Guardians of New Zealand Superannuation

STATEMENT OF INTENT

FOR THE PERIOD COMMENCING 1 JULY 2006

NEW ZEALAND SUPERANNUATION FUND

1. Statement from the Board

On behalf of the Guardians of New Zealand Superannuation (GNZS) we are pleased to present the Statement of Intent for the period commencing beginning 1 July 2006.

GNZS was established as a Crown entity under the New Zealand Superannuation and Retirement Income Act 2001 (the Act). Our purpose is to manage and administer the New Zealand Superannuation Fund (the Fund) in accordance with the Act.

The Fund is the property of the Crown. Its purpose is to build a portfolio of financial assets to help reduce the impact of providing retirement income, in the form of New Zealand Superannuation, to an ageing population. Under the Act no withdrawals are allowed from the Fund until at least 30 June 2020. Current modelling suggests that withdrawals will not commence until 2028 but this is subject to change.

The mandate given to the Board is set out in section 58(2) of the Act. This requires our organisation to invest the Fund on a prudent, commercial basis and, in doing so, manage and administer the Fund in a manner consistent with:

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

In meeting this responsibility we aspire to be recognised as the most respected institutional investor in the New Zealand market and to be regarded as a centre of excellence internationally.

The Crown Entities Act 2004 sets out the requirements of a Statement of Intent (SoI). It is expected to provide a high-level description and explanation of the operating intentions and performance expectations of an organisation. Importantly, it provides a basis against which progress will be reported in the Annual Report. The SOI is required to have a medium-term focus – at least three financial years into the future – although detailed forecasts of the financial position of the entity for the next financial year (1 July 2006 to 30 June 2007) are required.

In addition to general features of an SOI, section 65 of the Act requires us to include some specific comments on the expected performance of the Fund over the next financial year, as well as the risks to that performance and the steps being taken to manage those risks. This is addressed.

Interested readers will find more detailed information on the background leading to the establishment of the Fund, the expected level of contributions by government, the investment strategy, Fund performance and the policies implemented by the Guardians for the management of the Fund's assets on our website (www.nzsuperfund.co.nz).

The Board accepts responsibility for the contents of this Statement of Intent and hopes it will provide readers with a good insight into the priorities of our organisation.

David May

DAVID MAY
Chairman

Sir DOUGLAS GRAHAM
Deputy Chairman

2. Background Information

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

The Board of the Guardians first met in September 2002 and spent the first year focusing on developing both the organisational infrastructure (recruitment, policies, appointment of key service providers) and developing the initial investment strategy for the Fund.

On 30 September 2003 government transferred a portfolio of Treasury bills, valued at $2.4 billion, to the Fund. Investment performance is calculated from this date. The Fund now comprises a broadly diversified portfolio of assets. The majority of these are invested in public markets (share and bond markets around the world) but a growing proportion is being allocated to private markets (sectors where, in return for giving up some liquidity, investors expect to receive higher returns for a given level of risk). Given the Fund's long timeframe, this is appropriate.

Contributions to the Fund are calculated in accordance with a formula set out in section 43 of the Act. Based on estimates prepared by The Treasury, and forming part of the May 2006 Budget, these are expected to average $2.25 billion per year over the next three years.

At the beginning of the 2006/7 financial year, the Fund's assets are expected to be $10.0 billion. Over the next three financial years, the balance of the Fund (reflecting contributions from government and expected investment income earned net of fees and after payment of tax) has been estimated by Treasury to be as follows:

AS AT 30 JUNE	BALANCE
2007	$ 12.8 billion
2008	$ 15.8 billion
2009	$ 19.3 billion

The Fund is presently around 6% of GDP and, given the restrictions on withdrawals for at least another 14 years, is expected to continue to grow as a percentage of Crown wealth. Current estimates are that it will peak at almost 39% of GDP by 2035. In nominal dollar terms the Fund is expected to reach around $80 billion by 2020 and $160 billion by 2030.

3. Nature And Scope Of Our Organisation

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

As noted in the introductory statement from the Board, we are required to invest the Fund on a prudent, commercial basis and in doing so, manage and administer it in a manner consistent with:

a) best-practice portfolio management;

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

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

The requirement to operate the Fund in line with best practice brings both great opportunities and challenges. It is, by definition, evolving, and requires us to be diligent about identifying emerging insights and processes. Accordingly, we put a considerable amount of effort into seeking out organisations around the world that are distinguished for their approach and results. To date we have learnt a lot from them and expect this to continue.

The core focus of our organisation is the development of an investment strategy which takes full advantage of the Fund's characteristics and executing this through partnerships with high-quality, and closely aligned organisations.

Our starting position is that we will not seek to duplicate services which are efficiently provided through the competitive marketplace. This means we will concentrate on building competence in differentiating between potential providers, carefully selecting our partners and closely monitoring their provision of services to us to ensure our objectives are met. As the scale and complexity of this task grows, we will ensure our internal resources are appropriate.

We will explore developing internal capacity where we believe external suppliers cannot meet our specific needs. The quality and cost of an outsourced service are the benchmarks against which we will judge these opportunities. Possible triggers for insourcing include where there is the potential for substantial agency conflicts, where there is such a limited supply of providers that pricing is uncompetitive, or where we believe we can achieve lower costs of delivery without an unacceptable increase in risk.

Our Annual Report lists the external investment managers holding mandates. Presently there are 33 appointments. In addition, we have a number of specialist advisory relationships covering areas as diverse as general investment strategy, manager research, private equity, timber, proxy voting and portfolio monitoring for compliance with our policy on ethical investing.

