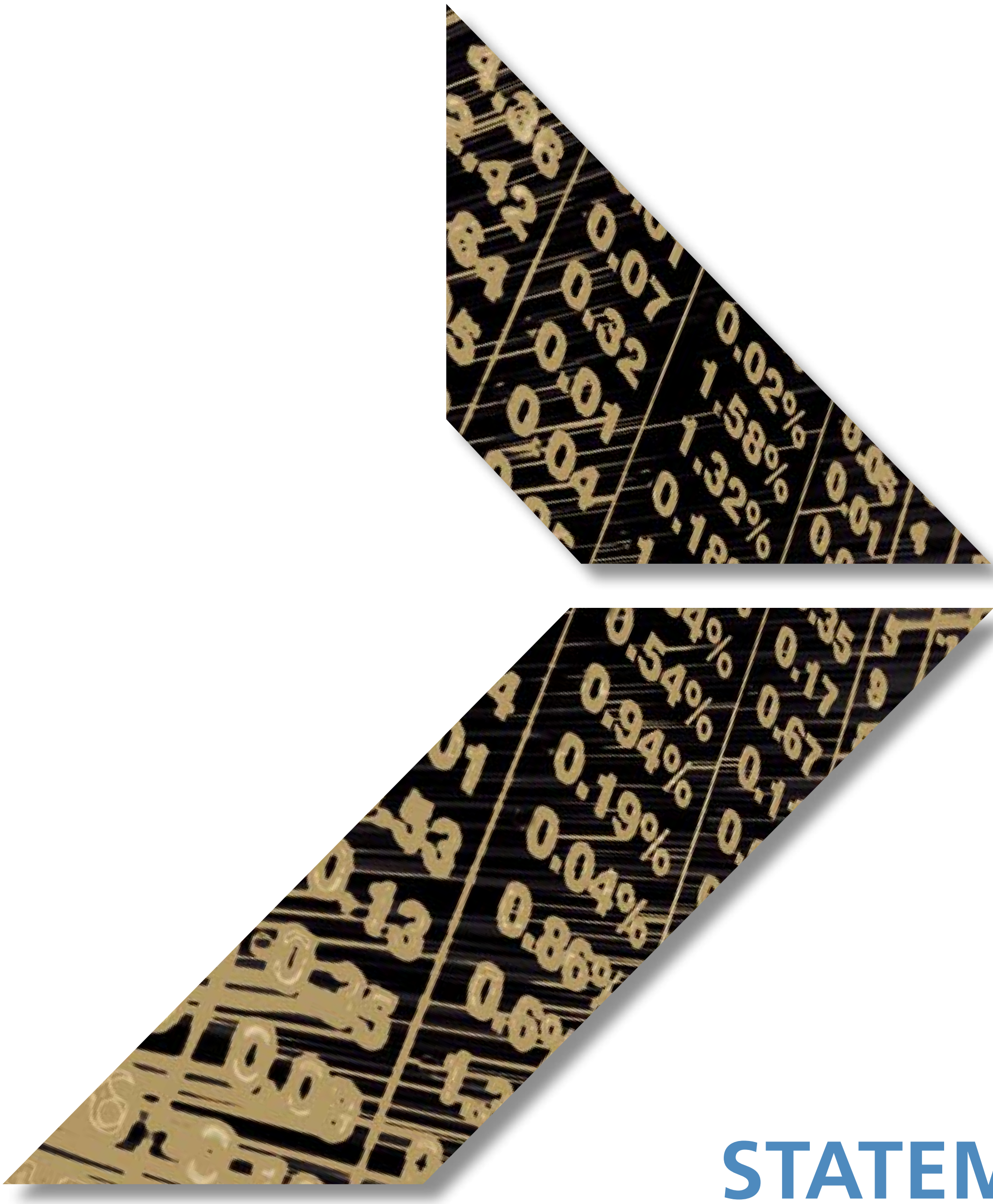
Guardians of New Zealand Superannuation



STATEMENT OF INTENT

For the period commencing 1 July 2010 to 30 June 2015

NEW ZEALAND
SUPERANNUATION
FUND

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The New Zealand Superannuation Fund and the Guardians of New Zealand Superannuation were established by specific legislation for a specific purpose.

The big picture

Between 2005 and 2050 Government data predicts that the number of New Zealanders eligible to retire (aged 65+) is expected to double. The associated cost of providing their retirement income New Zealand Superannuation (NZS) is also expected to double.

What this means is that there will be fewer 'working-age' people whose productivity can be tapped, through taxation, to fund NZS for a greater number of retired New Zealanders than ever before in New Zealand's history. This has clear implications for future Governments' ability to fund other vital areas such as health, welfare, education and law enforcement.

This is a situation with clear relevance for you, your children and your grandchildren.

How does the Fund and the Guardians respond to this?

The establishment of the Fund and the Guardians recognises New Zealand's ageing population as a significant, multigenerational issue. The Fund attempts to address this situation by 'smoothing' the tax burden between generations of New Zealanders, of the future cost of NZS. It does this by investing Government contributions received during the early period of the Fund and, through returns generated over decades of investing, by growing the size of the Fund. At a certain point - currently from 2031 - the Government then begins making withdrawals from the Fund to help to meet the cost at that time of NZS.

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

In the 2009 Budget the Government decided to reduce contributions to the Fund until the Crown operating balance returns to surplus sufficient to resume contributions. The Treasury estimates this to be in 2020. The Treasury has explained that this means the Fund will be smaller in size when withdrawals begin in 2031 and so the 'buffer' effect of the Fund will also be less.

Regardless, the focus of the Guardians on adding the maximum possible economic value is unchanged.

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

We think of it this way – the **Fund** is expected to add to Crown wealth over the long term by earning more for the Government in investment returns than the Government would save in debt servicing i.e. adding to Crown wealth and improving its ability to meet increased Superannuation commitments in the future.

For our SOI we wanted to state that impact in a way meaningful to all New Zealanders. That is why we have described the Fund's ultimate outcome as "Reducing the tax burden on future New Zealand taxpayers of the cost of New Zealand Superannuation". We believe that if the Fund improves the Crown's financial position, it will have reduced the tax burden.

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

- Best-practice portfolio management
- Maximising return without undue risk
- Without prejudicing New Zealand's reputation in the world community

For our SOI we have simply expressed this as 'managing the Fund'. It comprises our work to manage the investments, costs, risk, governance and our own organisational growth and ultimately to add value to the Fund and its intended outcome.

It is obvious that this is a long-term outcome. Our SOI sets out in detail how we plan to achieve that outcome, and how we intend to measure our progress toward it.

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

BOARD STATEMENT

On behalf of the Guardians of New Zealand Superannuation we are pleased to present our Statement of Intent (SOI) for the five-year period commencing 1 July 2010.

As is appropriate, this SOI builds on the five-year plan we set out in 2009. That plan reflected lessons learned from the global financial crisis (GFC). It was also impacted by the Government's decision, announced in the 2009 Budget, to suspend contributions to the Fund until the operating balance of the Government's accounts was sufficient in terms of cash flow to resume those contributions.

