REPORTS OF THE

GOVERNMENT SUPERANNUATION FUND AUTHORITY

FOR THE YEAR ENDED
30 JUNE 2007

2007

GOVERNMENT SUPERANNUATION FUND
Te Pūtea Penihana Kāwanatanga

FOR THE YEAR ENDED
30 JUNE 2007

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Reports presented to the House of Representatives pursuant to Section 150(3) of the Crown Entities Act 2004.

GOVERNMENT SUPERANNUATION FUND AUTHORITY

Chairman's Report

On behalf of the Government Superannuation Fund Authority Board (**the Board**), I am pleased to present the annual report of the Government Superannuation Fund Authority (**the Authority**) for the year ended 30 June 2007.

A separate annual report has been prepared by the Authority for the Government Superannuation Fund (**GSF or the Fund**), commencing on page 31.

The Authority was established as a Crown entity by section 15A of the Government Superannuation Fund Act 1956 (**the GSF Act**) and became an autonomous Crown entity under the Crown Entities Act 2004 (**the Crown Entities Act**).

The Authority's mission is to use best practice to manage the Fund and administer the GSF Schemes, in accordance with the GSF Act, with the prime objectives of enabling:

- returns to be maximised without undue risk,
- the Crown's contribution to GSF to be minimised, and
- the needs and reasonable expectations of stakeholders to be met.

The Authority is responsible for interpreting the provisions of the GSF Act relating to the GSF Schemes and exercising discretionary provisions. Management carries out these functions under delegation from the Board.

Highlights of the 2007 Year

- A surplus after tax of $355 million for the Fund following good returns from international and New Zealand equities, and property. The surplus equates to a 9.5% return on average net assets.
- A surplus pre tax of $553 million, representing a return of 14.9% on average net assets.
- Investment returns being ahead of our Investment Performance Measure for the period from 2 October 2001 to 30 June 2007, on an annualised basis.
- Net assets increased from $3.79 billion to $4.00 billion.
- Investment in collateralised commodity futures completed.
- Completion of a review of our Investment Strategy, following legislative amendments to the way investment assets are taxed.
- The Authority became a signatory to the United Nations Principles for Responsible Investment.
- Work commenced on fully scoping the operations and functions of the GSF Business System, used in the administration of the GSF Schemes, as the first step in determining the specification for a new and more sustainable administration system.

Investment Returns

The Fund's surplus after tax for the year of $355 million represents a return of 9.5% on average net assets. The surplus pre tax was $553 million and represents a return of 14.9% on average net assets.The after tax return has exceeded the Investment Performance Measure (**IPM**) (see next page) over the year by 5.8%, and over the last three years by 4.3% per annum.

Investment returns, measured on an annualised basis, are ahead of the IPM for the period from 2 October 2001, when the Authority took over responsibility for the management of the Fund, to 30 June 2007. This represents added value of $600 million above the returns that would have been made had the Fund continued to invest only in Government Stock.

The after tax return of 9.5% also compares with the median after tax return of 6.4% for the year in the Mercer Investment Performance Survey covering 65 superannuation schemes. The average after tax return for the Fund over the last three years was 10.1%. This compares with the median after tax return in the Mercer Survey, over the same period, of 9.4%.

Returns from all asset classes were positive for the year, but performance against benchmarks was mixed. International equities returned 22.4%, in line with the benchmark, and New Zealand equities returned 20.5%, lower than the benchmark return of 22.6%. Despite the downturn in the April – June 2007 quarter, property generated a return of 22.1% for the year (benchmark 15.0%). The return from international fixed interest of 6.5% (benchmark 7.2%) was in line with the long term average return from this asset class, while the return from New Zealand fixed interest (2.5%), was ahead of the benchmark (1.8%).

In the report for the year ended 30 June 2006 we advised of a decision in principle to allocate up to 15% of the assets of the Fund to assets other than equities and fixed interest securities, in addition to the existing 7.5% allocation to property. The first step in implementing this decision was the investment of 3% of the Fund in Collateralised Commodity Futures (**CCFs**). Investment in CCFs was undertaken on a staged basis during the year and this asset class is now fully invested. The return from CCFs (6.1%) was ahead of the benchmark (5.2%).

It is important to take a long term view of investment returns, as the Fund is expected to exist and pay pensions for another 60 years. Investment returns are volatile and performance in any particular year is not indicative of the long term performance of the Fund.

Details of the investment returns for all asset classes and the benchmark indices used by the Authority are set out in the annual report for the Fund (see Investment Commentary page 35).

Investment Strategy

The Authority is required to invest the Fund on a prudent commercial basis. In doing so, it must manage and administer the Fund in a manner consistent with best practice portfolio management, maximising returns without undue risk to the Fund as a whole.

Key features of the Investment Strategy, confirmed for the Fund in 2006, were the Investment Objective, IPM and Risk Parameter, as set out below.

Investment Objective
To minimise the Crown's contribution to GSF by maximising the return on the assets of the Fund over the long term, without undue risk, and within a best practice framework.

Investment Performance Measure (IPM)
The performance of the Fund will be assessed by comparing the after tax return with the NZX New Zealand Government Stock Gross Index return (after tax) plus 2.5% per annum measured over rolling 10 year periods.

Risk Parameter
Having no more than 1 in 10 chance in any one year of a loss to the total Fund greater than $100 million (after tax).

The IPM and Risk Parameter are reviewed at least annually, taking into account the investment and tax environment in which the Authority operates. Last year, we reported that the Government had proposed changes to the way gains and income from New Zealand, some Australian and international shares are taxed. We noted that, if the proposed tax changes took effect, the IPM may no longer be achievable without increasing the risk profile of the Fund. In that event the Board may need to determine whether to increase the level of risk taken by the Fund, or accept a lower IPM.

Once the tax changes were passed into law, the Authority undertook a full review of the Investment Strategy for the Fund. A key outcome of the review was to leave the IPM unchanged and increase the risk profile for the Fund. The increase in the risk profile will be achieved by changing the Strategic Asset Allocation, effective 1 October 2007, increasing the allocation to growth assets (primarily equities and property) and decreasing the allocation to fixed interest. Further comment on the Strategic Asset Allocation for the Fund is set out on page 12.

The increase in the risk profile is also reflected in the new Risk Parameter set for the Fund.

Risk Parameter
Having no more than 1 in 10 chance in any one year of a loss greater than 6.0% of the total Fund (after tax).

The new Risk Parameter also recognises the growth in the Fund from $3.2 billion in 2003, when the parameter was first put in place, to $4 billion in 2007. As at 30 June 2007, 6% of the total Fund was $240 million.

Another key outcome was to establish a review of the composition and structure of the international equities portfolio to take into account the amendments to the way New Zealand, some Australian and international shares will be taxed. The review was ongoing at year end. Any changes to the composition and structure of the international equities portfolio will be made from 1 October 2007, when the tax amendments come into effect for the Fund.

Responsible Investment

The GSF Act requires the Authority to manage and administer the Fund in a manner consistent with (amongst other things) avoiding prejudice to New Zealand's reputation as a responsible member of the world community. The Authority is also required to prepare a statement of investment policies, standards and procedures (**SIPSP**) which must cover ethical investment, including policies, standards or procedures for avoiding prejudice. The SIPSP is published at the end of the Annual Report of the Fund, starting on page 63.