4. Our Objectives And How We Intend To Achieve Them

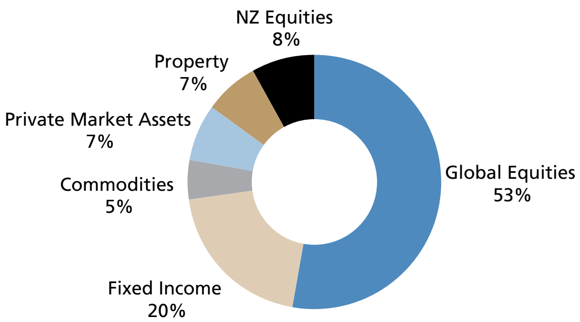
(as required under s141(1)(c) and (d) of the Crown Entities Act)

4.1 Financial Objectives – Delivering Sound Investment Performance For The Fund

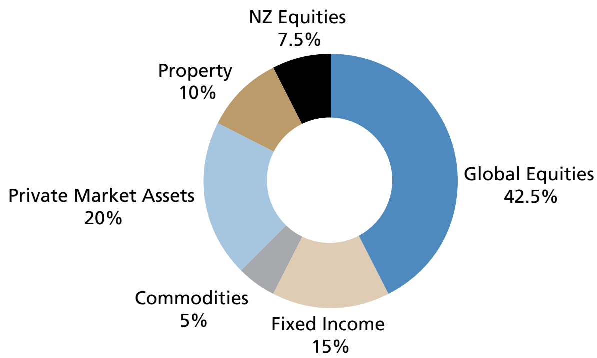
The measurement of our organisation's success is dominated by the returns we generate on the Crown's assets in the Fund. In return for taking investment risk, we need to achieve adequate compensation in excess returns above the risk-free rate. We have set a minimum excess return target of 2.5% p.a. measured over rolling 20-year periods. This is an appropriate timeframe given our mandate.

We believe the strategy we have developed will meet this objective and is consistent with our statutory obligation to maximise returns within risk levels we see as appropriate. The current asset allocation and our longer-term target portfolio are illustrated below. The strategic asset allocation is reviewed at least annually by the Board and in section 5 we set out the level of investment returns we expect to earn from this asset mix.

CURRENT PORTFOLIO (31/3/06)



LONG-TERM TARGET PORTFOLIO



We acknowledge there is interest in our performance over shorter periods of time. Updates are provided monthly on the Fund's website in the interests of transparency but we believe measuring performance over rolling five-year periods strikes an appropriate balance between accountability for our decisions and the very long investment mandate we have been given.

The portfolio is based on a number of beliefs which are summarised below:

(i) **We believe it is important to be clear about our return objectives, risk tolerance and the timeframe over which we will measure results.** Given our mandate, returns and volatility over short periods of time are not a concern in themselves.

(ii) **We believe risk and return are strongly related and that diversification reduces total risk.** Combining lowly correlated assets to deliver stable returns is critical to our success.

(iii) **We believe risk and return characteristics vary over time and include both a random component and a partly predictable component based on current pricing compared to long-term averages.** In general, the longer the time horizon, the greater the predictable component. We will make medium-term adjustments to the portfolio to take advantage of this insight.

(iv) **We believe we should exploit the premium available to investors who do not require liquidity.** Our long investment horizon, combined with the fact that no outflows are required until after 2020, means we are extremely well positioned to capture this premium.

(v) **We believe different types of risks can be unbundled to make the portfolio more efficient.** Examples include the separation of market risk (beta) and active risk (alpha) and the decoupling of foreign currency exposure and international assets.

(vi) **We believe that to correctly establish the merit of an investment opportunity, we must examine it on a risk-adjusted basis, post-expenses and foreign taxation, and taking into account the effect of leverage in any vehicle we might invest in.** Individual investments will be assessed on their expected impact upon the total portfolio, rather than the characteristics of the particular sector or transaction.

(vii) **We believe that while, in general, the average return to active management is zero before costs, there is value in taking active risk in public markets.** While we recognise it takes considerable skill to build a stable of active managers that deliver returns above benchmark, we believe we can achieve this. While close attention needs to be paid to both the explicit costs (manager fees) and hidden costs (transactions) of active management, we will focus on the expected after-cost benefit. Operating the Fund at a low cost is not, in itself, an objective.

(viii) **We believe alignment of interest matters.** We will work to minimise principal-agent conflicts through financial incentives, transparency around related party transactions and appropriate governance to promote investors' interests.

(ix) **We believe that long-term financial performance can be affected by environmental, social and governance (ESG) issues.** We will encourage the companies we invest in to meet international standards in these areas.

Central to our approach is the premise that diversification makes a portfolio more efficient (i.e. less risk is incurred for each unit of return generated). The combination of the Fund's long investment horizon, and no withdrawals for a very long period of time, means we are able to diversify our portfolio more widely than the average investor.

As can be seen from the asset allocation graphs, we are aiming to have at least a third of assets invested outside public markets (i.e. outside listed equities and bonds). This includes areas like property, private equity, infrastructure, commodities and timber, as well as less well-explored sectors which are often classified as "absolute return strategies". Presently we have around one-fifth of the Fund invested in these sectors.

We are also concentrating on further improving the efficiency of our active management programme in public markets. While the risk attached to investing in different asset classes (market risk, or beta) will always dominate, we see real value in the generation of additional, uncorrelated returns from active management (alpha). Presently, less than 2% of the Fund's total risk budget is taken in the form of active management and we are looking to raise this.

4.2 Non-financial Objectives

More than other Crown entities, our objectives are dominated by financial results. The non-financial aspects of our success relate primarily to the achievement of best-practice standards and to enhancing the organisation's reputation as a high-quality institution.

4.2.1 Meeting Best Practice

In terms of our objective of meeting best practice, we have identified six areas to focus on outside of the way we construct the portfolio. The objectives we have set here are:

- We must access advice, experience and partner organisations from around the world to ensure we are operating to best-practice standards.
- We must ensure we operationalise our investment strategy efficiently and ensure there are effective controls to manage the attendant risks.
- We must be open in our dealings, transparent in our reporting and communicate effectively with our stakeholders to support the achievement of the Fund's aims.
- We must develop a governance model that clarifies responsibility and promotes accountability.
- We must invest in a talented and committed team of people.
- We must aim for mutual respect in our relationships with external partners in order to maximise value.

Our business plan addresses these areas and we provide more detail on the steps we are taking to achieve these objectives in section 8.2.

