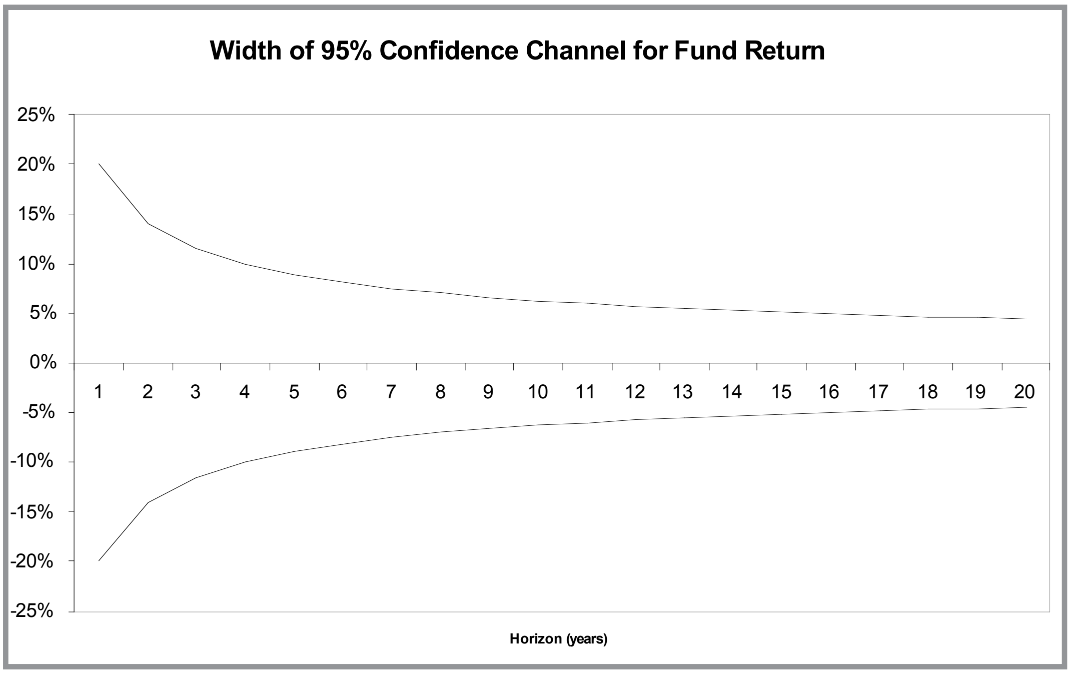
We benchmark the Fund's performance against the 90-day Treasury bill rate (i.e., a proxy for the Government's 'risk-free' rate or its opportunity cost of raising debt). Based on the SAA we have designed, we have set an internal expectation to deliver a rate of return averaging at least 2.5% per annum above the 90-day Treasury bill rate over rolling 20-year periods. This is measured on a time-weighted basis and pre-New Zealand tax. This benchmark gives us a measure of how well the Fund has been rewarded for the risk taken on.

In practical terms though 20 years is beyond the patience of most observers, beyond the terms of any Board member and in all likelihood beyond the length of service that we might hope to expect from most staff members. We therefore also monitor a five-year rolling average period as a useful intermediate target.

The chart on the following page demonstrates the wide channel that Fund performance sits within. In any given year we expect to be within +/- 20% of our median estimate 95% of the time (as we have seen there are occasional results that will fall outside that range). Those confidence intervals improve to +/- 9% over five year periods and +/- 4.5% over 20-year horizons.

We have set an internal expectation to deliver a rate of return averaging at least 2.5% per annum above the 90-day Treasury bill rate over rolling 20-year periods.

4. As the Fund is part of the core Crown, taxes paid in New Zealand by the Fund have a neutral impact on the Crown.



The next measure is how the Fund would have done if we had invested only in the passive portfolio. As a reminder this was our lowest cost implementation option. What matters here is the difference between this measure and the actual Fund return. This difference tells us what value we have added through actively deviating away from the passive portfolio.

While we will measure and report on this measure of value added each year we expect it to be volatile. A vast body of empirical evidence demonstrates that is the case for active investors both successful and unsuccessful. Our mid-point value added target is 0.50% per annum. We expect that to fluctuate within a 95% confidence interval of +/- 6% over any one year improving to +/- 2.7% over five-year horizons. By way of illustration, a 10% fluctuation given the value of the Fund at 31 March 2009 is NZ$1.16 billion.