Public interest concerning how the investment community incorporates environmental, social and governance factors into the investment process has emerged over time, but has intensified over the last year. The Authority has closely monitored these developments and has implemented a number of new initiatives in what has become known as responsible investment. The initiatives include:

- becoming a signatory to the United Nations Principles for Responsible Investment to provide a framework for the Board when considering responsible investment issues,
- appointing a proxy voting service to strengthen the Authority's voting process for its direct shareholdings and to assist in achieving consistency in the voting undertaken by investment managers appointed by the Authority, and
- expanding the section in the SIPSP, that previously dealt with ethical investment and avoiding prejudice, to cover the wider subject 'responsible investment' (see page 83).

The Authority will report further on the implementation of its responsible investment policies in future annual reports.

Statutory Review

The first statutory review of the Authority, since it was formed in 2001, was undertaken in 2006. Comment on the outcome of the review was included in last year's annual report.

The review made a number of recommendations on:

- whether the Authority should target pre tax or post tax returns for the Fund, and
- areas such as management of transitions from one investment manager to another, custody and asset/liability modelling.

These recommendations have all been addressed.

Following further consideration and discussions with Government officials the Authority has determined to continue targeting post tax returns for the Fund.

A manager has been appointed to assist with the management of transitions, and a benchmark review has commenced on the services provided by the custodian. Also following discussions with Government officials, full asset liability modelling (**ALM**) will not be undertaken for the Fund. It was agreed that, due to the fact that the Crown funds its share of the GSF entitlements as they fall due, and the level of unfunded liabilities, ALM would not assist in determining the optimum allocation of assets to achieve the IPM.

Schemes

The Authority has commenced work on fully scoping the operations and functions of the GSF Business System, used in the administration of the GSF Schemes, as the first step in determining the specification for a new and more sustainable administration system.

The GSF Business System is more than 15 years old and incorporates technology that is no longer in common use in New Zealand. People with relevant technology skills are becoming increasingly scarce.

During the year 312 GSF Police Scheme members elected to transfer to the Police Superannuation Scheme (**PSS**) bringing the total number of transfers since August 2005 to 1,044 and the total amount transferred to the PSS to $386.5 million.

Website

The Authority's website – *www.gsfa.govt.nz* – continues to be an important part of our communications strategy and contains comprehensive information on both the Authority and the Fund. The content explains how the Authority operates and gives all members and interested parties immediate access to our latest quarterly investment results, as well as any changes the Authority makes to its policies, investment strategies and personnel.

The website provides an easy way to keep up to date with the operations of the Authority and the Fund.

Conclusion

The Board expresses its appreciation to the Minister of Finance and Government officials for their support during the year and to the Management team for their high level of work and commitment to the Authority's objectives and to the members of the GSF Schemes.

I also express my thanks to my fellow Board members for their expertise and commitment throughout the year.

Basil Logan

Chairman
Government Superannuation Fund Authority Board

STATEMENT OF GOVERNANCE AND ACCOUNTABILITY

The Authority was established as a crown entity by section 15A of the GSF Act and became an autonomous Crown entity under the Crown Entities Act. The business of the Authority is to manage the assets, and administer the schemes of the Fund in accordance with the GSF Act.

Section 15G of the GSF Act specifies that the Board is responsible for the business of the Authority.

Government Superannuation Fund Authority Board

The Minister of Finance appointed the following seven members to the Board:

Basil Logan CNZM, Chairman (appointed 2001, first reappointed 2003 and again in 2006) is also the Chairman of Opus International Consultants Limited.

David May, Deputy Chairman (appointed 2001, first reappointed 2004 and again in 2007) was formerly Chief Executive of Jacques Martin NZ Ltd and Managing Director of Colonial Life NZ Ltd. He is Chairman of the Guardians of New Zealand Superannuation, and a director of Southern Cross Healthcare.

Colin Blair OBE (appointed 2001, first reappointed 2003 and again in 2006) was formerly a Partner of the accounting firm Deloitte, and was the Retirement Commissioner until February 2003.

Helen Bowie (appointed 2001, first reappointed 2003 and again in 2006) is a partner of Chapman Tripp Sheffield Young.

Tim McGuinness (appointed 2001, first reappointed 2004 and again in 2007) is a Board member of the Earthquake Commission, a trustee of the Police Superannuation Scheme, NZ Fire Service Scheme, Globus NZ Pension Plan and the NZ Qualifications Authority Superannuation Scheme, Chairman of trustees of the Dairy Industry Superannuation Scheme and the Fonterra Superannuation Scheme, and a director of Whai Rawa Fund Limited. He previously held senior investment management positions at Royal & Sun Alliance and Norwich Union Investment Management.

Ralph Stockdill ONZM (appointed 2002, reappointed 2005) held senior management positions at the Department of Labour in the employment relations area before his retirement. Immediately before his appointment to the Board, Mr Stockdill was a member of the Executive of the Government Superannuitants Association.

Susie Weaver (appointed 2001, first reappointed 2002 and again in 2005) is a principal of Weaver Consulting Ltd and former General Manager of Investments at Armstrong Jones, now ING (NZ).

Remuneration of Board Members

Remuneration of Board members is in accordance with the rates set by the Minister of Finance.

Responsibilities and Operations of the Board

The Board is responsible for all decisions relating to the business of the Authority.

The Board has established four committees with specific responsibilities for Audit and Risk Review, Investments, Schemes and Responsible Investing. The Chairman is an ex officio member of all committees.

As required by the GSF Act, the Board does not delegate the following powers:

- the power of delegation,
- the power to grant power of attorney, and
- the power to appoint scheme administration managers, investment managers, other service providers, and custodians.

The Board held eight regular meetings during the year, one special meeting to review strategic issues, and an investment workshop.

Auditor

The Auditor-General is the auditor of the Authority. The Auditor-General has appointed Michael Wilkes of Deloitte to act on his behalf.

Management Team

The Authority and the Board of Trustees of the National Provident Fund (**NPF**) have formed a joint venture company, Annuitas Management Limited (**Annuitas**). Each organisation has entered into a management services agreement (**MSA**) with Annuitas.

The main function of Annuitas is to provide staff (**Management**) who act in managerial and secretarial roles on behalf of the Authority and NPF. The MSA between Annuitas and the Authority contains delegations of authority to enable Management to carry out the day to day management of the Authority's investment, custody and scheme management arrangements. In the case of scheme management, the delegation includes interpretation of the provisions of the GSF Schemes and exercise of discretionary powers in accordance with the Statement of Provisions, Policies and Procedures, subject to appropriate consultation with the Board.

The Management team is:

• Alan Langford	Chief Executive
• Euan Wright	Chief Financial Officer
• Philippa Drury	General Manager, Schemes
• Paul Bevin	General Manager, Investments
• Nicky Rumsey	Manager, Investments
• Peter McCaffrey	Manager, Investments
• Denise Healey	Manager, Investments

Indemnity

In 2006, the Authority:

- provided indemnities to each Board member under Deeds of Indemnity whereby the Authority agreed to indemnify each Board member (subject to certain exceptions) for certain costs and liabilities in respect of certain acts and omissions (being acts and omissions in good faith and in performance or intended performance of the Authority's functions) to the maximum extent permitted by the Crown Entities Act, and

- entered into Deeds of Indemnity with five members of the Management team whereby it agreed to indemnify the member of the Management team (subject to certain exceptions) for certain costs and liabilities in respect of certain acts and omissions (being acts and omissions in good faith and in performance or intended performance of the Authority's functions) to the maximum extent permitted by the Crown Entities Act.

The indemnity provided by the Authority to each Board member and the members of the Management team does not protect the Board member, or the member of the Management team, against any liability, claim or proceeding of any kind for any dishonesty or fraud or anything else that either:

- as a matter of public policy cannot be indemnified at law, or
- which is criminal liability that the Authority has determined, in its absolute discretion, should be excluded from the indemnity.