4.2.2 Enhancing Our Reputation

The legislation has an explicit requirement for us not to "prejudice New Zealand's reputation as a responsible member of the world community". This is a minimum standard and we are taking a number of steps to enhance the Fund's reputation as a competent investor:

- We will continue to use our website and other publications to give interested parties visibility into our thinking, processes and results. This keeps us motivated to be innovative in setting our investment programme and to strive for high standards in its implementation. We believe we are at the leading edge of the market in terms of transparency and we intend to stay there.
- We recognise our responsibilities as a share-owner. This covers the way we exercise our voting rights to promote alignment between the management of companies in which we invest, and ourselves as the investor. It also covers the expectation that the portfolio is constructed in a socially responsible manner. To mitigate the risk of reputation damage through the inclusion of inappropriate investments in the portfolio, we have developed a policy on responsible investment. This sets standards and commits the Fund to conforming to international protocols and participating in global initiatives in this area.
- We believe our reputation as an investor is intimately tied to the quality of the people working for the organisation. It is these people who will drive the development of an innovative investment strategy, the execution of that strategy through partnerships with high-quality external managers, and the efficient operationalisation of the strategy through our outsourced back office. We are committed to making our organisation an attractive place for skilled professionals to join. We intend to support them through a commitment to their education and other professional development and recognise them through a remuneration strategy which acknowledges their contribution to the Fund's financial success.

5. Estimating Returns For The Fund

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

5.1 Background

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

- **The risk-free component**
  This is the return on short-term sovereign debt, a proxy for the return attainable with little or no investment risk.

- **Reward for market risk (beta)**
  The long investment horizon of the Fund, and the lack of need for short-term liquidity, means that the Fund can be invested outside the risk-free markets in the expectation that adequate reward will be received to compensate for the risk involved. The size of the risk premium varies with different types of assets. The strategic asset allocation reflects our view of the most efficient combination of market risk premia (or beta).

- **Reward for active management risk (alpha)**
  While the combination of market risk exposures is expected to make the main contribution to the Fund's return, the exploitation of market inefficiencies to generate returns from security selection (alpha) is also expected to be relevant. While this has traditionally been achieved by allowing portfolio managers to take positions away from the relevant index exposure in a given asset class, we are increasingly seeking to capture additional returns through retaining firms that are able to generate returns from trading decisions without exposing the Fund to the underlying market exposure.

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

5.2 Estimating Returns Over Varying Periods Of Time

An appropriate starting point for estimating future returns is the long-term risk and review modelling set out in detail in our March 2005 "Strategic Asset Allocation Review" ("SAA Review"), available on our website. This considered expected returns and risks over a 30-year horizon. Over a single year, there is much greater variability than over the long term and a single year estimate is simply the mid-point of a very wide range.

To illustrate, in our SAA Review we observed that the expected return over a single year is the risk-free rate plus 4% (that is, an excess return of 4%). The standard deviation of this excess return (a measure of volatility) is 10%. This means the margins around the expected mid-point of the "risk-free rate plus 4%" are very wide. Indeed, it implies that in two years out of three the annual return will fall in a range of 6% below the risk-free rate to 14% above it. In one year out of 20, the annual return would be expected to fall outside a much wider range of 16% below the risk-free rate to 24% above it.

Lengthening the period for estimating returns produces a much more useful result. For example, our SAA Review notes that the estimated average excess return for a 30-year period is 3.75% but the standard deviation drops from 10% to 1.9%. This implies a two-thirds probability that the average return will fall within a range of 1.85% to 5.65% above the risk-free rate. Over the same period, the probability of the Fund's returns exceeding the risk-free rate is approximately 98% and the probability of generating an excess return above the risk-free rate of more than 2.5% p.a. is approximately 75%.

5.3 Estimating A Return For 2006/7

Section 65 of the New Zealand Superannuation and Retirement Income Act requires us to comment on our expectations about the performance of the Fund over the next financial year in sufficient detail to enable meaningful assessment against this at the end of the year.

We believe the purpose of this requirement is to encourage us to reflect our views about the current investment environment and its likely impact on earnings. We do not have any particular confidence about what the next 12 months will bring but if we look out over the medium term (10 years), our views become more certain. This allows us to indicate whether, based on current market conditions, we expect that returns from investment markets are likely to be higher or lower than our long-term estimates.

For the purposes of meeting the requirement under section 65 of the Act, then, we have decided to assume that the next year will be typical of the next decade. Consistent with the strong investment returns over the past few years, we observe most asset classes are presently relatively highly priced in historical terms. We believe, therefore, that over the next decade the Fund is likely to deliver a return lower than the long-term earning rate in our SAA Review.

Our estimate for the next decade is made up as follows:

- **The risk-free rate @ 5.3%:**
  This is our estimate of the yield on 90-day NZ Treasury bills measured fortnightly in line with contributions to the Fund. While there is no specific market mechanism for pricing in the future expected rate of return on such short-term securities, the pricing of longer-term government debt provides useful information in this area. Current bond yields reflect the expectations of finance market participants about future levels of interest rates, together with a premium for holding longer-term debt (the "term premium"). These yields can, however, fluctuate widely over short intervals and for this reason we prefer to look at period averages as well as current levels. For the three months to April 2006, yields on 10-year New Zealand Government debt have averaged close to 5.8%. Separating the implied rate of return for cash from the term premium is a judgement, however some guidance is offered by considering average yield curve slopes over long periods, both in New Zealand and abroad. Based on this analysis, the term premium for 10-year debt is estimated to be 0.5% which suggests the expected long-term cash rate is 5.3% p.a. In our view this is a reasonable expectation for the average level of risk-free return over the next 10 years.

- **The reward for market risk (beta) @ 2.4%:**
  The reward for market risk is defined as the margin between the risk-free rate and the return that would be generated if the portfolio was invested in line with the strategic asset allocation and all of the Fund's investments performed in line with their benchmarks. Our modelling generates an expected return over the next 10 years of 2.4% (expressed as an annual compound rate for the period consistent with the way we report our returns). This 10-year estimate has a volatility of 3.2% (i.e. a two-thirds probability of falling in the range of 0.3% below the risk- free rate to 6.1% above it.

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

This means the estimated nominal average return over the next 10 years is 8.2% p.a.

It is very important to note there is considerable uncertainty around this mid-point estimate. This is illustrated by our assumption that it has a two-thirds probability of falling in the range of 5.2% p.a. to 11.2% p.a. and a 95% probability of falling in the range of 2.0% p.a. to 14.4% p.a.