While five years is a reasonable horizon for this measure we note that even then the outcome is most unlikely to be statistically significant – in other words it will be difficult to discern with absolute precision the relative significance of the influence of our input and that of market fluctuation. This is the nature of investing.

An important but secondary financial measure for us is our total cost structure expressed as a ratio of total costs to the value of the Fund. The reason we describe this as a secondary measure is that, as we lay out in section 6, it is a relatively straightforward matter to implement a lowest cost passive portfolio. Because we focus on enhancing the Fund's returns through active management the net of cost measures above take precedence.

Having said that, we can benchmark our cost structure against like funds with similar risk profiles and who also actively manage. We subscribe to a global benchmarking service that does this.

We expect a reduction in total costs per dollar of Fund size over the period of this statement. Specifically, we expect a decline from 73 to 64 basis points (excluding performance fees) from 2010 to 2013. The difference between achieving 64 basis points and maintaining 73 basis points with a growing Fund, represents a saving of many millions of dollars over that time. Within that overall reduction we expect a reduction in internal costs per dollar of Fund size – i.e. the costs specific to the Guardians – from 16 to 13 basis points.

Measurement against investment duty

As discussed, our performance must be measured not only against the financial outputs we have set out above, but our investment duty. As a reminder, that has been set out by the Crown as follows:

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

Delivering against our financial outputs clearly also delivers against our investment duty. However, in addition to these financial measures we have chosen a number of non-financial indicators. These include:

- Our progress with Responsible Investment. We are a signatory to the United Nations Principles of Responsible Investment. Asset owner signatories, of whom there are some 500 representing total assets of approximately USD20trn complete an annual self assessment of their progress towards achieving the aims of the six UNPRI principles. Comparative results are available by region. Our aim is to be an active participant and where possible a leader in both debate and policy development in our region (Australasia), and therefore in the top quartile by assessment, and to be up with good practice globally, i.e. second quartile or better.
- Assessment of our policies and practices against peers. Delivery of a quantitative measure of our performance against best-practice is elusive. However we have settled on four strands of measurement which we believe represent a rigorous approach:
    - The first is an ongoing evaluation of our management practices against a self-selected global peer group. These funds, which include some of the world's leading pension funds and the leading US university endowments are all leaders in the industry and recognised by such by their peers. Their business practices vary considerably although underlying core principles can be seen in each. Because of that variation we do not seek to emulate any one organisation but rather to extract the best practices relevant to our own circumstances.

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We expect a reduction in total costs per dollar of Fund size over the period of this statement.

- The second is that the Guardians are subject to an independent review every five years. The reviewer is selected by the Minister of Finance. The next review is due in calendar year 2009.
- A third measure is how we score against the Generally Accepted Principles and Practices for Sovereign Wealth Funds developed under the auspices of the International Monetary Fund.
- The final measure of best practice acknowledgement is how we are ranked in independent studies. Such studies are not undertaken systematically but they are a recurring theme of academic research.

8. Our measurement and performance matrix

DESIRED OUTCOME: REDUCING THE TAX BURDEN ON FUTURE TAXPAYERS OF THE COST OF NEW ZEALAND SUPERANNUATION/NZS				
Financial outputs	**Relevant investment duty**	**Frequency**	**Benchmark**	**Target**
Determining an optimal mix of market exposures	Maximising return without undue risk Best-practice portfolio management	Rolling five year	NZ 90-day Treasury bills	Treasury bills + 2.5% p.a.
Best-practice portfolio management	Maximising return without undue risk Best-practice portfolio management	Rolling five year	% return on index matching passive SAA	Match index
Adding value through active management	Maximising return without undue risk Best-practice portfolio management	Rolling five year	Zero net of all fees	+ 0.50% p.a.
Non-financial outputs				
UNPRI rating	Avoiding prejudice to New Zealand's reputation	Annual	Peer comparison	Top quartile as Australasian asset owners. Top half as global asset owners
Peer evaluation	Best-practice portfolio management Avoiding prejudice to New Zealand's reputation	Ongoing	Five-year performance Auditor General feedback	Positive review
Independent review selected by Minister of Finance	Best-practice portfolio management	Five yearly	n/a	Positive review
Compliance with Generally Accepted Principles and Practices (GAPP) for SWF	Best-practice portfolio management Avoiding prejudice to New Zealand's reputation	Annual	GAPP assessment	Meet all principles
Independent studies	Best-practice portfolio management Avoiding prejudice to New Zealand's reputation	As available	Best practice as determined by study	Top quartile or equivalent