The Fund is large and has an important task. As Guardians we remain determined to add economic value and to develop organisational characteristics to ensure our ongoing success. We maintain a long-term perspective on investing and developing our organisation. During the 2009/10 financial year we temporarily increased our weighting toward some classes of growth assets because we believed they were undervalued and presented an excellent opportunity. Subsequently, since the lowest point of the crisis in March 2009, we have experienced significant growth in returns as global markets have returned closer to more 'normal' conditions.

“We are mindful of the Government's desire for fiscal prudence and our statutory duty to invest on a commercial, prudent basis.

2010 Statement of Intent

The purpose of the Fund is to reduce the tax burden on future New Zealand taxpayers arising from the cost of providing New Zealand Superannuation. The purpose of the Guardians is to manage and administer the Fund to best achieve its purpose. The management activities set out in our 2010 SOI reflect this desired outcome.

Risk continues to be appropriate to our purpose and to our mandate

The risk in our portfolio is calibrated to our mandate, to maximise returns without undue risk, and to our long-term purpose. Consequently, our portfolio is weighted largely toward growth assets. Each of the investment strategies we pursue to develop our portfolio fits clear investment beliefs and our competitive advantages in location, our Government ownership, investment horizon, and liquidity requirements.

Costs are similar to what was forecast in the 2009 SOI and are rigorously benchmarked

The expected cost of managing the Fund in 2010-11 is similar to what was forecast in our previous SOI. We project actual costs to increase compared to those in 2009-10 (when our costs were lower than forecast), largely because of an anticipated increase in our investment activity.

Our investment decisions are based on expected net return, which requires us to weigh up the certainty of incurring cost against expectations of higher long-term returns. In doing so, we are mindful of the Government's desire for fiscal prudence and our statutory duty to invest on a commercial, prudent basis. As such, we place considerable emphasis on relevant peer benchmarks:

a. Our absolute costs are assessed in the annual CEM Survey, which benchmarks our costs against peer funds (see page 12). We publish the results in our Annual Report.

b. Our Reference Portfolio provides a transparent benchmark against which to measure the net value added by our active investments (i.e. our returns relative to a simple, low-cost, passively managed portfolio) over relevant periods of time (see page 9). Fund performance relative to the Reference Portfolio is also published in our Annual Report.

c. We incur external manager fees only when we firmly believe that the manager is: operating in an environment conducive to generating returns above the Reference Portfolio; utilising a good investment strategy; and satisfying our due diligence hurdles.

We are pursuing a full suite of New Zealand investment strategies

In May 2009 we received a direction from the Minister of Finance relating to investment in New Zealand, subject to our duty to invest on a commercial, prudent basis. Our analysis indicates that market conditions following the GFC were conducive to the Fund achieving an expected return in New Zealand, sufficient to compensate for the additional asset concentration risk. This was true in a few specific areas and we have established strategies accordingly. We expect to make progress on each of these strategies in 2010/11 with market conditions more conducive to such activity. The strategies agreed to date include:

- NZ Direct strategy providing capacity to make a small number of significant investments;
- Expansion Capital strategy aimed at small to mid-sized businesses with capital constraints and genuine growth potential;
- Cornerstone investment in Public Infrastructure Partnerships (PIP) Fund aimed at direct investment in public infrastructure; and
- A rural land strategy (a global strategy but with clear potential for applicability to New Zealand).

We are focussed on driving commercial benefits from our international relationships

Over time we have established a network of relationships with peer funds around the world. This network has sufficient strength for us now to focus on driving commercial and reputation benefits. Our goals in this regard are detailed in our Forecast Statement of Service Performance on page 16 but, in particular, as suitable opportunities arise we may be in a position to bring in other responsible, long-term sources of investment capital to the New Zealand economy.

We believe that the Guardians and Fund are well positioned to achieve our outcome of reducing the tax burden on future New Zealand taxpayers of the cost of New Zealand Superannuation. With an organisational backbone tempered by the global financial crisis and its aftermath, we have developed internal capabilities and clear investment strategies to capture favourable investment opportunities.

David May

DAVID MAY
Chairman
12 May 2010

DAVID NEWMAN
Deputy Chairman
12 May 2010

OUTCOME FRAMEWORK

This framework sets out what we are trying to achieve and how we plan to achieve it.

Our **outcome** is reducing the tax burden on future New Zealand taxpayers arising from the cost of New Zealand Superannuation.

Our single output is the management of the Fund. This output comprises the following **work programmes**: investment, cost control, risk management, governance, and organisational capability.

We have set out our key initiatives under each work programme and how their success will be measured in the short and medium term. We will report on progress against those measurements in our Annual Report.

OUTCOME OF FUND: WHAT IS OUR GOAL?

Reducing the tax burden on future New Zealand taxpayers of the cost of New Zealand Superannuation

(See page 5)

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

Managing the Fund

(See page 8)

IMPORTANT EXTERNAL AND INTERNAL INFLUENCES: WHAT EXPECTATIONS ARE THERE ABOUT HOW WE DELIVER OUR SERVICES?

Internal	External
Our Values	Statutory duties imposed by legislation
Our Investment Beliefs	
Our Mission	
Our Vision	

(See the *Introduction to the Guardians and Fund* on the front page of the website)

WORK PROGRAMMES: WHAT ACTIVITIES ARE WE UNDERTAKING TO DELIVER OUR SERVICE?

Investment	Cost control	Risk management	Governance	Organisational capability

(See pages 9-15)

Our single output is the management of the Fund.

OUTCOME

Reducing the tax burden on future New Zealand taxpayers arising from the cost of New Zealand Superannuation

Where to go for more information: See the *Why We Exist* page on our website

On current Treasury projections the Government begins capital withdrawals in 2031. Those who are eligible to first receive New Zealand Superannuation in 2031 are now aged 44.

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

However, we acknowledge that there is considerable interest in the Fund's progress and that most observers would not expect to wait until 2027. In fact, there are waypoints short of 20 years' time which have significance for the performance of the Fund and for our management of it. These can be seen in Table 1.

Tables 1-3 on this and the following pages set the context for the one, five, and 20-year periods we have established for our outcome and our output measures.

Table 1 – Significant time periods for the Guardians and Fund

Horizon period	Why does it matter?	Relevant SOI measurement period
1 year	Monitoring of short term investment manager performance. Financial reporting to the Crown.	1 year
Minimum 5-10 years	Core period for review of Reference Portfolio (see page 10) and to assess value-add and excess return. Interval for Independent Review	5 and 10 years
10-20 years	Key period for judging the impact of Fund returns on the Fund's objective and of our long-term value-add strategies.	10 and 20 years
>20 years	Withdrawals begin. Consistent with longer-term mandate of the Fund	20 years

Table 2 – Outcome measures

	Measure	Guardians One year horizon	Fund Five year horizon	Fund 20 year horizon
Maximising returns....	Reference Portfolio Returns relative to T-Bills	+3.20%	+3.20% per annum	+ 2.35% per annum
	Actual Fund returns relative to Reference Portfolio (after costs)	+0.55%	+0.80% per annum	+0.95% per annum
....without undue risk	Expected worst case downside return[1]	-31% (per annum)	-5% per annum	-3% per annum

1. We define a 'worst case' scenario as one with a 1 in 100 chance of occurring within the specified timeframe. It is based on a 30-year investment horizon. See page 7 for further explanation.