Readers may note this estimate is lower than in previous years. In 2003/4 our estimate was 9.2% p.a. This was lowered to 9.0% in 2004/5 and 8.65% in 2005/6. The reasons are consistent. Very strong equity and property markets over this period have compressed our expectations of future earnings.

5.4 How Does Performance To Date Compare With Our Earlier Forecasts?

In the 2.5 years since we began investing, the excess return over the risk-free rate has been approximately 9% (i.e. annualised returns of around 15% against the risk-free rate of approximately 6% for the same period). We had previously estimated the average expected excess return would be around 3.5% over this period. What does this say about our forecasting framework?

Despite the significant difference between recent returns and our estimated average, it is within the expected range. Over this period the expected volatility around the average is approximately 6% (down from 10% for a single year). This means that with an average expected excess return of 3.5%, the result had a two-thirds probability of being within a range of 2.5% below the risk-free rate to 9.5% above it. Accordingly, the excess return of 9% is within this two-thirds probability range.

Can this level of excess return be maintained? It is most unlikely. We estimate that continuing to generate more than 9% p.a. above the risk-free rate over the next 10 years has a probability of only a few percent.

This should not be seen, in any way, as us being resigned to delivering whatever markets bring. We are continually focused on improving the mix of assets in the Fund to boost returns, and in identifying highly skilled investment managers to add value from active management. We do think it is important, however, to ensure that readers are realistic about the likely long-term returns for the level of risk we are taking.

The model set up by Treasury to calculate contributions to the Fund, and to estimate its balance, assumes a long-term earning rate of 8.65% (pre-tax but post-fees). This lies within the range of our recent estimates and is broadly consistent with our own estimate of a return of 3.75% above the risk-free rate (assuming the risk-free rate averages around 5% over the long term). A link to the Treasury model is on our website.

6. Risks To The Performance Of The Fund And Actions Taken To Manage These Risks

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

There are a number of risks to Fund performance over relatively short periods of time. The variability of returns from sectors and managers over any one-year period has been outlined previously and remains the predominant consideration when comparing returns over the short and long term.

The three key risks to the performance of the Fund, and the steps we are taking to deal with these, are as follows:

a) Over the short term, returns from investment markets are below long- term expected levels

This issue has been specifically addressed in the previous section. The Fund holds exposure on a wide range of assets around which long-term reward assumptions are made. In making these assumptions considerable care is taken, and they are reviewed at least annually, but the risk remains that the market returns for the Fund are considerably below expectations, especially over relatively short periods of time. Factors affecting short-term performance include:

- the risk that equity markets, broadly, do not yield the expected return over the risk-free rate to investors;
- the risk that within equity markets there may be non-uniform performance with some sectors significantly underperforming others. Examples include divergence in returns by sector, geographic region, style (growth versus value) and size (large versus small stocks);
- the risk of significant movements in currencies;
- the risk of default on the fixed income assets; and
- the risk of significant changes in interest rates which have not beenanticipated by, and priced into, markets.

We cannot remove these risks from the Fund but we will focus on managing them. Diversifying between markets, and thereby reducing the exposure to any one of these risks, is the most important defensive step. This includes increasing the proportion of the Fund in private markets (e.g. timber, infrastructure assets and private equity) and less traditional asset classes (e.g. commodities futures).

b) Our appointed investment managers fail to deliver to our expectations

We only appoint active investment managers where we have a high degree of confidence in the manager to deliver compensating returns. We do acknowledge, however, that our investment managers may fall short of the objectives set for them and, after costs, may underperform the market in which they operate. The development of a rigorous internal methodology to establish a degree of conviction in external managers before appointment, and monitoring them afterwards, is an important step towards mitigating this risk. Our thinking on this issue is detailed in our 2004/5 Annual Report.

The risk of poor decisions by external managers is especially high in private markets where a smaller number of individual decisions make up a larger part of the managers’ portfolios. There is also less ability to exit poorly performing transactions. We pay particular attention to the processes we use to select our external managers in these areas to minimise this “implementation risk”.

c) Operational risk is not well managed

The combination of asset classes within the portfolio, and investment managers within an asset class, substantially defines the investment policy of the Fund. These policy settings need to be efficiently implemented and the middle and back office services provided by the Guardians' service providers need to be of a consistently high quality. We recognise the potential for deterioration of our returns through poor implementation and are building our resources in this area to ensure that we keep up with international standards. We need to be satisfied that we are working with best-practice service providers to mitigate these risks. This will be a particular focus in 2006/7.

Practical steps we take to manage operational losses include:

- setting parameters around the strategic asset allocation and ensuring that the portfolio remains within these ranges through rebalancing;
- reducing leakage from the Fund through the close monitoring of transaction costs incurred by managers and the custodian;
- monitoring the performance of key service providers to ensure that the Fund's needs continue to be met;
- ensuring that the Fund's exposures to derivatives are appropriately managed so that market exposure remains within well understood guidelines;
- developing appropriate risk management strategies and indemnity provisions to reduce the impact of operational losses; and
- managing the tax efficiency of investment vehicles.

7. Managing The Organisational Health

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

7.1 The Board

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

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

For the 2006/7 year, the Board intends to operate the following committees:

- **Audit and Risk Committee:** Oversees the internal and external audit of the Fund, the risk management framework and its application, compliance (including tax compliance) and the accuracy of key financial statements.
- **Responsible Investing Committee:** Oversees the implementation of the ethical investment policy (under s61(d) of the Act) and the policy for the exercise of voting rights (under s61(i) of the Act).
- **Employee Policy and Remuneration Committee:** Oversees the development of employment and remuneration policies.