Forecast Statement of Service Performance

In the context of the matrix above, the following projects are particularly relevant for the coming financial year:

Project	Relevant output	Relevant investment duty	Frequency	Relevant Benchmark	Relevant Target
Review of Strategic Asset Allocation	Determining an optimal mix of market exposures	Best-practice portfolio management	Periodic	NZ 90 day Treasury bills	+ 2.5% p.a.
Implementation of Strategic Tilting	Adding value through active management	Maximising returns without undue risk	Ongoing	Zero net of all fees	+ 0.10% p.a. (element of 0.85% p.a.)
Focus on cost efficiency, including embedding of Treasury unit	Adding value through active management (esp. Cost control)	Best-practice portfolio management	Ongoing	Zero net of all fees	+ 0.50% p.a.
Independent Review commissioned by Minister of Finance	All three – relates to 'fit-for-purpose' portfolio	Best-practice portfolio management	Five-yearly, timing determined by Minister	n/a	Positive review

9. Our accountability to the Minister of Finance

We provide a quarterly report on the progress of the Guardians and the Fund to the Minister of Finance in addition to the public disclosure on our website (www.nzsuperfund.co.nz).

The Act clearly gives the Guardians responsibility for setting the investment strategy for the Fund. Accordingly, we would not expect to consult the Minister on the development or implementation of strategy.

There are a limited number of activities we cannot undertake without prior approval from the Minister. We described these in section 3. From time-to-time we have sought such approvals together with exemptions from restrictions in broader public sector legislation and the Minister has given those approvals. An example is our ability to use derivatives as part of the investment strategy.

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 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 as well as report any such directions in our Annual Report.

The Act clearly gives the Guardians responsibility for setting the investment strategy for the Fund.

10. Acquisitions

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

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 it to seek control of that entity. We are very conscious of this obligation. The investment guidelines we have in place with external managers place strict limits around the proportion of a company's issued capital each manager can own. We actively monitor the proportion of issued capital the Fund owns to ensure it is not deemed to hold 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.

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

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

11. Estimated Returns for the Fund

Estimating a Return for 2009/10

We are legally required to outline our expectations of 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 impossible. At best we can use our modelling techniques to provide a range of likely outcomes and outline the mid-point of this range.

In practice, our predictive confidence about market returns improves the longer the investment horizon. The mid-point of our estimated Fund return for 2009/10 is derived from our expectations for market returns over the next decade as a whole. An example of this range, and how wide it can be even over a 10-year period, is provided below. We also provide numerical examples for each component.

> “Our predictive confidence about market returns improves the longer the investment horizon.

- ***The risk-free rate at 5.9%***

This is our estimate of return of 90-day New Zealand Treasury bills. This estimate is based on subtracting an estimated 0.2% term premium from our assessment of the equilibrium New Zealand Government 10-year bond yield.

- ***The reward for market risk at 4.3%***

We define the reward for market risk as the margin between the risk-free rate and the return that would be generated on the passive portfolio.

We estimate this number over a 40-year horizon (to generate the long run reward for market risk). We also estimate over the shorter 10-year horizon, which incorporates the impact on returns arising from reversion towards equilibrium valuations.

Our modelling suggests a long-run return for market risk of 2.9% per annum with an additional 1.4% return per annum over the next 10 years, as assets are priced well below equilibrium valuations at present.

Our estimate of the 10-year reward for market risk has a 95% probability range of around +/- 6% (i.e. there is a 95% probability of the reward for market risk falling in the range of 1.7% per annum below the risk-free rate and 10.3% per annum above the risk free rate over that period).

- ***The reward for value-adding activities of 0.5%***

The return from the activities we undertake to add value to the Fund comes from those activities we describe in Section 7.

As with our estimates for the return for market risk, we project a long-run (40-year horizon) return for value-adding and then consider whether the current market environment suggests a greater or lesser ability to add value. In this case our long- run estimate is 0.5% per annum but we think that the current opportunity set will deliver a slightly higher value-add.

This means the mid-point of our estimated range for the nominal average return over the next 10 years is 10.70% p.a.