Explanation of measures chosen

One-year Guardians' estimate

We are legally required to outline our expectations for the performance of the Fund over the next financial year. Predicting short-term financial market returns with useful accuracy over such a near-term horizon is, however, impossible. To reflect this we use a longer-term forecast – over five years – and then interpolate this forecast into annual figures. How we have calculated the five-year forecast is set out in detail on page 19.

Five and 20-year Fund estimates

These measures are based on movement toward long-run equilibrium for each asset class[2]. This involves two assessments:

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

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

If the Fund outperforms Treasury Bills over time it adds value to the Crown's financial position. We believe this impact can be expressed as reducing the tax burden on future New Zealand taxpayers.

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

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

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

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

If the Fund outperforms the Reference Portfolio over time we as managers are adding value to the Fund. This impact represents an additional contribution to reducing the tax burden on future New Zealand taxpayers.

The Reference Portfolio is our estimate of the best simple, low-cost, passive portfolio we could invest in to achieve our mandate. It therefore represents a benchmark for our ability to add value with more complex, expensive, active investment strategies such as strategic tilting, investing in private and/or illiquid assets, and investing in specific skills. We see these active investment strategies as consistent with our statutory duty regarding best-practice portfolio management; our investment beliefs and our competitive advantages. We discuss them in more detail on page 10.

"If the Fund outperforms Treasury Bills over time it adds value to the Crown's financial position. We believe this impact can be expressed as reducing the tax burden on future New Zealand taxpayers.

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

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

The volatility of the Fund returns over time shows the level of risk present in the investment path we have chosen for the Fund.

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

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

In Table 2, our modelling work, which has taken into account the additional potential for downside risk following the GFC, suggests there is a 1-in-100 chance of Fund returns being worse than: -31% in any one year; -5% in any consecutive five-year periods; or -3% in any consecutive 20-year period. In any such case, we need to explain what has happened (and will do so in the relevant period's Annual Report).

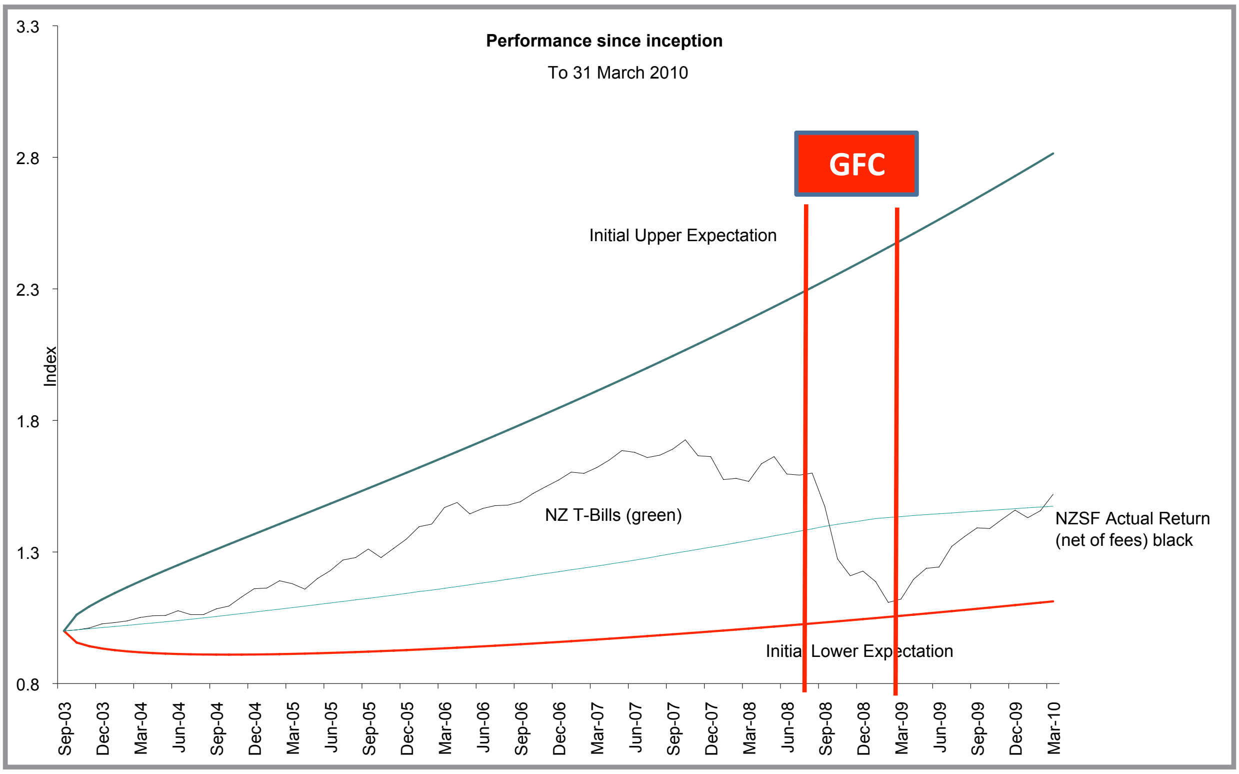
Our Reference Portfolio is designed with a 30-year investment horizon in mind. The 'worst-case' estimates are therefore also modelled on this time horizon.

Cumulative Fund return over time

This graph sets out the Fund's performance (the black line) relative to Treasury Bills (the green line) since inception. The graph also sets out the initial extreme upper and lower expectation ranges for the Fund's returns over time.

Most clear from this graph is the impact of the Global Financial Crisis (GFC). It is also clear from performance prior to the GFC that, while our focus is on minimising the risk of worst-case outcomes, returns can also exceed expectations on the upside.

Perhaps most important, this graph shows that the Fund has been in existence for less than seven years which is a very short time relative to its long-term purpose.



OUTPUT

Managing the Fund

For more information on our Values, Investment Beliefs, Mission, Vision and statutory duties see pages 4-6 of our *Introduction to the Guardians and Fund* on the front page of our website.

There are a number of important external and internal influences on how we manage the Fund:

- the internal influences - our Values, Investment Beliefs, Mission and Vision – are our own conception of how we should manage the Fund; and
- the external influences are statutory duties embedded in our establishing legislation.

Consistent with our outcome measures we have used one, five and 20-year periods for measuring our outputs. These are set out in table 3 below. We explain what each work programme encompasses, set out any key developments in each programme for 2010 and explain the measures we have chosen for each.

Table 3 – output measures

Contributing work programme	Measure	Guardians One Year Horizon	Fund Five Year Horizon	Fund 20 Year Horizon
Investment programme	**Measure and targets are same as for outcome**		**Measure and targets are same as for outcome**	
Cost control	**1. Costs relative to peers in CEM survey**	Rating of 'median cost, value-adding'	Ongoing	Ongoing
Risk management	**1. Expected worst case downside return[3]**	Better than -31%	Better than -5% p.a.	Better than -3% p.a.
	2. Transparency ratings over time (at least Linaburg Maduell)	10/10 Linaburg, results as appropriate to other surveys	Ongoing	Ongoing
	3. Annual updating of response to 'Santiago' Principles	Completed	Ongoing	Ongoing
	4. UNPRI Assessment over time	Top quartile	Ongoing	Ongoing
	5. Published records of voting, RI in practice	Published	Ongoing	Ongoing
Governance	**6. Outcome of independent reviews**	N/A (done five-yearly)	Good review, review and response published	Good review, review and response published
Organisational capability	**7. Key person risks identified and covered**	Achieved	Ongoing	Ongoing
	8. Key performance indicators achieved	Achieved	Ongoing	Ongoing

3. 'Worst case' means a 1 in 100 chance of occuring within the specified timeframe. See page 7 for further explanation.