7.2 Management Structure

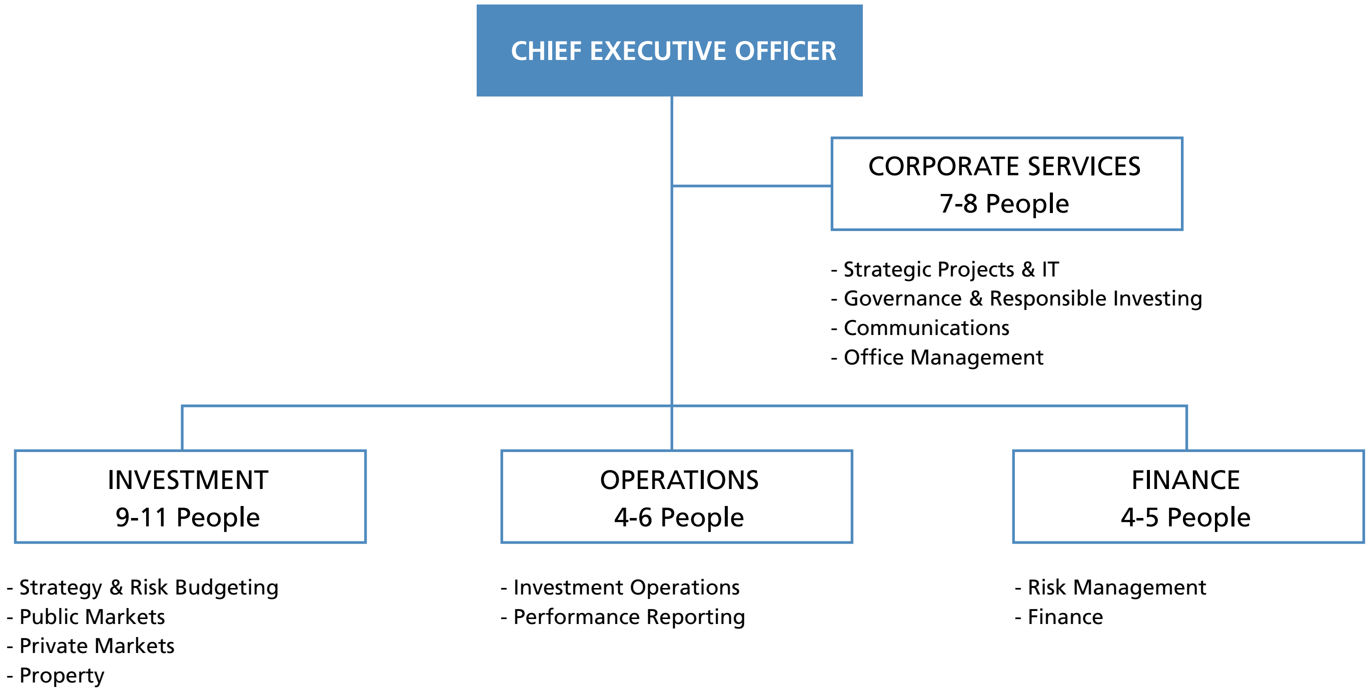
The Board has appointed a Chief Executive Officer who, in turn, has appointed a number of other members of the management team. The Board has a formal delegation agreement with the CEO who, with the Board's approval, has further delegated some powers to other staff members.

At the commencement of the 2006/7 year, there will be the equivalent of 16 full-time employees. The Board has recognised that the level of internal resources in the organisation needs to increase to effectively respond to the investment opportunities available to the Fund and to manage the implementation challenges. We note the comparative levels of internal resourcing in our international peers and observe the benefit this has brought them. Over the next two to three years it is expected internal staff numbers will be approximately double, bringing the total staff to between 30 and 35.

This will still make it a small organisation when compared with its global peers. We expect to see around 10 additional staff recruited over the 2006/7 year with the following two years bringing much smaller growth.

Our staffing level is a function of an operating model which relies extensively on outsourced providers. As noted earlier, our position is that we will not seek to duplicate services which are efficiently provided through the competitive marketplace. This means we will concentrate on building competence in differentiating between potential providers, carefully selecting our partners, and closely monitoring their provision of services to us to ensure our objectives are met. This is a deceptively complex task. We need to ensure that we have the right quality, and quantity, of people to carry this out to a high standard.

The chart below outlines the areas of responsibility of our organisation and the expected number of employees over the next two to three years.



8. Judging Our Performance

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

8.1 Financial Performance Measures

The most important performance measure for the organisation is the return generated on Crown assets in the Fund. We measure our success in terms of excess return over the risk-free rate and our expectations are set out in section 5 of this document. We report our progress monthly on our website so interested parties can track our short- and long-term performance. The key objective here is to:

Improve the efficiency of our investment programme (i.e. increase the likely return for a given level of risk).

Success will be measured by the progress we make in the four key areas outlined below:

- reviewing the strategic asset allocation to ensure it is efficient over the longer term;
- introducing a framework for making strategic tilts to the portfolio where, in our view, the medium-term outlook for a given sector varies from long-term expectations. This generally occurs where current pricing is materially above or below the long-term average;
- continuing the diversification towards private markets. Here results are very closely linked to the quality of the assessment process and our ability to identify quality partners; and
- increasing the contribution of active risk in the portfolio. Returns from active management are largely independent of market movements and are therefore a very effective diversification tool. We are happy with our early achievements in this area but will focus on continual improvement.

8.2 Non-financial Performance Measures

The non-financial measures of the organisation's success are best summarised by a high level-review of the operating business plan. The following are our objectives in this area and the key priorities for the period ahead. The Board will monitor progress and we will report our performance against these at the end of the year. The objectives, and the tasks we will be focusing on, are listed below:

Access advice, experience and partner organisations from around the world to ensure we are operating to best-practice standards.

- Ensure competition of views from external sources in policy development. This is a key aspect of the governance process by the Board and is a natural part of management's policy development approach.
- Benchmark risk-adjusted performance against an appropriate peer group. We formally participate in a global survey of results and efficiency.
- Expand networks with high-quality peer funds. We place a great deal of emphasis on this at both a formal and informal level.

Operationalise our investment strategy efficiently and that there are effective controls to manage the attendant risks.

- Ensure custody and investment administration services appropriately support the organisation's developing needs. We will undertake a full analysis of the organisation's needs over the medium term and put in place a structure to meet these.
- Ensure information management systems can meet business requirements. Technology will play an increasing role in the success of the organisation. We will invest in the capacity and security of our internal infrastructure and explore the value that can be added through an internal data warehouse.
- Exploit opportunities to generate revenue and minimise costs. Initiatives to be fully explored during the year include a securities lending programme and improving the cost-efficiency of our brokerage arrangements.
- Ensure risk management environment is appropriate. We have a dedicated internal resource to lead this area who will work with the Board and management to meet best-practice standards.
- Ensure office environment is cost-effective and conducive to success. We recognise that our work environment needs to be harmonious and supportive to get the best results and that we receive value from our suppliers.