The Authority has determined that all criminal liability, other than strict liability offences, should be excluded from the scope of the indemnity. Broadly speaking, strict liability offences are those for which no intent needs to be established.

Insurance

During the financial year the Authority continued Directors and Officers insurance cover for Board members and members of the Management team in respect of potential liabilities and costs incurred through acts and omissions made in the performance or intended performance of the functions of the Authority. Insurance is not provided for an act or omission that is in bad faith.

The Authority also continued Company Reimbursement insurance cover in respect of any claims made by Board members, or members of the Management team, under the indemnities described above.

The scope of the Directors and Officers insurance cover and the Company Reimbursement insurance cover is consistent with the limitations imposed by the Crown Entities Act.

STATEMENT OF RESPONSIBILITY

The financial statements of the Authority, for the year ended 30 June 2007, have been prepared in accordance with section 154 of the Crown Entities Act.

The Board is responsible for the preparation of the Financial Statements and the Statement of Service Performance, and for the judgments made in them.

The Board confirms that internal control systems have been established and maintained during the period to provide reasonable assurances as to the integrity and reliability of the financial and non-financial reporting.

In our opinion, the attached Statement of Service Performance and Financial Statements for the financial year fairly reflect the financial position, as at 30 June 2007, and the operations of the Authority for the year ended 30 June 2007.

Basil Logan.

Basil Logan

Chairman
Government Superannuation Fund Authority Board

Colin Blair

Chairman
Audit and Risk Review Committee
Government Superannuation Fund Authority Board

5 September 2007

STATEMENT OF SERVICE PERFORMANCE

Output Class O1 – Management of the Government Superannuation Fund

This output class provides investment and scheme management for the Fund.

Outputs in this class are:

- management of the GSF assets (ie, the Fund),
- management of the GSF Schemes, including the agreement between the Authority and the Scheme Administrator, and
- interpretation of the provisions in the GSF Act and exercising discretionary powers (set out in the GSF Act).

The performance targets are set out in the Authority's Statement of Intent for the year commencing 1 July 2006.

Investment Management

FORECAST Service Performance	Performance ACHIEVED
Ensure the Authority adheres to its SIPSP and records all changes to its policies, standards and procedures in this document.	**Achieved.** The Authority has adhered to its SIPSP during the year and has recorded all changes to its policies, standards and procedures, as they relate to investment, in the document.
Ensure the safe custody of the Fund's assets.	**Achieved.** The Authority has appointed a widely experienced Custodian and is satisfied the Fund's assets are in safe custody.
Regularly review the Investment Strategy and make changes as appropriate. This will involve ensuring the key investment assumptions, used in developing the Strategic Asset Allocation, are reasonable and appropriate and the Investment Strategy continues to meet the requirements of the GSF Act and is consistent with the Authority's Investment Beliefs.	**Achieved.** The Investment Strategy is reviewed annually, or when there is a significant external event (eg, the tax changes commented on the next page) that could impact on the key investment assumptions. The Authority is satisfied that, following the review undertaken as a result of the taxation changes discussed on the next page, the Investment Strategy continues to meet the requirements of the GSF Act and is consistent with the Authority's Investment Beliefs (included in the SIPSP).

FORECAST Service Performance	Performance ACHIEVED
Develop appropriate responses to the 1 April 2007 investment taxation changes. The range of responses may include a change to the Strategic Asset Allocation or asset classes held by the Fund, a change to the target level of risk (Risk Parameter) or a change in the IPM.	**Achieved.** Once the taxation changes had been finalised, the Authority carried out a full review of the Investment Strategy and Strategic Asset Allocation for the Fund, including the key investment assumptions. The outcomes of the review were a new Strategic Asset Allocation and Risk Parameter for the Fund, while the IPM was maintained. The new Strategic Asset Allocation will be implemented from 1 October 2007, being the date the taxation changes apply to the Fund. The Strategic Asset Allocation, Risk Parameter and IPM are discussed further in the Chairman's Report.
Investigate alternative asset classes and managers, with the view to identifying suitable investments that, when combined with existing asset classes, contribute towards increasing returns and/or reducing risk for the Fund.	**Achieved.** Detailed work was carried out during the year on a range of alternative assets with emphasis on CCFs and Fund of Hedge Funds (**FOHF**). Three percent of the Fund has been invested in CCFs, while FOHF is still under review to determine whether they will contribute towards increasing returns and/or reducing risk for the Fund, and to identify suitable products and managers.
Monitor the Custodian's performance in accordance with the requirements of the custody agreement to ensure that the quality of service and the accuracy and timeliness of reports on the Fund are maintained.	**Achieved.** Quarterly meetings are held with the Custodian to fully review the Custodian's performance under the Service Level Agreement (part of the custody agreement). The review focuses on the quality of service and the accuracy and timeliness of reports on the Fund. A benchmark review has commenced on the services provided by the Custodian.
Monitor the investment managers' capabilities to ensure they remain appropriate and that the managers have the resources and ability to meet the performance requirements over the long term, as specified in investment management agreements.	**Achieved.** Management holds regular meetings with the investment managers at which their current capabilities are assessed and checks are carried out to assure they have the resources and ability to meet performance requirements over the long term.
Review investments to ensure compliance with the requirement to "avoid prejudice to New Zealand's reputation as a responsible member of the world community".	**Achieved.** The Authority has appointed two specialist investment screening organisations, which carry out reviews of all the directly owned securities held by the actively managed portfolios against the avoiding prejudice requirement.

Over the year, implementation of the Fund's Strategic Asset Allocation has developed as set out below. Also included in the table is the Strategic Asset Allocation, effective 1 October 2007.

Asset Class	**Strategic Asset Allocation at 30 June 2006 %**	**Strategic Asset Allocation at 30 June 2007 %**	**Strategic Asset Allocation Effective 1 October 2007 %**
New Zealand fixed interest	8.0	5.0	4.0
International fixed interest	27.0	27.0	20.5
New Zealand equities	15.0	15.0	13.0
International equities	42.5	42.5	52.0
Property	7.5	7.5	7.5
Collateralised Commodity Futures (CCFs)	–	3.0	3.0
TOTAL	**100.0**	**100.0**	**100.0**

During the year the investment in CCFs was undertaken on a staged basis. The allocation to New Zealand fixed interest was reduced from 8% to 5% to provide for CCFs.

All asset classes were within their rebalancing tolerances at 30 June 2007 and, with the exception of CCFs, were maintained within the rebalancing tolerances during the year.

Scheme Administration

FORECAST Service Performance	**Performance ACHIEVED**
The Scheme Administrator's performance will be monitored in accordance with the performance standards included in the scheme administration management agreement between the Authority and Datacom, including service levels to contributors, annuitants and employers, and other key performance standards.	**Achieved.** Weekly meetings are held by Management with the Scheme Administrator at which Datacom's performance is assessed against the performance standards included in the scheme administration agreement. Service levels were compromised during the year by additional workload imposed by the Police transfers and by a higher than planned staff turnover at Datacom.
The Statement of Policies will be maintained and, subject to consultation with interested parties, amended to record any policy changes made by the Authority.	**Achieved**. No changes were required or made to the Statement of Policies, which was originally published by the then Superintendent of the Fund on 28 September 2001.
Submissions from Datacom will be dealt with in accordance with the GSF Act and the Statement of Policies. All submissions to be responded to within five working days.	**Achieved.** All 171 submissions were determined in accordance with the GSF Act and the Statement of Policies and all were responded to within five working days.