WORK PROGRAMMES

Investment programme

What is encompassed

This programme encompasses all of our investment activity. For more information on our investment process, asset allocation, significant holdings and how we assess and select investment managers please see the What We Do and Structuring the Fund sections of our website.

> We have built capacity to invest directly in large assets in New Zealand.

Key influences on 2010 SOI

1. Having regard to the New Zealand Investment directive

In May 2009 we received a direction from the Minister of Finance which stated 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 full direction and our response are available via the *Investing in New Zealand* section of our website. In brief, we undertook to examine a range of investment opportunities allowing us to comply with the direction and with our statutory duties to invest on a prudent, commercial basis. We report our progress against the direction in ensuing Annual Reports. The first such report is on page 36 of our 2009 Annual Report.

While we remain optimistic that a number of value-adding investments will come to fruition over the period of this SOI, there is no guarantee that they will. Each opportunity must be weighed against our statutory duty to maximise returns without undue risk. We have built capacity to invest directly in large assets in New Zealand. We also believe that there is an opportunity to provide expansion capital to small and medium-sized growing businesses in New Zealand. We have also committed capital to an externally managed New Zealand infrastructure fund. For more information on our New Zealand investment strategies see the *Investing in New Zealand* section of our website.

2. The Reference Portfolio

The composition of the Reference Portfolio is currently being finalised and will be disclosed on our website and in our 2010 Annual Report.

Why are we using the Reference Portfolio?

The Reference Portfolio is important for a number of reasons, but primarily because:

- it represents a balance of risk and return which, because of our long-term investment horizon, is necessarily weighted in favour of growth assets;
- it underpins our expectations of the returns the Fund should produce over the long-term; and
- because it is represents a low-cost way to invest, it establishes an important performance benchmark for the additional value-adding investment activities we undertake within the Fund's actual portfolio.

What is in the Reference Portfolio?

We will disclose the detail of its composition once it is finalised. Very basically, the Reference Portfolio comprises exposures which are

- low-cost, simple (i.e. listed asset classes) and passive
- representative of the investable market
- appropriate to the risk profile of the Fund and
- relevant to a New Zealand investor.

How does it differ from our current passive benchmark?

Like the Reference Portfolio, the passive benchmark comprises passive public markets exposures (e.g. listed equities). However it also includes 'non-equilibrium' and 'active' investment concepts such as set allocations to illiquid assets such as infrastructure. The Reference Portfolio includes only low-cost, simple, passive exposures. It does not contain proxies for illiquid assets.

In Table 4 on the following page we illustrate the basic difference between the previous structure and the structure based on the Reference Portfolio.

Is the Reference Portfolio 'set and forget'?

The Reference Portfolio is an 'equilibrium' concept. This means that it is structured based on our assumptions of what the long-term value of various asset classes **should** be, regardless of what is actually happening to those values in any given market conditions. Therefore the Reference Portfolio's composition will only change if:

- our assumptions change about what long-term equilibrium return-for-risk should be; or
- aspects of the Fund's purpose or endowments change; or
- market developments mean that a narrower or wider set of representative market exposures can be obtained passively and at low-cost.

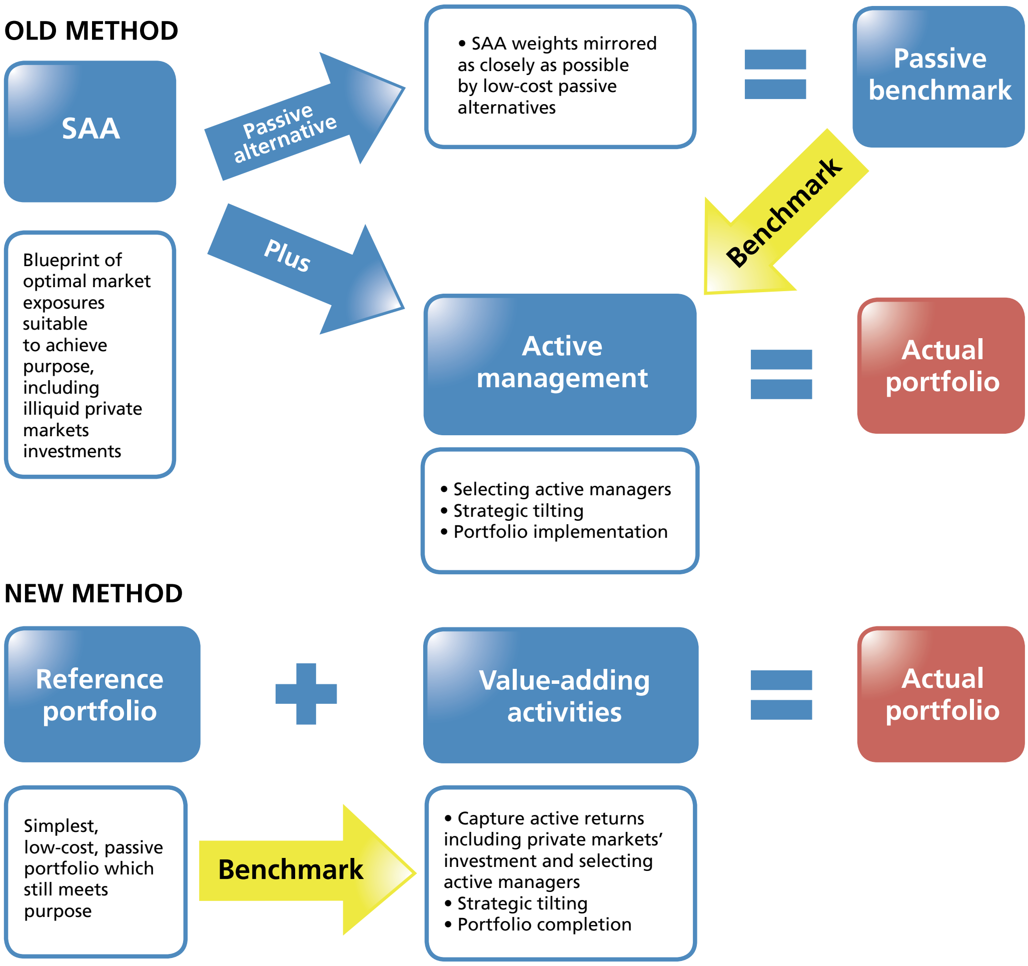
The Reference Portfolio will be augmented for practical purposes with asset-class ranges for the purpose of managing the Fund i.e. to ensure a regular benchmark against which we rebalance our investments.

How do we add value to the Reference Portfolio?