Be open in our dealings, transparent in our reporting and communicate effectively with our stakeholders to support the achievement of the Fund's aims.

- Ensure the quality and timeliness of our disclosure builds stakeholder confidence and our communication with all levels of government is effective and appropriate.
- Increase the understanding of our organisation's purpose, strategy and expected performance in the financial services and wider community. Our website is an important tool here and we will continue to make use of it. In addition we will build on our presence in the financial services community to improve our relationships.
- Ensure the Fund's policies and practices on responsible investing are in line with international initiatives and effectively communicated. Our focus here is on working with our peers, both locally and globally.

Develop a governance model that clarifies responsibility and promotes accountability.

- Ensure optimal use of the Board's limited time. Good governance is critical and to achieve this the Board needs to be kept fully updated on key issues without being overloaded with details.
- Review effectiveness of Board/Management operating model. We understand that the most effective organisations have clearly defined roles and responsibilities for the Board and management and we will continuously assess the efficiency of our model.
- Ensure the financial statements meet integrity expectations. The quality of reports from our internal and external auditors is a critical factor in the organisation's health.

Invest in a talented and committed team of people.

- Ensure employee compensation model is effective to meet recruitment and retention needs. We intend to introduce a revised model which places more emphasis on assessing management's role in contributing to the Fund's success.
- Provide effective personal development programmes for employees and Board members.
- Reduce key person reliance/risk through succession planning. Small teams are especially vulnerable to loss of key staff. While it is difficult to fully protect the organisation against this risk, we will consciously address this in the near term.

Aim for mutual respect in our relationships with external partners in order to maximise value.

- Ensure key advisory relationships are stable and productive. True success will come from a combination of the capacity of our internal team and alliances with skilled, and aligned, specialist advisors. We must constantly invest in these relationships.
- Ensure key service provision relationships are competitive and reliable. The integrity and competitiveness of our service providers is critical. We aim to assess these on an annual basis.

9. Reporting To The Minister Of Finance

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

We provide a quarterly report on the progress of the Fund to the Minister of Finance in addition to our public disclosure on our website.

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

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

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

10. Process For Meeting Requirement Not To Acquire A Substantial Interest In Another Entity

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

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

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

From time to time, opportunities to purchase privately traded assets carry associated obligations to take over operating entities specific to that asset. In these cases, we need to balance the benefit to the Fund of progressing with the transaction against the restriction on taking control of the operating entity. Recent examples include the opportunity to purchase timberland estates which come with existing commercial obligations. Our approach here is to progress the transaction if we see investment merit in it and work to change the ownership structure of the operating entities "as soon as practicable" as is required under the Act. We take professional legal and taxation advice on these transactions and ensure that the Minister of Finance is kept informed.

11. Financial Projections For The 2006/7 Year

(as required under s142 of the Crown Entities Act)

We have prepared forecast financial statements for both the Guardians of New Zealand Superannuation (in its role as manager and administrator of the Fund) and for the Fund itself.

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

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

Over the past few years there has been considerable discussion over the most appropriate treatment of costs incurred by the Guardians. During 2005/6, agreement on how these would be met was reached with Treasury and the Auditor General following a review of legal advice and analysis of the experience of similar institutions abroad. This was subsequently endorsed by the Minister of Finance.

Under this approach, those costs incurred by the Guardians in its role as a Crown entity (principally governance, performance reporting and stakeholder communication) are met from Parliamentary appropriation. These expenses amount to $1.54 million p.a. ($1.73 million GST inclusive).

The costs incurred in the establishment and implementation of investment policy, the management of our outsourced back office, and the financial and risk management of Fund assets are recovered from the Fund. This is the majority of the Guardians' activities with most staff allocated to these roles. The cost of these employees (together with related expenses like office services, travel, professional development) amounts to $6.24 million).

Together this means that the total operating cost of the Guardians in 2006/7 is expected to be $7.78 million (GST exclusive). This is equivalent to 0.07% of expected average Fund assets over 2006/7.

We see the new model for the treatment of expenses as very appropriate. It places full responsibility for managing both the structure of the investment programme, and the operating costs, on the Guardians. Investment returns will be measured after all operating costs, including all Guardians' expenses, are taken into account. Importantly, there is no loss of transparency in the change as all operating costs, irrespective of whether they are sourced from appropriation or Fund assets, will be consolidated in the financial statements of the Guardians and subject to the reporting and disclosure obligations of the Crown Entities Act.

We have also prepared forecast financial statements for the Fund. We have assumed that earnings will be in line with our medium-term estimate (i.e. 8.2% p.a. after costs but before NZ tax). Some costs are fixed (e.g. audit costs and most advisory services) and can be fairly estimated, but the majority are variable (i.e. base and performance fees paid to investment managers or transaction fees paid to the custodian). We have prepared estimates of these variable costs based on our expectations of the portfolio over the year.

Forecast Financial Statements for the Guardians of New Zealand Superannuation for the Year Ended 30 June 2007

1. Projected Statement of Financial Performance

Forecast	2007 $000
Income from Parliamentary Appropriation	1,536
Income from New Zealand Superannuation Fund	6,243
Interest	66
Total Revenue	**7,845**
Board-related Expenses	420
Employee Remuneration and Related Costs	5,027
Staff Travel and Professional Development	773
Office Accommodation, Supplies, Telecommunications and Depreciation	1,224
External Communications	150
Professional Fees	185
Total Expenses	**7,779**
Operating Surplus/(Deficit)	**66**

2. Projected Statement of Movements in Taxpayers' Equity

Forecast	2007 $000
Public Equity as at 1 July	**1,541**
Operating Surplus	66
Total Recognised Revenue and Expenses	**66**
Capital Contributions from the Crown	0
Public Equity as at 30 June	**1,607**