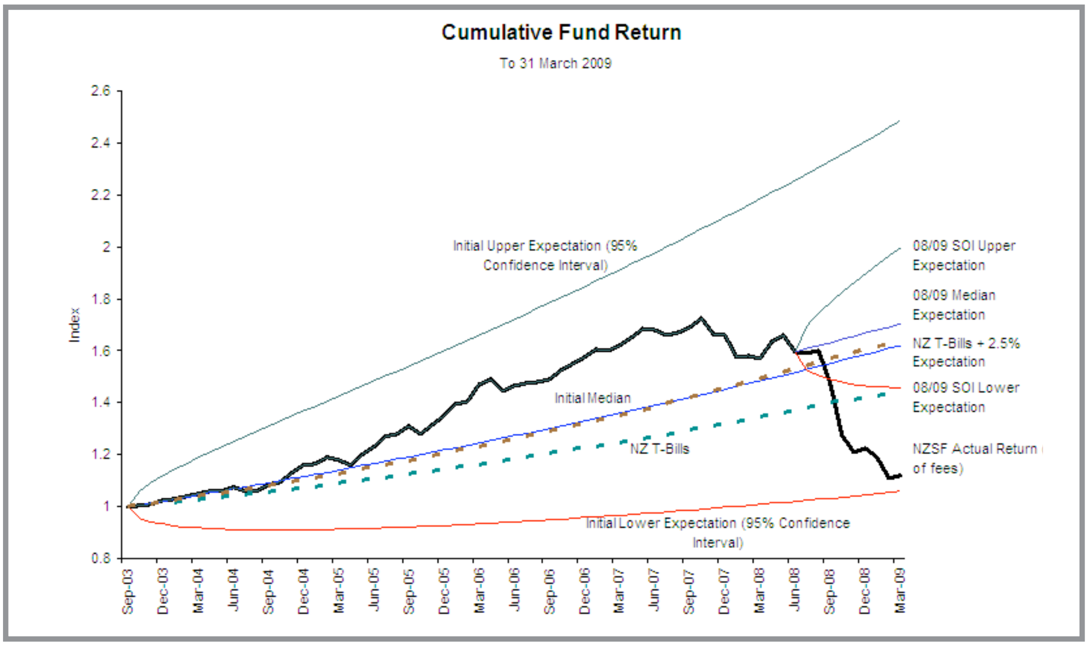
Again, we emphasise that there is considerable uncertainty around our mid-point estimate for expected financial market returns (as illustrated in the table in Section 7). Our modelling suggests only a two-thirds chance (around 68%) of returns finishing in the range of 8% per annum to 14% per annum. We have a 95% chance of returns falling in the range of 5% per annum to 17% per annum over any 10-year period.

As mentioned above, these confidence intervals are wider still over any single year. For example, over a one-year horizon the two-thirds probability range is around +/-10% either side of the mid-point range. The 95% range is around +/-20% either side of the mid-point. This can be seen in the graph at the bottom of this section.

Our 10.7% estimate for the long-term nominal average return is above our 2008/09 estimate of 9.6%. The increase reflects a small fall in the expected return for 90-day New Zealand Treasury bills and a large rise in risk premiums associated with declining equity and other asset markets over the last year.

Performance Comparison

In the five-and-a-half years since we began investing, the excess return over the risk-free rate has been -4.93% (i.e., annualised returns of 2.09% against the risk-free rate of 6.77% for the same period). The Guardians had previously estimated the average expected excess return would be around 2.5% over this period. The difference is just within the 95% confidence range around the central expectation, as can be seen in the below chart.



12. Financial Projections for the 2009/10 Year

12.1 Cost Allocation Model

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

The costs incurred by the Board of the Guardians (comprised of Board fees, the cost of travel to and from Board meetings, and the cost of external audit for the Guardians) are met from Parliamentary appropriation. These expenses amount to $0.50 million p.a. (GST exclusive) in 2009/10.

The Fund costs are those incurred in the establishment and implementation of investment policy, the management of the organisation, and the financial and risk management of Fund assets. These costs are recovered from the Fund and include remuneration, staff expenses such as office services, travel, and professional development. These costs amount to $21.17 million in 2009/10.

Together, the total costs of the Guardians in 2009/10 are expected to be $21.84 million (GST exclusive). This is equivalent to 0.16% of expected average funds under management over 2009/10.