The actual Fund at any one time can – and very likely will – deviate from the Reference Portfolio based on what additional activities we believe will add value. This is underpinned by our recognition that investment opportunities come and go and, to benefit from this fluctuation, the active portfolio must be more dynamic. There are also investment strategies that can be anchored to our investment endowments (tolerance for illiquidity, long-term investment horizon, our location and Government ownership) our competitive advantages (the knowledge we have e.g. about New Zealand markets) and our investment beliefs.

> **The Reference Portfolio represents a low-cost way to invest and so establishes an important benchmark for our value-adding activities.**

Table 4 - Comparing portfolio construction methods



Explanation of measures

The measures for our investment programme are the same as for our outcome.

Cost control programme

What is encompassed

This programme encompasses all activity aimed at making our management and administration of the Fund as cost-effective as possible.

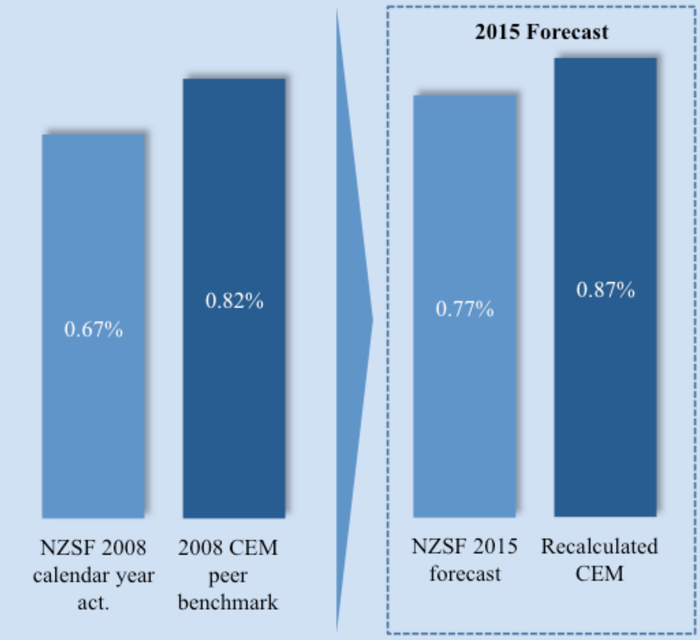
Key influences on 2010 SOI

Cost expectations

For the period covered by the 2010 SOI we expect total costs to be similar to the previous SOI. They are above our actual costs for 2009, as those costs were lower than budgeted for given the prevailing market conditions.

Asset Management Costs[1]

- Our current management costs are well below the 2008 CEM benchmark median for our peer group.
- Using the median peer cost per asset class from the 2008 CEM data we have calculated the cost of a median peer implementing an identical portfolio to our 2015 expected portfolio. This is shown below.



[1] These are defined by CEM as including investment management, oversight, custodial and other asset related costs (excludes performance fees)

The increase in forecast costs for 2010 reflects a return to more 'normal' market conditions and is a direct function of the more 'normal' corresponding level of investment activity we expect to be able to undertake. We believe the following points are important to understand about this:

- All the expenses we incur as part of our investment activity are subject to two important checks and balances: the low-cost principle underlying the Reference Portfolio; and the annual benchmarking of the costs we incur and the value we add, relative to peer funds, via the CEM survey (see below).
- Our expenditure includes investment in our own capabilities to manage the Fund efficiently i.e. in people and processes.
- Investment manager costs are an important component of our overall cost. We believe that pursuing certain active investment strategies will produce excess returns, and that some of these strategies are best managed by external experts.
- Peer group collaboration is a focus of this SOI, as can be seen in particular in our Statement of Service Performance on page 16. Its relevance to cost control will be through joint investments with other funds and, in the New Zealand context, through actively pursuing joint initiatives with fellow Crown Financial Institutions.

Explanation of measures

The Guardians participate in the annual cost structure benchmarking survey by CEM Benchmarking Inc. (CEM). The survey assesses the cost structure of the Fund against nearly 300 funds from around the world, focussing on 20 with similar risk profiles who also use active management strategies.

In the most recent survey, for the four years ended 31 December 2008, our Fund was rated low cost relative to our peer funds.

We disclose CEM survey results in each year's Annual Report. The most recent results are on page 42 of the 2009 Annual Report.

Risk management

What is encompassed

Managing risk is of fundamental importance to our governance of the Fund. Failing to appropriately identify, assess and manage risk has potentially significant financial, operational and reputational consequences. The risk management programme therefore encompasses our activities in those three risk-management areas. For more information on our risk management approach please see the Managing Risk section of our website, under What We Do.

Key influences in 2010 SOI

Following on from the lessons learned in the Global Financial Crisis our risk management focus is, internally, on enhancing our processes on managing risk and, externally, on ensuring we are as transparent as possible about our activities. In practice, this involves:

1. a thorough review of our policy frameworks to ensure that all of our policies – whether governing investment, operational, human resources or governance matters – are simple to understand and that all our staff are clearly aware of their responsibilities under each;
2. reviewing our significant disclosure channels including the website, Annual Report and SOI to ensure that our stakeholders and the public in general can easily understand why we exist, what we do, how we invest and why and how we are progressing against our objective; and
3. a focus on collaboration with peer funds (as set out in our Forecast Statement of Service Performance) to develop and share best practice, including in risk management and Responsible Investment. Peer funds are global funds (e.g. other sovereign wealth funds).

Explanation of measures

Financial

The Fund's key financial risk is that it will not meet its ultimate objective. We have already explained above, in discussing our Outcome Framework, that financial market returns are inherently volatile. We also discussed what, in this context, constitutes an 'undue risk'.

Consequently it is appropriate for our measurement of financial risk to be the same as that for undue risk i.e. a 'worst case' downside return worse than the lowest percentile expected return for the period.

Reputational

We are conscious that the Fund has as its ultimate beneficiaries future New Zealand taxpayers. We acknowledge that internationally we have status as representatives of New Zealand and this is reflected in our statutory duty to invest so as not to prejudice New Zealand's reputation in the world community. We believe that transparency is crucial to the formation, preservation and enhancement of our reputation and that transparency is best judged by external parties. Our chosen measures reflect that.

Transparency ratings

Currently there are not many third-party mechanisms rating the transparency of Sovereign Wealth Funds. One such rating is compiled by the San Francisco-based Sovereign Wealth Fund Institute and published on a quarterly basis. The rating is out of 10 and based on the Institute's

"We believe that transparency is crucial to the formation, preservation and enhancement of our reputation and that transparency is best judged by external parties.

conception about what the average person would expect to find out, easily, about a Sovereign Wealth Fund. Our Fund has been rated 10 since the inception of the index and our target is simply to remain a 10. The Institute's website is www.swfinstitute.org

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

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

Santiago Principles

The Santiago Principles are essentially principles for best practice by Sovereign Wealth Funds, drawn up by the International Forum for Sovereign Wealth Funds (IFSWF), which was established under the auspices of the IMF, and, of which New Zealand is a member. The principles are explained, and we at least annually review and publish our response to them, on our website under the *How Transparent are We?* section mentioned above. Consistent with Santiago Principle #24 we will continue to do so, publicly, at least annually.