3. Projected Statement of Financial Position

Forecast	2007 $000
Non-current Assets	
Computer Equipment at Cost	319
Leasehold Equipment at Cost	203
Office Equipment at Cost	176
Accumulated Depreciation	(476)
Total Non-current Assets	**222**
Current Assets	
Cash and Receivables	2,445
Current Liabilities	
Creditors and Accruals	1,060
Net Current Assets	**1,385**
Total Net Assets	**1,607**
Represented by:	
Public Equity	
General Funds	1,607
TOTAL PUBLIC EQUITY	**1,607**

4. Projected Statement of Cash Flows

Forecast	2007 $000
Cash Flows from Operating Activities	
Cash Provided from:	
Appropriation for Operating Expenses	1,850
Fees from New Zealand Superannuation Fund	6,622
Cash Disbursed to:	
Operating Expense	7,630
Net GST Payable	676
Net Cash Flows from Operating Activities	**166**
Cash Flows from Investing Activities	
Cash Provided from:	
Capital Appropriation from the Crown	0
Interest on Bank Account	66
Cash Disbursed to:	
Purchase of Fixed Assets	0
Net Cash Flows from Investing Activities	**66**
Net Increase/(Decrease) in Cash Held	232
Opening Cash Brought Forward	1,484
Closing Cash Balance	**1,716**

5. Summary of Significant Accounting Policies

Reporting Entity

These are the financial statements of Guardians of New Zealand Superannuation, a Crown entity in terms of the Public Finance Act 1989.

These financial statements have been prepared in accordance with section 41 of the Public Finance Act 1989.

Measurement Base

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

Accounting Policies

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

a) Budget figures

The budget was approved by the Board for the year.

b) Revenue

Guardians of New Zealand Superannuation derive revenue through the provision of outputs to the Crown and income from its investments. Such revenue is recognised when earned and is reported in the financial period to which it relates.

c) Goods and Services Tax (GST)

All items in the financial statements are exclusive of GST, with the exception of accounts receivable and trade creditors 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.

d) Taxation

Guardians of New Zealand Superannuation is a public authority in terms of the Income Tax Act 1994 and consequently is exempt from income tax.

e) Accounts receivable

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

f) Investments

Investments are stated at the lower of cost and net realisable value. Any write-downs are recognised in the Statement of Financial Performance.

g) Property, plant and equipment

Fixed assets, which are material in aggregate, are capitalised and recorded at cost. Any write-down of an item to its recoverable amount is recognised in the Statement of Financial Performance.

h) Depreciation

Depreciation is provided on a straight line basis on all fixed assets 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	3 years
Leasehold improvements	6 years

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

i) Employee entitlements

Provision is made in respect of Guardians of New Zealand Superannuation's liability for annual leave. Annual leave is expected to be settled within 12 months of reporting date, and is measured at nominal values on an actual entitlement basis at current rates of pay.

j) Leases

(i) Finance leases

Leases which effectively transfer to Guardians of New Zealand Superannuation substantially all the risks and benefits incident to ownership of the leased item are classified as finance leases. These leases are capitalised at the lower of the fair value of the asset or the present value of the minimum lease payments. The leased assets and corresponding lease liabilities are recognised in the statement of financial position. The leased assets are depreciated over the period Guardians of New Zealand Superannuation is expected to benefit from their use.

(ii) 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 systematic basis over the period of the lease.

k) Foreign currency transactions

Transactions denominated in foreign currencies are translated into the reporting currency using the exchange rate in effect at the transaction date.

Monetary items receivable or payable in a foreign currency, other than those resulting from short-term transactions covered by forward exchange contracts, are translated at balance date at the closing rate. For transactions covered by short-term forward exchange contracts, the rates specified in those contracts are used as the basis for measuring and reporting the transaction.

Exchange difference on foreign exchange balances are recognised in the Statement of Financial Performance.

l) Financial instruments

Guardians of New Zealand Superannuation is party to financial instruments as part of its normal operations. These financial instruments include bank accounts, short-term deposits, debtors and creditors. All financial instruments are recognised in the Statement of Financial Position and all revenues and expenses in relation to financial instruments are recognised in the Statement of Financial Performance.

Except for items covered by separate accounting policy, all financial instruments are shown at their estimated fair value.

m) Statement of cash flows

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

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

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

Financing activities are those activities relating to changes in equity and debt capital structure of Guardians of New Zealand Superannuation and those activities relating to the cost of servicing Guardians of New Zealand Superannuation Board's equity capital.

CHANGES IN ACCOUNTING POLICIES

There have been no changes in accounting policies since the date of the last audited financial statements.

All policies have been applied on a basis consistent with previous years.

Forecast Financial Statements for the New Zealand Superannuation Fund for the Year Ended 30 June 2007

1. Forecast Statement of Financial Performance

For the year ending 30 June 2007

Forecast	$M
Investment Income	1,017
Total Operating Revenue	**1,017**
Manager Base Fees	50
Manager Performance Fees	11
Custody and Administration Fees	11
GNZS Operating Expenses	7
Other Fees (Including Audit)	6
Total Expenses	**85**
Net Operating Income Before Tax	932
Income Tax Expense	280
Net Operating Income After Tax	652

2. Forecast Statement of Movements in Taxpayers' Equity

For the year ending 30 June 2007

Forecast	$M
Public Equity as at 1 July	**10,015**
Net Surplus After Tax	652
Total Recognised Revenues and Expenses	**652**
Capital Contributions from the Crown	2,049
Public Equity as at 30 June	**12,716**

3. Forecast Statement of Financial Position

For the year ending 30 June 2007

Forecast	$M
ASSETS	
Current Assets	
Cash	20
Receivables	90
Total Current Assets	**110**
Non-current Assets	
Fixed Assets	1
Investments	13,146
Total Non-current Assets	13,147
TOTAL ASSETS	**13,257**
LIABILITIES	
Current Liabilities	
Payables and Accruals	78
Provision for Tax	-
Total Current Liabilities	**78**
Non-current Liabilities	
Deferred Tax	463
Total Non-current Liabilities	**463**
TOTAL LIABILITIES	**541**
NET ASSETS	**12,716**
represented by:	
Public Equity	
General Funds	12,716
TOTAL PUBLIC EQUITY	**12,716**