FORECAST Service Performance	Performance ACHIEVED
Appeals against decisions made by, or on behalf of, the Authority will be responded to in accordance with the GSF Act. The Authority's reports to the Appeals Board will be provided at least 14 days before each scheduled hearing date.	**Achieved.** The four appeals made during the year, against decisions made by, or on behalf of, the Authority were reported to the Appeals Board at least 14 days before the scheduled hearing dates. Two appeals were declined by the Appeals Board. One appeal was allowed and one was partly allowed.
Sufficient funding will be provided to Datacom to ensure all entitlement payments are able to be made as they become due.	**Achieved.** Sufficient funding was provided to Datacom to ensure all entitlement payments were able to be made as they became due.
Actuarial data on the Fund, required for the Crown financial statements, will be provided in accordance with the timetable agreed with Treasury.	**Achieved.** Actuarial data, required for the Crown financial statements, was provided in accordance with the timetable agreed with Treasury.
Communications will be sent to contributors, annuitants and employers regarding the activities of the Authority and the performance of the Fund.	**Achieved.** A message from the Chairman was sent out to all contributors and annuitants covering the activities of the Authority and the performance of the Fund. Communications were sent to employers covering scheme administration issues.

Organisation

FORECAST Service Performance	Performance ACHIEVED
Maintain and report on the Authority's and Fund's accounts in accordance with the GSF Act and the Crown Entities Act.	**Achieved.** The Authority's and the Fund's accounts have been maintained and reported on in accordance with the GSF Act and the Crown Entities Act.
Evaluate the outcome of the statutory review of the Authority and respond accordingly.	**Achieved.** The Authority has reviewed and considered each of the recommendations and comments in the statutory review. In some cases the Authority has determined, after consultation with officials, that no further action is necessary on behalf of the Authority. Other recommendations have been fully accepted and adopted by the Authority and have been implemented. Examples of recommendations accepted and adopted by the Authority are benchmarking of the Custodian and documenting the decision making processes for transitions of investment assets from one portfolio to another.

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF FINANCIAL PERFORMANCE

FOR THE YEAR ENDED 30 JUNE 2007

2006 $000 Actual		Note	2007 $000 Actual	2007 $000 Forecast
Revenue				
18	Interest received		16	11
687	Other revenue, including rental from the Bowen space		686	545
12,432	Transfer from the Government Superannuation Fund	1	13,816	12,771
13,137	**Total revenue**		14,518	13,327
Expenses				
2,284	Scheme administration		2,199	2,400
7,821	Investment management and custody	2	9,058	7,664
3,032	Operating	3	3,261	3,263
13,137	**Total expenses**		14,518	13,327
–	**Net operating result**		–	–

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF FINANCIAL POSITION

AS AT 30 JUNE 2007

2006 $000 Actual		Note	2007 $000 Actual	2007 $000 Forecast
	Public equity			
–	General fund		–	–
–	**Total public equity**		–	–
	Represented by:			
	Current assets			
267	Cash at bank		282	170
2,561	Receivables and prepayments	4	2,307	2,170
2,828	**Total current assets**		2,589	2,340
	Current liabilities			
2,828	Payables	5	2,589	2,340
2,828	**Total current liabilities**		2,589	2,340
–	**Net assets**		–	–

The Financial Statements were approved by the Government Superannuation Fund Authority Board on 5 September 2007.

Basil Logan

Chairman
Government Superannuation Fund Authority Board

Colin Blair

Chairman
Audit and Risk Review Committee
Government Superannuation Fund Authority Board

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 30 JUNE 2007

2006 $000 Actual		*Note*	*2007 $000 Actual*	*2007 $000 Forecast*
	Cash flows from operating activities			
	Cash was provided from:			
12,571	Government Superannuation Fund	1	13,956	12,646
18	Interest		16	11
696	Other		770	545
13,285			14,742	13,202
	Cash was disbursed to:			
(13,382)	Operating expenses		(14,727)	(13,162)
(13,382)			(14,727)	(13,162)
(97)	**Net cash flows from operating activities**		15	40
(97)	Net (decrease)/increase in cash held		15	40
364	Opening cash brought forward		267	130
267	**Closing cash balance**		282	170

2006 $000 Actual		*Note*	*2007 $000 Actual*	*2007 $000 Forecast*
	Reconciliation of net operating result to net operating cash flows			
–	Net operating result		–	–
	Movements in working capital items:			
97	Receivables and prepayments		254	(125)
(194)	Payables		(239)	165
(97)	**Net cash flows from operating activities**		15	40

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF MOVEMENT IN PUBLIC EQUITY

FOR THE YEAR ENDED 30 JUNE 2007

2006 $000 Actual		*2007 $000 Actual*	*2007 $000 Forecast*
–	**Public equity at beginning of the period**	–	–
–	Net operating result	–	–
–	**Total recognised revenues and expenses for the period**	–	–
–	**Public equity at end of the period**	–	–

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF COMMITMENTS

AS AT 30 JUNE 2007

Section 22 of the Government Superannuation Fund Amendment Act 2001 (**the Amendment Act**) vested in the Authority the whole of the leasehold interest in floors 3 and 4 at 33 Bowen Street, Wellington (**the Bowen space**). The Bowen space lease terminates in February 2009. The annual rent was last reviewed in February 2006. The new rent, negotiated under the review, will apply until the termination of the Bowen space in February 2009.

The Authority has entered into subleases with the Ministry of Economic Development (**MED**) and Accident Compensation Corporation (**ACC**) for the Bowen space. The MED and ACC subleases are to 31 January 2009 . The future commitments stated below are gross commitments at current rental rates, before netting off rental income from subleases.

In terms of section 15E (1) of the GSF Act, the Authority's expenses are reimbursed by the Fund which recovers them from the Crown, as provided for in section 95 of the GSF Act, and from other employers. Accordingly, any shortfall between the lease commitments and the sublease rental income is not onerous to the Authority.

Other operating commitments include non-cancellable contracts for building services.

2006 $000 Actual		*2007 $000 Actual*
–	Capital commitments approved and contracted	–
Non-cancellable operating commitments		
1,574	Accommodation lease	976
504	Other operating commitments	273
2,078	**Total operating commitments payable (as detailed below)**	1,249
Term classification for accommodation lease commitments		
597	Not later than one year	597
598	Later than one year and not later than two years	379
379	Later than two years and not later than five years	–
1,574	**Total lease commitments**	976
Term classification for other operating commitments		
192	Not later than one year	167
192	Later than one year and not later than two years	106
120	Later than two years and not later than five years	–
504	**Total other operating commitments**	273

In terms of section 19(1) of the GSF Act the Authority has appointed Datacom Employer Services Limited to administer the GSF Schemes for a term of six years from 26 April 2005.

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

2006 $000 Actual		2007 $000 Actual
	Non-cancellable contractual commitments	
2,197	Scheme administration not later than one year	2,216
2,216	Scheme administration later than one year and not later than two years	2,241
6,460	Scheme administration later than two years and not later than five years	4,187
10,873	**Total non-cancellable contractual commitments payable**	8,644

On 3 November 2003 the Authority entered into a new MSA with Annuitas, a joint venture company formed by the Authority and the NPF, to provide secretarial and executive support to the Board. This agreement, although cancellable on twelve months written notice, is for an initial term of four years.

Estimated commitments under the existing MSA under are:

2006 $000 Actual		2007 $000 Actual
1,310	Management services not later than one year	477
437	Management services later than one year and not later than two years	–
1,747		477

The Authority will negotiate a new MSA with Annuitas to apply from November 2007.