UNPRI Assessment

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

Voting and Responsible Investment in practice reports

A simple transparency measure of the extent to which interested parties can see and understand how we have voted on Responsible Investment and governance issues with respect to investee companies; and more generally the Responsible Investment initiatives we have undertaken. All reporting on Responsible Investment matters is on our website under the *Responsible Investment* heading.

Governance

What is encompassed

We believe it is important for our stakeholders to be aware that our management and administration of the Fund is subject to regular and ongoing external assessment, and that those assessments are made public.

Key influences in 2010 SOI

Progress against Independent Review recommendations

In November 2009 the Minister of Finance was presented with the conclusions of an Independent Review into our management and administration of the Fund. The review, which is required every five years, was conducted by Mercer, a global financial advisor. We welcomed the conclusions of the review as overall being supportive of our governance. The vast majority of the recommendations were endorsements of actions already being undertaken. The full review

“

…our management and administration of the Fund is subject to regular and ongoing external assessment… those assessments are made public.

and our response to it are available via the *Performance* section of our website under *How Transparent Are We?* We have already implemented 70% of these recommendaions and we anticipate that most remaining action items will be addressed by the end of 2010/11.

The Leadership Team and Audit Committee review progress in implementing outstanding External Audit and Independent Review recommendations on a quarterly basis, to ensure completion of action items associated with these recommendations within expected timeframes.

Explanation of measures

Independent review

An independent review of our governance of the Fund is required every five years. The terms of reference, and funding, for the review are provided by the Minister of Finance. The Fund has had two such reviews since inception. They are both available via the *Performance* section of our website under *How Transparent Are We?*

Organisational capability programme

What is encompassed

This work programme encompasses ensuring that the Guardians' have appropriate internal capabilities to deliver our output of managing the Fund, in service of our outcome. Organisational capability includes the recruitment, retention, development and remuneration of our people. We expect the completed HR Strategy to produce further performance measures for this work programme.

Key influences in 2010 SOI

In 2010 we will conclude the implementation of our HR Strategy. The key elements of this are a tool for identifying the working culture our people want from the Guardians, including an annual survey of whether they are actually experiencing that culture working here; and new programmes for performance based remuneration and talent retention.

Explanation of measures

Key person risk

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

Achieving Key Performance Indicators

Each staff member must achieve KPIs which cover desired behaviours and their achieving key projects, all of which are driven by the staff member contributing to our overall outcome. This measure is therefore an indicator of the extent to which our people are performing.

STATEMENT OF SERVICE PERFORMANCE

Statement of Service Performance for 2010/11

In this section we set out the important initiatives which will occur under each work programme within the financial year to 1 July 2011. All of these initiatives are sourced directly from our Strategic Plan. We note that most of the initiatives identified will also apply to 2012.

- Table 5 sets out the broad initiatives together with the relevant work programme performance measure (see page 8) for each.
- Table 6 identifies in greater detail the specific activities encompassed by each initiative (and makes clear some activities are relevant to more than one initiative) as they are set out in our Strategic Plan.

Table 5 – Statement of Service Performance for 2010/11

Initiative	Explanation	Relevant work programme measure(s)
Peer collaboration project	We have an extensive network of strong global peer relationships over recent years. We see significant benefits from working more closely with peer funds to access skills and investments advantageous to the Fund. Our plans to do so comprise the peer collaboration strategy.	• **Investment** • **Cost control** • **Risk management** • **Governance** • **Organisational capability**
Excellence in investment opportunity search, evaluation and selection	Seeking opportunities to invest jointly with other funds and fellow Crown Financial Institutions (CFIs) as contribution to value add (excess return)	• **Investment** • **Risk management** • **Organisational capability**
Capturing the illiquidity premium	Improving processes for identifying opportunities with appropriate (or potentially appropriate) liquidity premiums from private and public markets investing; ensuring passive alternatives are identified and assessed; and, if proceeding, structuring such opportunities to ensure the premium is delivered.	• **Investment**
Excellence in portfolio completion	Improving our ability to identify and address potentially unnecessary investment costs.	• **Investment** • **Cost control**
Complete HR Strategy implementation	Review of organisational design, new performance-based remuneration programme, key talent management and ongoing capability development.	• **Organisational development**

Table 6 – Strategic Objectives and key planned activities

Five strategic objectives for the year ahead:

- Excellence in investment opportunity search, evaluation and selection
- Capturing the illiquidity premium
- Excellence in portfolio completion
- Collaboration with peers
- Complete HR strategy implementation

		Key planned activities in fiscal years 2011 and 2012	Excellence in search & eval	Capture illiquidity prem	Excellence in completion	Collaboration with peers	Complete HR strategy
Investment strategies	Portfolio Completion	Counterparty and transition panel development; implement liquidity framework; refresh funding model; refine/develop benchmarks			✓		
Investment strategies	Strategic Tilting	Broaden range of asset classes & scope; refine forecasting & integration with hurdles; increase maximum limits	✓				
Investment strategies	Private Markets Active Return	Develop opportunity map; enhance systematic monitoring; review infrastructure strategy; build PE, private property & NZ Direct	✓	✓		✓	
Investment strategies	Public Markets Active Return	Revise mandate set & build target exposure; develop opportunity map; enhance systematic monitoring; investigate internal NZ active	✓	✓		✓	
	Portfolio Level Change	Macro themes; peer collaboration strategy (including working with other CFIs); RI strategy implementation; risk management	✓		✓	✓	
Organisational development	Governance	Review of governance budget against best practice; Board learning & growth plans; develop risk mandate map; policy review	✓		✓		
Organisational development	Risk Management	Establish an enterprise risk model; enhancing risk measurement and monitoring systems; improving risk preparedness	✓		✓		
Organisational development	NZ Hallmark	Implementation of a Hallmark plan aimed at building a strong domestic reputation for having a positive impact in NZ				✓	
Organisational development	People	Cultural development programme; review organisational design; new bonus programme; key talent management programme	✓		✓	✓	✓
Organisational development	Processes & Technology	Process improvement; migrate to new IT framework; assess long term IMS requirements; cost of ownership benchmarking	✓		✓		
Organisational development	Physical location	Investigate overseas representation	✓			✓	

CONSULTATION AND REPORTING TO THE MINISTER

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

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

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

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

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

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

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

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

ACQUISITIONS

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

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

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

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

Required Statement of estimated returns for the Fund

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

Specifically, we begin with our expectation for market returns over the next five years and use this to form the mid-point of the range for the estimated Reference Portfolio Return for 2010/11. To that we add our expectations of returns from added-value activities to arrive at the mid-point for the Actual Fund. Finally, we estimate a range of possible Fund returns for 2010/11, given our estimate of the volatility of market returns. Using this approach we have estimated as follows:

Component of Return	Explanation
Risk-free rate **4.9%**	Our estimate of the return on 90-day Treasury Bills, reflecting that T-Bill yields are currently below equilibrium levels.
PLUS Reward for market risk (after costs) **3.2%**	We define the reward for market risk as the margin between the risk-free rate and the return that would be generated on the Reference Portfolio (after assumed costs of 0.3%). We estimate this number over a five-year horizon, allowing for movement towards equilibrium valuations (see page 6) and treat this as representative for 2010/11. Over a 20-year horizon our estimate on the same basis is 2.35%. Although we expect similar returns from the Reference portfolio over five and 20-year horizons, we expect T-Bill returns to rise closer to equilibrium levels over the 20-year horizon. Hence we expect the margin between the Reference Portfolio return and the return from Treasury bills to be smaller over 20 years than over five years. Our estimate of the reward for market risk has a very wide range over a one-year horizon, although this range is tightens over longer horizons. Around the mid-point the 90% probability range is around +/-20% for one year, +/- 8% for five years and +/- 3.5% for 20 years.
PLUS Reward for value-adding activities **0.55%**	Our estimation of the return from the investment activities we undertake to add value. We describe those activities as part of the explanation of the Reference Portfolio on page 9.
EQUALS 8.65%	**The mid-point of our estimated range for the Fund return over 2010/11 is 8.65%** This estimate is below our corresponding estimate of 10.70% in the 2009 SOI. This reflects the very strong market returns since the end of 2009/10. Higher starting prices for the various asset classes in which the Fund invests imply lower projected returns for the near future. As for the reward for market risk, the 90% probability range around the mid-point return is around +/-20% for one year, +/-8% over five years and +/-3.5% over 20 years.

Financial projections for 2010/11

Cost Allocation Model

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

Cost of the Guardians

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 $0.52 million p.a. (GST exclusive) in 2010/11.

The majority of the Guardians' costs are met from the Fund. The 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 $21.07 million in 2010/11.

Together, the total costs of the Guardians in 2010/11 are expected to be $21.70 million (GST exclusive). This is equivalent to 0.13% of expected average funds under management over 2010/11.

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. 8.65% 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.

Overall costs of managing the Fund

Overall, the cost of managing the Fund over 2010/11 – which includes the above costs plus such costs as fees paid to investment managers – is forecast to represent 0.54% of expected average funds under management. This is lower than we expect it to average over time, largely due to timing of compositional changes to our public and private markets investment programmes. We forecast that by 2015 these costs will have risen to 0.77% p.a. This would still be below the median established in the CEM cost-effectiveness benchmarking survey of peer funds (see page 12).

We note that estimating with any accuracy these costs in advance is difficult given the range of factors with potential to influence our expenditure e.g. market conditions and how we execute our investment programmes. For example, our actual costs in 2009/10 are estimated to be some 0.25% of funds under management below what was budgeted, primarily due to a change in the composition of both our private and public markets investment programmes.

Guardians of New Zealand Superannuation and Group

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 by way of resolution on 12 May 2010. The Board is responsible for the prospective financial statements presented, including the appropriateness of the assumptions underlying the prospective financial statements and all other required disclosures.

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

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

Guardians of New Zealand Superannuation and Group

Prospective Statement of Comprehensive Income

For the year ending 30 June 2011

	$000
Revenue from parliamentary appropriation	516
Revenue from New Zealand Superannuation Fund	21,065
Other income	164
Total revenue	**21,745**
Board-related expenses	(717)
Employee remuneration and related expenses	(16,398)
Depreciation	(2)
Other expenses	(4,628)
Total expenses	**(21,745)**
Net surplus	**-**
Other comprehensive income	-
Total comprehensive income for the year	**-**

Guardians of New Zealand Superannuation and Group

Prospective Statement of Financial Position

As at 30 June 2011

	$000
Assets	
Current assets	
Cash and cash equivalents	1,874
Trade and other receivables	1,627
Non-current assets	
Property, plant, and equipment	-
Total assets	**3,501**
Liabilities	
Current liabilities	
Trade and other payables	534
Accrued employee benefits	2,032
Non-current liabilities	
Provisions	435
Total liabilities	**3,001**
Net assets	**500**
Equity	
Accumulated surplus	-
General equity reserve	500
Total public equity	**500**

Guardians of New Zealand Superannuation and Group

Prospective Statement of Changes in Public Equity

For the year ending 30 June 2011

	$000
Balance at 30 June 2010	**500**
Net surplus for the year	-
Other comprehensive income	-
Total comprehensive income for the year	**-**
Balance at 30 June 2011	**500**

Guardians of New Zealand Superannuation and Group

Prospective Statement of Cash Flows

For the year ending 30 June 2011

	$000
Cash flows from operating activities	
Cash was provided from:	
Receipts from the Crown	516
Receipts from New Zealand Superannuation Fund	20,290
Other income	90
Interest received	45
Goods and Services Tax	456
Cash was applied to:	
Payments to suppliers	(4,403)
Payments to employees	(16,398)
Net cash provided by/(used in) operating activities	**596**
Net increase in cash and cash equivalents	**596**
Cash and cash equivalents at the beginning of the year	1,278
Cash and cash equivalents at the end of the year	**1,874**

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. They comply with the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable financial reporting standards as appropriate for public benefit entities.

The prospective financial statements of the Guardians of New Zealand Superannuation and Subsidiaries for the year ended 30 June 2011 were authorised for issue in accordance with a resolution of the Board on 12 May 2010.

BASIS OF PREPARATION

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

The prospective financial statements have been prepared on 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 comprehensive income and financial position have been applied:

(a) Consolidation of subsidiaries

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

Guardians of New Zealand Superannuation and Group

Summary of Significant Accounting Policies (continued)

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

Subsequent expenditure

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

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

Subsequent measurement

Subsequent to initial recognition, 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 comprehensive income in the year the item is disposed of.

Impairment

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

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

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

Recoverable amount is the greater of fair value less costs to sell and value in use. 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

(i) Intangible assets

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

(j) Employee benefits

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

Provisions made in respect of employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of 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 deferred income in the statement of financial position. The aggregate benefits of incentives are recognised as a reduction of rental expense on a straight-line basis over the period of the lease.

(l) Foreign currency transactions

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

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

(m) Financial instruments

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

Guardians of New Zealand Superannuation and Group

Summary of Significant Accounting Policies (continued)

(m) Financial instruments (continued)

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

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

(n) Provisions

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

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

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

(o) Payables

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

(p) Equity

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

(q) Statement of cash flows

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

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

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

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

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

(r) Changes in accounting policies

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

(s) Critical accounting estimates and assumptions

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

Employee entitlements – long-term incentives

A component of the long-term incentive scheme is a measure of the performance of the Fund, calculated based on a rolling four-year performance average. The calculation of this liability utilises assumptions regarding the future performance of the Fund, the employee's average salary over the vesting period, the percentage of service rendered and the likelihood of the employee leaving before the long-term incentive is fully vested (no attrition has been factored into the current year calculation). The key variable is the performance of the Fund. Should the performance of the Fund differ from the assumption utilised in the calculation of the long-term incentive liability, this will impact the employee benefits expense in the statement of comprehensive income, and the carrying amount of the liability in the statement of financial position. The Group minimises the risk of this estimation uncertainty by using a model based on historical evidence to forecast future returns of the Fund.