4. Forecast Statement of Cash Flows

For the year ending 30 June 2007

Forecast	$M
Cash Flows from Operating Activities	
Cash Provided from:	
Dividends and Interest	129
Cash Applied to:	
Operating Expenses	86
Taxation	165
Net Cash Flows from Operating Activities	**(122)**
Cash Flows from Investing Activities	
Cash Provided from:	
Sale of Investments	390
Cash Applied to:	
Purchase of Investments	2,316
Purchase of Fixed Assets	1
Net Cash Flows from Investing Activities	**(1,927)**
Cash Flows from Financing Activities	
Cash Provided from:	
Transfers from the Crown	2,049
Cash Applied to:	
Net Cash Flows from Financing Activities	**2,049**
Net Increase in Cash Held	-
Opening Cash Brought Forward	20
Effect of Exchange Rate on Foreign Currency Balance	-
Closing Cash Balance	**20**

5. Summary of Accounting Policies

REPORTING ENTITY

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

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

The Crown is required to make capital contributions to the Fund for investment based on a percentage of GDP as set out in the Act. Capital contributions are made by the Crown into the Fund on a fortnightly basis for the purpose of investment, and funding the net cost of New Zealand superannuation entitlements ("superannuation entitlements").

STATUTORY BASE

The financial statements have been prepared in accordance with the Financial Reporting Act 1993 and the New Zealand Superannuation and Retirement Income Act 2001.

MEASUREMENT BASE

The financial statements have been prepared on the basis of historic cost with the exception that certain assets and liabilities are measured at market value.

SPECIFIC ACCOUNTING POLICIES

The financial statements are prepared in accordance with New Zealand generally accepted accounting practice. The accounting policies that materially affect the measurement of financial performance and financial position are set out below.

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 Movements in Public Equity.

(ii) Superannuation entitlement payments

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

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 financial statements.

c) Income tax

In accordance with section 76 of the Act the Fund is treated as if it is a body corporate for tax purposes and is therefore subject to income tax on any income derived from investments, and that income is treated as gross income of the Fund under the Income Tax Act 1994.

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

The impact of all timing differences between accounting and taxable income is recognised as a deferred tax liability or asset. This is the comprehensive basis for the calculation of deferred tax under the liability method.

Deferred tax is provided for on unrealised gains and losses on investments.

A deferred tax asset, or the effect of losses carried forward that exceed the deferred tax liability, is recognised in the financial statements only where there is virtual certainty that the benefit of the timing differences, or losses, will be utilised.

d) Investments

Investments are recorded on a trade date basis and are stated at 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) Fixed interest securities are valued at the last quoted sales price as of the close of business on the day the securities are being valued at balance date.

(ii) Listed securities are stated at the end-of-day market value as quoted by the relevant exchange at balance date.

(iii) Investments in unit trusts are stated at market value based on unit prices provided by the underlying fund manager at balance date.

(iv) In the case of private equity, timber and infrastructure assets, where quoted market prices are not available, fair value is determined based on carrying values and other relevant information reported by external managers of the investments. These carrying values are determined by the external managers using accepted industry valuation methods. These methods include considerations such as earnings multiples of comparable publicly traded companies, discounted cash flows and third party transactions, or other events which would suggest a significant change in the value of the investment. In the first year of ownership, cost is generally considered to be an appropriate estimate of fair value for private equity and infrastructure investments unless there is evidence of a significant change in value.

(v) The fair value of private markets real estate investments is determined using accepted industry valuation methods, such as discounted cash flows and comparable purchase transactions. In the first year of ownership, cost is generally considered to be an appropriate estimate of fair value for real estate investments unless there is evidence of a significant change in value.

(vi) Investments in pooled vehicles are stated at fair value based on prices provided by the investment manager based on the value of the underlying assets at balance date.

(vii) Fair value for over-the-counter derivatives such as swaps and forward contracts is determined based on the quoted market prices for underlying assets. The fair value of commodity swap instruments is provided by the investment manager based on the value of the underlying instruments as quoted on the relevant index at balance date.

e) Receivables

Receivables are stated at their estimated realisable value.

f) Property, plant and equipment

Fixed assets, which are material in aggregate, are capitalised and recorded at cost. Any write-down of an item to its recoverable amount is recognised in the Statement of Financial Performance.

g) Depreciation

Depreciation is provided on a straight line basis on all fixed assets 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	3 years
Leasehold improvements	6 years

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

h) Income recognition

Interest income is accounted for on an accrual basis.

Dividend income and distributions are recognised on the "ex-date".

Any unrealised gains and losses arising from the revaluation of investments or conversion to New Zealand dollars at balance date, and realised gains and losses on the sale of investments during the year, are included in the Statement of Financial Performance. Realised gains and losses are calculated with reference to the weighted average cost of investments.

i) Foreign currency transactions

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

Foreign currency monetary assets and liabilities at balance date are translated at the rate of exchange ruling as at that date. Realised foreign exchange gains and losses represent gains and losses upon sale of investments that relate to foreign exchange movements in assets, and gains and losses upon settlement of forward foreign exchange contracts. Unrealised foreign exchange gains and losses represent the translation of foreign-dominated assets and liabilities.

j) Statement of Cash Flows

The following are the definitions of the terms used in the Statement of Cash Flows:

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

Investing activities are those activities relating to the acquisition, holding and disposal of investments. Investments include securities not falling within the definition of cash, including cash flows from the settlement of forward foreign exchange contracts.

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

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

k) Financial instruments

The Fund is party to financial instruments as part of its normal operations. These financial instruments include bank accounts, investments, receivables and payables. Financial instruments, including derivatives that are hedges of specific assets, are recognised on the same basis as their underlying hedged assets. All financial instruments are recognised in the Statement of Financial Position and all revenues and expenses in relation to financial instruments are recognised in the Statement of Financial Performance.

Investments are recorded at market value, which equates to fair value, and all other financial instruments are shown at their estimated fair value.

All forward foreign exchange contracts are valued at market value based on the 4pm London close.

l) Prior year comparatives

Certain prior year comparatives have been reclassified to conform to current year presentation.

CHANGES IN ACCOUNTING POLICIES

There have been no changes in accounting policies during the year and the accounting policies are consistent with those used in the previous period.