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

The Guardians have prepared prospective financial statements for the Fund. The estimates assume that earnings will be broadly in line with their medium-term estimate (i.e. 10.7% p.a. after costs but before New Zealand tax). Some costs are fixed (e.g. audit costs and most advisory services) and can be easily estimated, but the majority are variable (i.e. base and performance fees paid to investment managers or transaction fees paid to the custodian). The Guardians have prepared estimates of these variable costs based on their expectations of the portfolio over the year.

12.2 Prospective Financial Statements

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

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

The Board has authorised the issue of these prospective financial statements on 21 May 2009. 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. The Board does not intend to update these prospective financial statements subsequent to presentation.

Guardians of New Zealand Superannuation and Group

Prospective Statement of Financial Performance
For the year ending 30 June 2010

	$000
Revenue from parliamentary appropriation	504
Revenue from New Zealand Superannuation Fund	21,174
Other income	161
Total revenue	**21,839**
Board-related expenses	(823)
Employee remuneration and related expenses	(14,053)
Depreciation	(2)
Other expenses	(6,961)
Total expenses	**(21,839)**
Net surplus/(deficit)	**0**

Guardians of New Zealand Superannuation and Group

Prospective Statement of Financial Position
As at 30 June 2010

	$000
Assets	
Current assets	
Cash and cash equivalents	1,164
Trade and other receivables	1,778
Non-current assets	
Property, plant, and equipment	0
Total assets	**2,942**
Liabilities	
Current liabilities	
Trade and other payables	817
Accrued employee benefits	1,355
Provisions	270
Total liabilities	**2,442**
Net assets	**500**
Equity	
Accumulated surplus	0
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 2010

	$000
Balance at 30 June 2009	**500**
Profit for the year	0
Total recognised revenue and expense for the year	**0**
Balance at 30 June 2010	**500**

Guardians of New Zealand Superannuation and Group

Prospective Statement of Cash Flows
For the year ending 30 June 2010

	$000
Cash flows from operating activities	
Cash was provided from:	
Receipts from the Crown	504
Receipts from New Zealand Superannuation Fund	21,174
Interest received	41
Goods and Services Tax	718
Cash was applied to:	
Payments to suppliers	(8,236)
Payments to employees	(14,053)
Net cash provided by/(used in) operating activities	**148**
Net increase in cash and cash equivalents	**148**
Cash and cash equivalents at the beginning of the year	1,016
Cash and cash equivalents at the end of the year	**1,164**

Guardians of New Zealand Superannuation and Group

Summary of Significant Accounting Policies

GENERAL INFORMATION

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

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

STATEMENT OF COMPLIANCE

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

The prospective financial statements of the Guardians of New Zealand Superannuation and Subsidiaries for the year ended 30 June 2010 were authorised for issue in accordance with a resolution of the Board on 21 May 2009.

BASIS OF PREPARATION

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

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

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

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

(a) Consolidation of subsidiaries

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

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

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

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

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

(b) Revenue and income

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

Rendering of services

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

New Zealand Superannuation Fund reimbursement of costs:
Stage of completion is measured by the proportion of costs incurred to date, compared to the total costs of the outputs.

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

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

Interest

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

(c) Goods and Services Tax (GST)

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

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

(d) Taxation

The Guardians are 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 expected realisable value after providing for doubtful and uncollectible debts.

(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, items of property, plant, and equipment are 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 financial performance in the year the item is disposed of.

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

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

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 financial performance immediately.

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

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

Held for sale

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

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

(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
Leasehold improvements	3–6 years

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

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

(j) Employee benefits

Provision is made for benefits accruing to employees in respect of wages and salaries, annual leave, long service leave, employee 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 the 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

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

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

(l) Foreign currency transactions

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

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

(m) Financial instruments

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

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, 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.

(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 and other sources of revenue that support the Group's operating activities. Cash outflows include payments made to employees, suppliers, and for taxes.

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

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

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

(r) Changes in accounting policies

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

(s) Critical accounting estimates and assumptions

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

Employee entitlements – long-term incentives

A component of the long-term incentive scheme is a measure of the performance of the Fund, calculated based on a rolling four-year performance average. The calculation of this liability utilises assumptions regarding the future performance of the Fund. Should the performance of the Fund differ from the assumption utilised in the calculation of the liability for long-term incentive, this will impact the employee benefits expense in the statement of financial performance, and the carrying amount of the liability in the statement of financial position. The Group minimises the risks of this estimation uncertainty by using a model based on historical evidence to forecast future returns of the Fund.