SIGNIFICANT ASSUMPTIONS ADOPTED IN THE PREPARATION OF PROSPECTIVE FINANCIAL STATEMENTS

The Guardians' forecast is based on the key assumption that the headcount for the Guardians will increase from 65 to 71 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 Comprehensive Income

For the year ending 30 June 2011

	$000
Income	
Interest income	127,661
Dividend income	370,302
Timber sales	22,428
Fair value changes in investments at fair value through profit or loss	922,291
Net foreign exchange gain	-
Fair value changes in timber investments – forests	1,763
Share of profit of investments accounted for using the equity method	54,091
Other income	-
Net operating income	**1,498,536**
Expenses	
Timber expenses	(9,142)
Depreciation and amortisation	(2,825)
Managers' fees – base	(39,760)
Managers' fees – performance	(19,751)
Custody fees	(5,386)
Other expenses	(33,971)
Profit for the year before income tax expense	**1,387,701**
Income tax expense	(334,552)
Profit for the year after income tax expense	**1,053,149**
Other comprehensive income	
Net fair value gains on available-for-sale financial assets	4,624
Gain on revaluation of property, plant, and equipment	-
Translation of foreign operations	-
Income tax on items of other comprehensive income	-
Other comprehensive income for the year, net of tax	**4,624**
Total comprehensive income for the year	**1,057,773**

New Zealand Superannuation Fund and Group

Prospective Statement of Financial Position

As at 30 June 2011

	$000
Assets	
Cash and cash equivalents	621,009
Investments	
Derivative financial instrument assets	126,458
Other financial assets	15,340,669
Investments accounted for using the equity method	888,057
Timber investments - forests	160,951
Total investments	**16,516,135**
Trade and other receivables	297,805
Property, plant, and equipment	47,566
Intangible assets	706
Total assets	**17,483,221**
Liabilities	
Trade and other payables	88,839
Provisions	26,249
Taxation Payable	149,512
Deferred Tax Liability	94,420
Total liabilities	**359,020**
Net assets	**17,124,201**
Equity	
Retained surplus	2,226,286
Available-for-sale reserve	7,669
Land revaluation reserve	8,167
Contributed capital	14,882,079
Total public equity	**17,124,201**

New Zealand Superannuation Fund and Group

Prospective Statement of Changes in Public Equity

For the year ending 30 June 2011

	Land revaluation reserve $000	Available for sale reserve $000	Contributed capital $000	Retained surplus/ (deficit) $000	Total $000
Balance at 30 June 2010	**8,167**	**3,045**	**14,882,079**	**1,173,137**	**16,066,428**
Profit for the year				1,053,149	1,053,149
Other comprehensive income		4,624			4,624
Total comprehensive income for the year	**-**	**4,624**	**-**	**1,053,149**	**1,057,773**
Fund capital contributions from the Crown			-		-
Capital contributions from the Crown in respect of funding the net cost of New Zealand superannuation entitlements			8,822,221		8,822,221
Capital withdrawals by the Crown in respect of funding the net cost of New Zealand superannuation entitlements			(8,822,221)		(8,822,221)
	8,167	**7,669**	**14,882,079**	**2,226,286**	**17,124,201**

New Zealand Superannuation Fund and Group

Prospective Statement of Cash Flows

For the year ending 30 June 2011

	$000
Cash flows from operating activities	
Cash was provided from:	
Dividends received	368,056
Interest received	129,632
Receipts from customers	15,052
Cash was applied to:	
Managers' fees	(44,621)
Payments to suppliers	(46,817)
Income tax paid	(223,034)
Net cash provided by/(used in) operating activities	**198,268**
Cash flows from investing activities	
Cash was provided from:	
Proceeds from the sale of investments	13,599,978
Cash was applied to:	
Payment for the purchase of investments	(13,766,794)
Purchases of property, plant, and equipment	(1,150)
Purchases of intangible assets	(650)
Net cash provided by/(used in) investing activities	**(168,616)**
Cash flows from financing activities	
Cash was provided from:	
Capital contributions from the Crown	-
Net cash provided by/(used in) financing activities	-
Net increase in cash and cash equivalents	**29,652**
Cash and cash equivalents at the beginning of the year	591,357
Effects of exchange rate changes on foreign currency cash	**-**
Cash and cash equivalents at the end of the year	**621,009**

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 consolidated financial statements comprise the Fund and its subsidiaries (Group).

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

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

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

STATEMENT OF COMPLIANCE

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

The prospective financial statements for the year ended 30 June 2011 were authorised for issue in accordance with a resolution of the Board of Guardians of New Zealand Superannuation on 12 May 2010.

BASIS OF PREPARATION

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

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

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

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

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

(a) Capital contributions

(i) Fund capital contributions

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

(ii) Superannuation entitlement payments

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

(b) Capital withdrawals

(i) Fund capital withdrawals

In terms of section 47 of the Act no withdrawals of Fund capital contributions are permitted in any financial year before 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 at balance date. Current tax for current and prior years is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

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

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

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

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

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

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies (continued)

(c) Income tax (continued)

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

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

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

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at balance date. The measurement of deferred tax liabilities and assets reflects the tax consequences of that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

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

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

(d) Financial instruments

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

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

(e) Investments

Investments are represented by the following: KEY

- Financial assets at fair value through profit or loss (either designated at fair value through profit or loss or held for trading):
    - Equities i)
    - Fixed interest securities ii)
    - Derivatives iii)
    - Collective investment funds iv)
    - Certain private equity investments v)
    - Unlisted unit trusts vi)
- 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))

Initial recording

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 comprehensive income.

Subsequent measurement

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

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

Determination of fair value

Fair value is an estimate of the amount of consideration that would be agreed upon in an 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) Highly liquid fixed interest securities are valued at the last quoted bid price by a reputable pricing vendor or broker as of the close of business at balance date. Where the market for fixed interest securities is illiquid, prices are determined by a reputable pricing vendor who uses models to value these securities. The models can utilise a variety of inputs including loan level data, prepayment and default assumptions and

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies (continued)

(e) Investments (continued)

benchmark prices for similar securities. Because of the inherent uncertainty of valuation, it is possible that those values estimated for the illiquid securities may differ from those values that would have been used had a ready market for those securities existed and those differences may be significant

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

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

v) 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, and achieve exposure to assets and asset classes. The use of derivatives is governed by the Fund's Statement of Investment Policies, Standards, and Procedures as approved by the Guardians, which provides written principles on the use of derivatives by the Group.

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

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

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

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

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

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

(g) 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.

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies (continued)

(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 comprehensive income together with the change in fair value for each accounting period.

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

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

(j) Receivables

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

(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 comprehensive income, in which case the increase is credited to the statement of comprehensive income 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 comprehensive income to the extent that it exceeds the balance, if any, held in the asset revaluation reserve relating to a previous revaluation of that asset.

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

Disposal

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

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

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

Impairment

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

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

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

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

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

(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 (held by the Guardians) or the estimated remaining useful lives of the improvements, whichever is shorter.

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies (continued)

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

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

Securities lending fees are recognised as earned.

(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 comprehensive income.

(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 comprehensive income 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

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.

New Zealand Superannuation Fund and Group

Summary of Significant Accounting Policies (continued)

(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. 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

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

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

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

Actual financial results achieved for the period covered are likely to vary from the information presented.

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.