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF CONTINGENT LIABILITIES

AS AT 30 JUNE 2007

The Authority has an obligation under contract to redecorate the Bowen space on 17 February 2009. In terms of section 15E (1) of the GSF Act, the Authority's expenses are reimbursed by the Fund which recovers them from the Crown, as provided for in section 95 of the GSF Act, and other employers. Accordingly, the Authority's obligation does not constitute a liability of the Authority.

There were no contingent liabilities as at 30 June 2007.

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

STATEMENT OF ACCOUNTING POLICIES

The following policies have been applied in the preparation of the financial statements

(i) Reporting entity and statutory base

The Authority was established as a Crown entity by section 15A of the GSF Act and became an autonomous Crown entity under the Crown Entities Act. The core business of the Authority is to manage the assets and administer the GSF Schemes.

These financial statements have been prepared in accordance with section 154 of the Crown Entities Act.

Separate financial statements have been prepared for the Fund in terms of section 93 of the GSF Act.

(ii) Measurement base

The financial statements are prepared on the historical cost basis. The reporting currency is in New Zealand dollars.

(iii) Particular accounting policies

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

(a) Forecast figures

The forecast figures are those approved by the Board at the beginning of the period and presented in the Authority's Statement of Intent.

The forecast figures were prepared in accordance with generally accepted accounting practice, and are consistent with the accounting policies adopted by the Board for the preparation of the financial statements.

*(b) Goods and services tax (***GST***)*

The Authority makes principally exempt supplies for GST purposes as it manages superannuation schemes. GST is imposed on certain services supplied from outside New Zealand. The affected transactions for the Authority are mainly fees incurred in relation to the custody of assets and the provision of investment reports. Apart from GST on transactions relating to the lease of the Bowen space, which are recoverable as input tax, GST is included in expenditure.

(c) Taxation

As a public authority, in terms of the Income Tax Act 2004, the Authority is exempt from income tax.

(d) Statement of cash flows

The statement of cash flows has been prepared using the direct approach.

- Cash and cash equivalents

Cash and cash equivalents consist of current accounts in banks, used in the day to day cash management of the activities of the Authority, and are unconditionally convertible to cash within two working days.

- Operating activities

Operating activities include all receipts of revenues and investment income, and payments of expenses.

- Financing activities

Financing activities relate to changes in equity capital structure.

(e) *Operating leases*
Section 22 of the Amendment Act, vested in the Authority the Bowen space. The lease of the Bowen space is classified as an operating lease. Payments under the lease are recognised as expenses in the periods in which they are incurred.

(f) *Financial instruments*
The Authority is party to financial instruments as part of its normal operations. These financial instruments include bank accounts, debtors, and creditors. All financial instruments are recognised in the Statement of Financial Position. All revenues and expenses in relation to financial instruments are recognised in the Statement of Financial Performance.

All financial instruments are shown at their estimated fair values.

(g) *Accounting for Joint Ventures*
The Authority has a 50% ownership in Annuitas, but does not equity account for Annuitas as this is deemed to be immaterial. The authorised, issued and paid up capital of Annuitas is $2.

(iv) Reporting period

The reporting period is the year ended 30 June 2007. Comparative figures are for the year ended 30 June 2006.

(v) Changes in accounting policy

There were no changes in accounting policies during the year. All policies have been applied on a basis consistent with those used in the prior year.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2007

1 Transfer from the Fund

In terms of section 15E (1) of the GSF Act, the administrative expenses of the Authority, including investment management and custody expenses, are reimbursed by the Fund. Both the Crown and other employers reimburse the Fund under section 95 of the GSF Act for the Authority's expenses. In the reporting period, as certified by the Government Actuary:

- the Crown contributed 81.5% of the Authority's investment management and custody expenses reimbursed by the Fund, and other employers contributed the balance of 18.5%.
- the Crown contributed 81.4% of the Authority's other operating expenses reimbursed by the Fund, and other employers contributed the balance of 18.6%.

2 Investment management and custody

2006 $000		2007 $000
6,837	Investment management expenses	8,126
984	Custodian expenses	932
7,821	Total	9,058

3 Operating expenses

2006 $000	Operating expenses include:	2007 $000
121	Audit	139
–	Other assurance fees paid to Auditor - IFRS	65
183	Board fees and expenses	182
691	Gross rental and outgoings - Bowen space	750
1,080	Annuitas Management Limited	1,250

4 Receivables and prepayments

2006 $000		2007 $000
2,510	Government Superannuation Fund	2,268
–	Other receivables	11
51	Annuitas Management Limited	28
2,561	Total receivables and prepayments	2,307

5 Payables

2006 $000		2007 $000
1,849	Investment management	1,899
702	Professional services	429
277	Other creditors	261
2,828	Total payables	2,589

6 Financial instruments

(a) *Credit risk*

Credit risk is the risk that a third party will default on its obligation to the Authority, causing the Authority to incur a financial loss. Financial instruments, which potentially subject the Authority to credit risk, consist principally of cash, bank deposits and receivables.

The Authority has a minimal credit risk in its holdings of cash, bank deposits, and receivables.

The Authority does not require any collateral or security to support financial instruments.

There is no significant concentration of credit risk other than in the Fund, which is an obligation of the Crown.

The maximum amount of credit risk for each class is the carrying amount in the Statement of Financial Position.

(b) *Currency risk*

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.

Except for USD429,000 (2006: USD333,000) management fees payable to three international fixed interest managers, the Authority has no exposure to currency risk.

(c) *Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

The Authority has no significant interest rate risk.

(d) *Fair values*

The fair values of financial instruments are equivalent to the carrying amounts disclosed on the Statement of Financial Position.

7 Employee remuneration

The Authority has no employees.

Annuitas provides staff who act in management and secretarial roles for both organisations.

During the year Annuitas employed eleven staff (3 part time) (2006: nine). Total remuneration was $1,665,200 (2006: $1,385,000) and the Authority reimbursed $936,000, or 56% (2006: $789,000, 57%) of the total.

8 Board fees

Board members were paid the following fees during the period.

2006 *$*		*2007* *$*
	Chairman	
37,400	Basil Logan	37,400
	Deputy Chairman	
23,376	David May	23,376
	Members	
18,700	Colin Blair	18,700
18,700	Helen Bowie	18,700
18,700	Tim McGuinness	18,700
18,700	Ralph Stockdill	18,700
18,700	Susie Weaver	18,700

The Authority also met Board members' travel expenses, where applicable, to attend Board meetings, and for travel on matters directly related to the business of the Authority. Travel expenses totalled $8,424 in 2007 (2006: $7,827).

As noted in the Statement of Governance and Accountability, during the year the Authority continued with Directors and Officers insurance cover for Board members and members of the Management team, and Company Reimbursement insurance in respect of any claims made by Board members, or members of the Management team, under indemnities provided by the Authority. The total cost of the insurance was $19,125 (2006: $19,125) per annum.

9 Related party information

The Authority is an autonomous Crown entity.

In terms of section 19(1) of the GSF Act the Authority has appointed Datacom Employer Services Limited to administer the GSF Schemes for a term of six years from 26 April 2005.

The Authority has entered into various transactions with Government Departments and Crown organisations on an arm's length basis in the normal course of business. These transactions are not considered to be related party transactions.

During the year the Authority entered into an agreement with the Guardians of New Zealand Superannuation to share with the Guardians information gathered from the Authority's sovereign screening programme. David May (Deputy Chairman) is Chairman of the Guardians of New Zealand Superannuation.