SIGNIFICANT ASSUMPTIONS ADOPTED IN THE PREPARATION OF PROSPECTIVE FINANCIAL STATEMENTS

The Guardians' forecast is based on the key assumption that the headcount for the Guardians will increase from 58 to 63 full-time equivalent employees.

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

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

New Zealand Superannuation Fund and Group

Prospective Statement of Financial Performance
For the year ending 30 June 2010

	$000
Income	
Interest income	97,575
Dividend income	264,787
Timber sales	26,260
Fair value changes in investments at fair value through profit or loss	949,077
Net foreign exchange gain / (loss)	-
Fair value changes in timber investments – forests	47,876
Share of profit of investments accounted for using the equity method	89,488
Other income	7,635
Net operating income / (loss)	**1,482,698**
Expenses	
Timber expenses	(13,848)
Depreciation and amortisation	(2,181)
Managers' fees – base	(58,208)
Managers' fees – performance	(12,717)
Custody fees	(6,000)
Other expenses	(38,674)
Profit / (loss) for the year before income tax expense	**1,351,070**
Income tax expense	(306,864)
Profit / (loss) for the year after income tax expense	**1,044,206**

New Zealand Superannuation Fund and Group

Prospective Statement of Financial Position

As at 30 June 2010

	$000
Assets	
Cash and cash equivalents	422,907
Investments	
Derivative financial instrument assets	51,816
Other financial assets	12,759,148
Investments accounted for using the equity method	871,857
Timber investments - forests	415,622
Total investments	**14,098,443**
Trade and other receivables	71,792
Property, plant, and equipment	48,621
Deferred tax asset	613,276
Total assets	**15,255,039**
Liabilities	
Trade and other payables	646,805
Provisions	17,090
Taxation Payable	21,894
Total liabilities	685,789
Net assets	**14,569,250**
Equity	
Retained surplus	(396,659)
Foreign currency translation reserve	59,760
Land revaluation reserve	24,070
Contributed capital	14,882,079
Total public equity	**14,569,250**

New Zealand Superannuation Fund and Group

Prospective Statement of Changes in Public Equity

For the year ending 30 June 2010

	$000
Balance at 30 June 2009	**13,275,044**
Gain/(loss) on revaluation of land	-
Net income for the year recognised directly in equity	-
Profit for the year	1,044,206
Total recognised revenue and expense for the year	**1,044,206**
Fund capital contributions from the Crown	250,000
Balance at 30 June 2010	**14,569,250**

New Zealand Superannuation Fund and Group

Prospective Statement of Cash Flows
For the year ending 30 June 2010

	$000
Cash flows from operating activities	
Cash was provided from:	
Dividends received	264,787
Interest received	97,575
Receipts from customers	33,895
Cash was applied to:	
Managers' fees	(72,028)
Payments to suppliers	(56,881)
Income tax paid	-
Net cash provided by/(used in) operating activities	**267,348**
Cash flows from investing activities	
Cash was provided from:	
Proceeds from the sale of investments	12,879,063
Cash was applied to:	
Payment for the purchase of investments	(13,499,583)
Net cash provided by/(used in) investing activities	**(620,520)**
Cash flows from financing activities	
Cash was provided from:	
Capital contributions from the Crown	250,000
Net cash provided by/(used in) financing activities	**250,000**
Net increase/(decrease) in cash and cash equivalents	(103,172)
Cash and cash equivalents at the beginning of the year	526,079
Effects of exchange rate changes on foreign currency cash	-
Cash and cash equivalents at the end of the year	**422,907**

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, 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 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.

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.

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

STATEMENT OF COMPLIANCE

The Fund is a profit-oriented entity. The prospective financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP) as it relates to prospective financial statements.

The prospective financial statements of the New Zealand Superannuation Fund and Subsidiaries for the year ended 30 June 2010 were authorised for issue in accordance with a resolution of the Board on 21 May 2009.

BASIS OF PREPARATION

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

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

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

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

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

(a) Capital contributions

(i) Fund capital contributions

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

(ii) Superannuation entitlement payments

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

(b) Capital withdrawals

(i) Fund capital withdrawals

In terms of Section 47 of the Act no withdrawals of Fund capital contributions are permitted in any financial year before 1 July 2020.

(ii) Superannuation entitlement payments

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

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

(c) Income tax

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

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

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

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

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

- 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 of that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

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

Income tax relating to items recognised directly in equity is recognised in equity and not in the statement of financial performance.