During the reporting period, the Authority paid Annuitas $1,250,000 (2006: $1,080,000) for management and secretarial services.

10 Actual versus forecast

Increases in market values of investments resulted in greater investment management and custody expenses than the forecast set out in the Statement of Financial Performance on page 15.

11 Adoption of New Zealand Equivalents to International Financial Reporting Standards

In December 2002 the New Zealand Accounting Standards Review Board (**ASRB**) announced that all New Zealand reporting entities will be required to comply with New Zealand equivalents to International Financial Reporting standards (**NZ IFRS**) for periods commencing on or after 1 January 2007, with the option to comply early for periods beginning on or after 1 January 2005.

The Authority has decided to adopt the NZ IFRS for the year ended 30 June 2008, with 1 July 2006 being the transition date ie, the start of the comparative period.

Upon first time adoption of the NZ IFRS, comparative information will be restated in NZ IFRS compliant financial statements. Details of the impact of the adoption to comparative information will be set out in those financial statements.

The Board has established a conversion project, monitored by the Board's Audit and Risk Review Committee, to achieve transition to NZ IFRS reporting. The project includes assessing the impacts of NZ IFRS to the Authority, then designing and implementing changes required to current accounting policies and procedures, as well as systems and processes, in order to successfully transition to NZ IFRS.

As the Authority operates on zero-sum equity and without investments, the change to NZ IFRS is not expected to have a material impact on the Authority's financial statements.

Deloitte.

REPORT OF THE AUDITOR-GENERAL

TO THE READERS OF THE GOVERNMENT SUPERANNUATION FUND AUTHORITY'S FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION

For the Year Ended 30 June 2007

The Auditor-General is the auditor of the Government Superannuation Fund Authority (**the Authority**). The Auditor-General has appointed me, Michael Wilkes, using the staff and resources of Deloitte to carry out the audit on his behalf. The audit covers the financial statements and statement of service performance included in the annual report of the Authority for the year ended 30 June 2007.

Unqualified Opinion

In our opinion:

The financial statements of the Authority on pages 15 to 26:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
    - the Authority's financial position as at 30 June 2007; and
    - the results of its operations and cash flows for the year ended on that date.

The statement of service performance of the Authority on pages 10 to 14:

- complies with generally accepted accounting practice in New Zealand; and
- fairly reflects for each class of outputs:
    - its standards of delivery performance achieved, as compared with the forecast standards outlined in the statement of forecast service performance adopted at the start of the financial year; and
    - its actual revenue earned and output expenses incurred, as compared with the forecast revenues and output expenses outlined in the statement of forecast service performance adopted at the start of the financial year.

The audit was completed on 5 September 2007, and is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Authority and the Auditor, and explain our independence.

Basis of Opinion

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements and statement of service performance did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements and the statement of service performance. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

The audit involved performing procedures to test the information presented in the financial statements and statement of service performance. We assessed the results of those procedures in forming our opinion.

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the Board;
- confirming year-end balances;
- determining whether accounting policies are appropriate and consistently applied; and
- determining whether all financial statement and statement of service performance disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements or statement of service performance.

We evaluated the overall adequacy of the presentation of information in the financial statements and statement of service performance. We obtained all the information and explanations we required to support our opinion above.

Responsibilities of the Government Superannuation Fund Authority Board and the Auditor

The Board is responsible for preparing financial statements and a statement of service performance in accordance with generally accepted accounting practice in New Zealand. The financial statements must fairly reflect the financial position of the Authority as at 30 June 2007 and the results of its operations and cash flows for the year ended on that date. The statement of service performance must fairly reflect, for each class of outputs, the Authority's standards of delivery performance achieved and revenue earned and expenses incurred, as compared with the forecast standards, revenue and expenses adopted at the start of the financial year. The Authority's responsibilities arise from the Crown Entities Act 2004 and the Public Finance Act 1989.

We are responsible for expressing an independent opinion on the financial statements and statement of service performance and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001 and the Crown Entities Act 2004.

Independence

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the New Zealand Institute of Chartered Accountants.

Other than the audit, and the provision of other assurance services, we have no relationship with or interests in the Authority.

Michael Wilkes

DELOITTE

On behalf of the Auditor-General

WELLINGTON, NEW ZEALAND

DIRECTORY

Executive Office

Level 12, The Todd Building
95 Customhouse Quay
PO Box 3390
Wellington

Investment adviser

Russell Investment Group Limited

Tax adviser

PricewaterhouseCoopers

Solicitors

DLA Phillips Fox
Crown Law

Banker

Bank of New Zealand

Auditor

Michael Wilkes
Deloitte
on behalf of the Auditor-General

GOVERNMENT SUPERANNUATION FUND

Authority's Report

On behalf of the Government Superannuation Fund Authority (**the Authority**), I have pleasure in presenting this report on the Government Superannuation Fund (**the Fund or GSF**) for the year ending 30 June 2007. The report is made in accordance with section 93B of the Government Superannuation Fund Act 1956 (**the GSF Act**).

The Fund dates back to 1948 when it was established to provide a way for state sector employees to save for their retirement. Contributors make regular payments to the Fund and, in return on retirement, receive a defined level of income. Employers, who are not funded directly by the Government, pay contributions as set by the Government Actuary, at the amount necessary to fund the balance of their employees' entitlements. The Government has never paid employer contributions in respect of its own employees. Instead, it meets the balance of the costs of the employees' entitlements as they become payable. The Fund was largely closed to new members in 1992.

In 2001, the Authority was established to manage the Fund's assets and administer the GSF Schemes.

This annual report sets out how the assets of the Fund are invested, the annual results for the financial year ending 30 June 2007, information on membership and various other matters required by the GSF Act.

Information on the Authority can be found in the Authority's annual report commencing on page 1.

Investment Results

The Fund's surplus pre tax, for the year of $553 million, represents a return of 14.9% on average net assets. The surplus after tax of $355 million represents a return of 9.5% on average net assets.

The after tax return has exceeded the Investment Performance Measure (**IPM**) - (see page 3) over the year by 5.8% and over the last three years by an average of 4.3% per annum.

The Fund's surplus after tax is now ahead of the IPM measured since the Authority took over responsibility for the management of the Fund on 2 October 2001. This out performance represents added value of $600 million above the returns that would have been made had the Fund continued to invest only in Government Stock.

The after tax return for the year of 9.5% also compares with the after tax return of the median superannuation scheme, in the Mercer Investment Performance Survey, covering 65 superannuation schemes, for the year ended 30 June 2007, of 6.4%. The average after tax return for the Fund over the last three years is 10.1%. This compares with the median average after tax return in the Mercer survey, over the same period, of 9.4%.

Returns from all asset classes were positive for the year, but performance against benchmarks was mixed.

The Authority takes a long term view of its Investment Strategy for the Fund. It is confident that, by investing in a diversified portfolio, in the long run the effects of volatility will be minimised and the IPM will be achieved.

The Authority regularly reviews its Investment Strategy and the Strategic Asset Allocation for the Fund to ensure they remain appropriate and consistent with legislative requirements and best practice.

The latest review was completed in the April/May of 2007. The outcome of this review is reported in the Chairman's report on the Authority on page 3.

The performance of the investment managers appointed by the Authority is also regularly reviewed to ensure that they are complying with the terms of the mandates and are meeting the expectations of the Authority.

Membership

Although the GSF Schemes were closed to new members in July 1992, and the Pacific Island sub-schemes closed on 22 October 1995, the GSF Schemes will continue to have a very substantial membership for many years. As at 30 June 2007, there were 18,718 contributors (2006: 20,240) to the GSF Schemes and 47,237 annuitants (2006: 47,523), a total of 65,955 members (2006: 67,763). Further details are set out in the Membership Commentary on page 39.

Mortgage Finance

No new mortgages are being granted. The GSF mortgage portfolio, as at 30 June 2007, consisted of three mortgages totalling $31,000 (30 June 2006: eight mortgages totalling $133,000), with an average earning rate of 6.06% for the year (30 June 2006: 5.32 %) after tax and mortgage administration charges.

Basil Logan.

Basil Logan

Chairman
Government Superannuation Fund Authority Board

REGULATORY STATEMENT

In accordance with the Superannuation Schemes Act 1989, the Authority states that to the best of its knowledge and belief, for the financial year ended 30 June 2007:

(a) All contributions required to be made to the Fund, under the GSF Act, have been made or accrued.

(b) All benefits required to be paid from the Fund under the GSF Act have been paid.

(c) Due to the partially funded nature of the GSF Schemes, the market value of assets did not match the accrued benefit liability of the Fund by $10,309 million (2006: $11,438 million). The deficiency is covered by Section 95 of the GSF Act, which requires the Minister of Finance to appropriate funds from public money to meet the annual deficiency in payments from the Fund.

(d) All employer contributions paid were in accordance with the most recent recommendations of the Government Actuary.

Basil Logan

Basil Logan

Chairman
Government Superannuation Fund Authority Board

STATEMENT OF RESPONSIBILITY

The financial statements of the Fund for the year ended 30 June 2007 have been prepared in accordance with Section 93 of the GSF Act.

The Authority is responsible for the preparation of the financial statements and the judgments made in the process of producing those statements.

The Authority confirms that:

- internal control systems have been established and maintained during the year to assure reasonable reliability and integrity of these financial statements, and
- the investment policies, standards, and procedures for the Fund, commencing on page 63, have been complied with.

In our opinion, the attached financial statements and reports fairly reflect the net assets, as at 30 June 2007, and the changes in net assets and the cash flows of the Fund, for the year ended 30 June 2007.

Basil Logan

Chairman
Government Superannuation Fund Authority Board

Alan Langford

Chief Executive

5 September 2007

INVESTMENT COMMENTARY

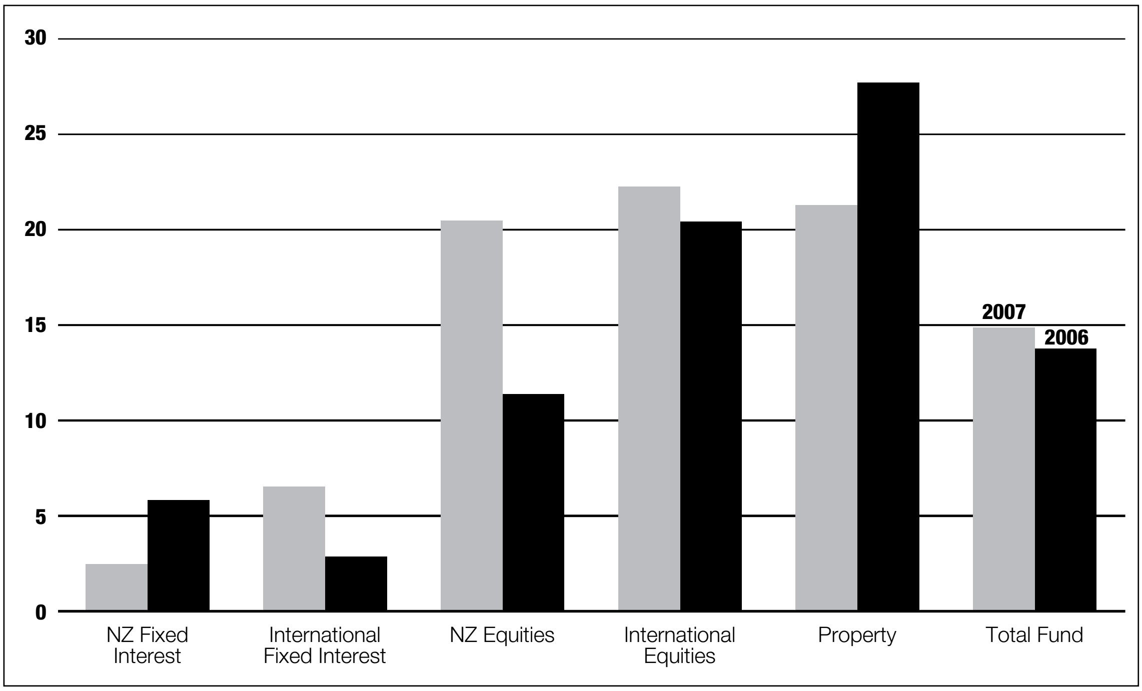
Investment Performance

The Fund's surplus pre tax, for the year of $553 million, represents a return of 14.9% on average net assets. The surplus after tax of $355 million represents a return of 9.5% on average net assets. Tax expense increased significantly in 2007, compared with 2006, due to higher taxable income primarily from the realised and unrealised taxable gains on the Fund's currency hedge contracts.

The performance of the Fund is assessed by comparing the Fund's return (after tax) with the return from Government Stock (after tax) plus 2.5% per annum measured over rolling ten year periods (ie, IPM). For the current year the after tax return of 9.5% compares with the return from the IPM of 3.7 %, an outperformance of 5.8%.

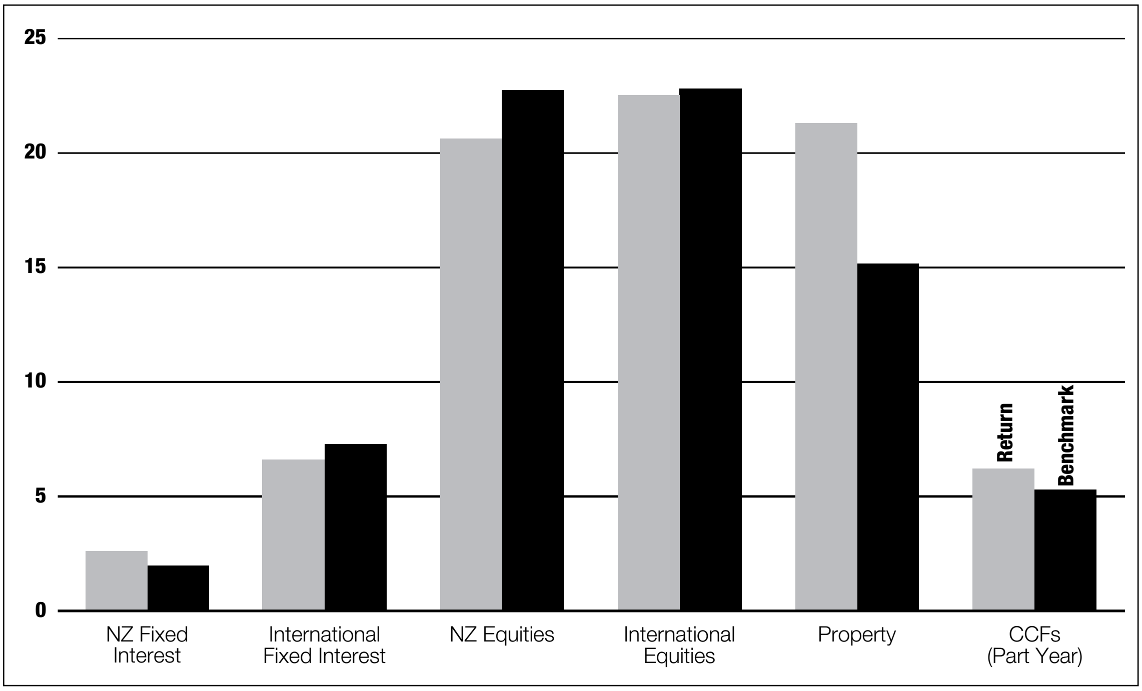
The table below compares the pre tax investment returns by asset class and for the Fund for the financial years ended 30 June 2006 and 2007. The best performing asset classes were property, and New Zealand and international equities.