(d) Financial instruments

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

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:

- 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)
    - Forward foreign exchange contracts iii)
    - Futures contracts iii)
    - Equity swaps iii)
    - Commodity swaps iii)
    - Multi-strategy funds iv)
    - Certain private equity investments v)
    - Unlisted unit trusts vi)
- Available for sale financial assets at cost: certain private equity investments vii)
- Investments accounted for using the equity method (refer accounting policy (h))
- Timber investments – forests (refer accounting policy (i))

Financial instrument investments (other than investments accounted for using the equity method and available for sale financial assets) are initially recognised at fair value on a trade date basis. Transaction costs, for example trading commission, are expensed immediately in the statement of financial performance. Subsequent to initial recognition, these investments are recorded at fair value and are classified in the category "at fair value through profit or loss". The Guardians manage and evaluate the performance of these investments on a fair value basis in accordance with the Fund's investment strategy and information about the investments is provided internally on this basis to the Guardians' key management personnel. Changes in fair value are recognised in the statement of financial performance.

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

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 as quoted on the relevant exchange as of the close of business at balance date. The fair value of unlisted equities 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.

ii) Fixed interest securities are valued at the last quoted bid price by a reputable pricing vendor or broker as of the close of business at balance date.

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

iv) Investments in multi-strategy 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 multi-strategy fund.

v) Investments in certain private equity funds (unlisted investment funds) 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 fund. 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 funds are classified as available for sale. The accounting policy for these investments is outlined under vii).

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) Certain private equity funds that do not have a quoted market price in an active market and whose fair value cannot be reliably measured using the valuation methods outlined in v) above are classified as available for sale and are measured at cost less impairment. Transaction costs are included in the cost of the investment. Management has determined that fair value for these funds cannot be reliably measured where the fund's financial statements have not been prepared under either IFRS or a recognised and reliable accounting basis such as US GAAP.

Derivatives
The Group enters into a variety of derivative financial instruments to manage its exposure to foreign currency risk (forward foreign exchange contracts), and achieve exposure to assets and asset classes (futures contracts, options, equity swaps, and commodity swaps). The use of derivatives is governed by the Guardians' Statement of Investment Policies, Standards, and Procedures as approved by the Board, which provides written principles on the use of derivatives by the Group.

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

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 commodity swaps and equity swaps is provided by the counterparty and is calculated by reference to the movement in the underlying index or basket of securities. Commodity swaps and equity swaps are settled net in cash. The fair value of options is calculated using a Black-Scholes option valuation model.

(f) Securities lending

Securities lending transactions are collateralised by securities or cash. The transfer of the securities to counterparties is only reflected in the statement of financial position if the risks and rewards of ownership are also transferred. Collateral advanced by the borrower in the form of securities 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 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, when the securities are returned by the borrower.

(g) Consolidation of subsidiaries

Subsidiaries are those entities that are controlled by the Fund.

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

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

(h) Investments in associates

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

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

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

(i) Timber investments - forests

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

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

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

(j) Receivables

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

(k) Property, plant, and equipment

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

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

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

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

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

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

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

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

Impairment

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

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

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

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

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

Held for sale

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

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

(l) Depreciation

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

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

Land improvements	15-50 years
Office equipment	3 years
Computer equipment	3 years
Office fitout	2-6 years

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

(m) 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.

(n) Payables

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

(o) 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.

(p) Income recognition

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

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

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

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.

(q) Foreign currency transactions

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

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

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

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

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

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

(s) Statement of cash flows

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

- *Operating activities* include all transactions and other events that are not investing or financing activities.
- *Investing activities* are those activities relating to the acquisition, holding, and disposal of investments. Investments include securities not falling within the definition of cash, including those cash flows from the settlement of forward foreign exchange contracts.
- *Financing activities* are those activities relating to capital contributions and to payments of superannuation entitlements (from 2020). As the current funding 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* include cash balances on hand, held in bank accounts, demand deposits, and other highly liquid investments with an original maturity of three months or less.

(t) 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.

(u) Changes in accounting policies

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

(v) Significant estimates and judgements

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

SIGNIFICANT ASSUMPTIONS ADOPTED IN THE PREPARATION OF PROSPECTIVE FINANCIAL STATEMENTS

Capital contributions from the Crown are determined using the Treasury's funding model which in turn relies on a number of macroeconomic and government budgetary factors, and the past performance of the Fund.

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

The distribution of investments between various categories is driven by the Fund's SAA, last updated in November 2007.

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

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

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

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

APPENDIX 1 – Investment Beliefs and Facts

Investment Decision	Investment Beliefs	Investment Facts
Governance and investment objectives	Clear governance and decision-making structures that promote decisiveness, efficiency and accountability are effective and add value to the Fund.	It is important to be clear about investment objectives for the Fund, risk tolerance, and the timeframe over which results are measured
Asset Allocation	Asset allocation is the key investment decision Investors with a long-term horizon can outperform more short-term focused investors over the long-run	Risk and return are strongly related. There are varied investment risks that carry premiums/compensations. Illiquidity risk is one such premium. Investment diversification improves the risk to return (Sharpe) ratio of the Fund
Asset class strategy and portfolio structure	Expected returns are partly predictable within asset classes and returns can revert toward a mean over time.	Investment markets are competitive and dynamic, with excess returns very difficult to find and constantly changing source Market volatility tends to cluster over short horizons but mean-reverts over longer horizons. Investment risks can be unbundled to make the Fund more efficient. This includes the separation of market (beta) and investment specific investment manager skills (alpha).
Manager and investment selection	Some managers can outperform a market benchmark (produce alpha) over time. Some active investment strategies can outperform a market benchmark, net of all costs, over various time periods We can identify managers that will outperform the market benchmark (produce alpha) over time. Identifying the life cycle of an investment is important to assessing the expected return Responsible asset owners who exercise best-practice portfolio management should have concern for environmental, social, and governance (ESG) issues of companies. Improving ESG factors can improve the long-term financial performance of a company	Each investment should be made on the basis of its expected value-add to the Fund as a whole. Principal/agent conflicts exist with outsourced investment managers
Execution	Managing fees and costs and ensuring efficient implementation can prevent unnecessary cost	

APPENDIX 2 – Organisation chart as at 30 April 2009

CHIEF EXECUTIVE OFFICER

GENERAL MANAGER Portfolio Research	GENERAL MANAGER Public Markets	GENERAL MANAGER Private Markets	GENERAL MANAGER Operations	GENERAL MANAGER Finance	GENERAL MANAGER Corporate Strategy	GENERAL MANAGER Human Resources
- Portfolio Strategy and Research	- External Manager Appointments (Commodities, Fixed Interest, Listed Equities, Private Equities)	- External Manager Appointments (Infrastructure, Property, Timber)	- Operations Information Technology, Portfolio Risk and Compliance, Treasury	- Fund's and Guardians' Accounting, Tax, Internal Audit	- Responsible Investment, Communications, Legal	- Human Resources - Administration
(5 people)	(8 people)	(5 people)	(16 people)	(7 people)	(6 people)	(6 people)

APPENDIX 3 – Glossary

New Zealand Superannuation and Retirement Income Act 2001 (Act): This Act defines current entitlements to New Zealand Superannuation; establishes the New Zealand Superannuation Fund (Fund) with sufficient resources to meet the present and future cost of New Zealand Superannuation; provides for Crown contributions to the Fund; establishes a Crown entity to manage and administer the Fund called the Guardians of New Zealand Superannuation; establishes a process for signalling political agreement on parameters for New Zealand Superannuation entitlements and fundings; and brings together in one Act all of the provisions for each of those matters.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Derivatives: Financial contracts that derive their value from an underlying asset or index, such as an interest rate or foreign currency exchange rate. They can be used to manage risk, reduce cost, and enhance returns. Some common derivatives are forwards, futures, swaps, and options.

Diversification: Investing in a variety of assets or through a number of managers in order to spread risk.

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

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

Fund manager (also asset or investment manager): Invests and manages the assets of others.

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

Index: A measure of performance of a collection of assets typically across a sector, country, region or style (e.g., Dow Jones, MSCI).

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

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

Management fee: A fee that the manager of a fund charges for managing the portfolio and operating the Fund.

Passive management: An investing strategy that mirrors a market index and does not attempt to beat the market. Also known as 'passive strategy' or 'passive investing'.

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

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

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

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

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

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

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

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

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

Risk tolerance: The amount of loss an organisation is willing or able to tolerate should a downside risk materialise.

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

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

Strategic tilting: Altering asset allocation weights as expected returns change over time.

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

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

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