Pre Tax Investment Returns by Asset Class and for the Fund



The table below compares the pre tax investment returns for each asset class with their benchmark indices.

Pre Tax Investment Returns v Benchmark (year ended 30 June 2007)



The volatility of investment returns and the range of results across sectors confirm the benefits of investing in a diversified portfolio and the need to assess the investment performance of the Fund over the longer term.

An analysis of the returns from each asset class against the benchmark index for the year follows.

New Zealand fixed interest 2.46%

The NZX Bond Index return was 1.83%

Returns from fixed interest investments, such as Government Stock and corporate bonds, are a combination of interest income and capital gains or losses as market yields fall (generating gains) or rise (generating losses).

New Zealand fixed interest yields moved higher over the year (the 10-year Government Stock rate was up 0.88% to 6.71%) resulting in low overall returns. Economic growth remained robust on the back of a buoyant housing market and strong domestic demand. This was of concern to the Reserve Bank of New Zealand (RBNZ), given it had been relying on a slower economy to help bring inflation down. As a result, the RBNZ initially left the official cash rate unchanged at 7.25% before increasing it to 8.00% in three steps during the April - June quarter.

International fixed interest 6.54%

The Lehman Brothers Global Aggregate Index (hedged to New Zealand dollars) return was 7.18%

The return from international fixed interest was in line with the long term average. Yield movements in the major markets were mixed, reflecting differing inflation and economic growth outlooks. In the key US market, the 10-year Government bond yield fell from 5.14% to 5.02% reflecting a weaker housing data and a slowing economic growth outlook. The Japanese 10-year yield declined from 1.93% to 1.88% as economic data was again mixed. The long awaited rebound in the Japanese economy did not eventuate, despite a weak currency and a relatively accommodative approach taken by the central bank. In contrast, the 10-year rates in the United Kingdom and Germany increased by 0.75% and 0.50% respectively.

New Zealand equities 20.45%

The Russell JB Were Tradeable Index return was 22.59%

New Zealand shares again managed to perform well in excess of most investors' expectations. This was partly due to merger and acquisition (M&A) activity, but also because company profits generally held up given the relatively mild economic slowdown. The strong New Zealand dollar noticeably held back the performance of exporters.

International equities 22.36%

The benchmark index is the weighted average return of the modified indices of the 'grey list' countries, as defined in part A of schedule 3 in the Income Tax Act 1994,104% hedged in New Zealand dollars. The return for this index was 22.66% for the year.

Overall, solid valuations and strong profit growth supported international share prices over the year. Markets were also buoyed by significant M&A activity, mainly by private equity funds. The German market (DAX Index) was the top performer, up 41%, supported by M&A activity and a strong economy, while the Japanese market was the laggard returning (a still reasonable) 12% for the year. Despite the Authority's policy to hedge part of its foreign currency exposure, the strength of the New Zealand dollar, which rose by close to 24% on an index-weighted basis, took some of the gloss off returns.

As the Fund's investments in international shares and the hedging programme are passively managed, a return in line with the index is the anticipated outcome. The Authority is gradually increasing the hedge percentage for international equities to 120% pre tax. By 30 June 2007 the hedge ratio had increased to 104% pre tax.

Property 22.06%

The return of the UBS Warburg Global Real Estate Investors Only Total Return Index, hedged in New Zealand dollars, was 14.96%.

The performance of the property sector is influenced by factors such as economic growth, business confidence, interest rates and vacancy levels.

Global property benefited from a continued 'search for yield' and M&A activity. Strong property market fundamentals, rising share markets, and significant capital flows, as investors increased their allocations to the sector, supported the broad based rally until the April – June quarter when returns declined. Given the strong returns over the last 2 years, we expect the returns from global property to be more modest in the future.

Review of Investment Strategy and Strategic Asset Allocation

During the year, following legislative changes to the way investment assets are taxed, the Authority reviewed the Investment Strategy and Strategic Asset Allocation for the Fund. As a result of the review, the Authority determined to leave the IPM (see page 3) for the Fund unchanged but to increase the risk profile by changing the Strategic Asset Allocation.

Effective 1 October 2007, the allocation to international equities will increase from 42.5% to 52%, the allocation to New Zealand equities will decrease from 15.0% to 13.0% and the allocation to fixed interest in total, including a 3% allocation to Collateralised Commodity Futures (**CCFs**) will decrease from 35% to 27.5%. The Authority will take market conditions into account in transitioning the portfolio to the new Strategic Asset Allocation. The increase in the risk profile is reflected in the new risk parameter set for the Fund of:

> Having no more than 1 in 10 chance in any one year of a loss greater than 6.0% of the total Fund (after tax).

The investment in CCFs was undertaken on a staged basis. Apart from CCFs, all asset classes were maintained within their rebalancing tolerances, set as part of the current Strategic Asset Allocation (see page 12).

Asset Class	*Investment Assets Actual at 30 June 2006*		*Investment Assets Actual at 30 June 2007*		*Strategic Asset Allocation Effective – 1 October 2007*
	$000	*%*	*$000*	*%*	*%*
New Zealand fixed interest	315,414	8.3	200,674	5.0	4.0
International fixed interest	1,031,395	27.1	1,022,224	25.4	20.5
New Zealand equities	522,319	13.7	651,514	16.2	13.0
International equities	1,619,376	42.6	1,710,484	42.6	52.0
Property	315,449	8.3	297,043	7.4	7.5
Collateralised Commodity Futures	–	–	135,715	3.4	3.0
	3,803,953	**100.0**	**4,017,654**	**100.0**	**100.0**

Investment management

The Authority has appointed experienced New Zealand and international investment managers to manage the various asset classes. The managers appointed by the Authority are listed in the Directory at the end of this report.

MEMBERSHIP COMMENTARY

The movement in contributors during the past five years was:

Year ended 30 June	*Total Contributors*	*Change*	*% Change*
2003	25,253	(1,737)	(6.44)
2004	23,719	(1,534)	(6.07)
2005	22,241	(1,478)	(6.23)
2006	20,240	(2,001)	(9.00)
2007	18,718	(1,522)	(7.52)

Contributors by scheme were:

Number 2006	*GSF Scheme*	*Number 2007*	*% of Total*
17,309	General Scheme	16,384	87.53
1,288	Armed Forces	1,080	5.77
1,423	Police	1,051	5.61
157	Prison Officers	148	0.79
43	Judges	35	0.19
20	Parliamentarians	20	0.11
20,240	**Total contributors at end of year**	18,718	100

The movement in the number of contributors during the year was:

Number 2006		*Number 2007*
22,241	Contributors at beginning of year	20,240
–	Reinstatement	5
(1,071)	Retirements	(1,042)
(15)	Withdrawals from the Fund	(13)
(20)	Death before retirement	(19)
(108)	Cessation of employment before retirement	(102)
(787)	Transfer to other schemes	(351)
20,240	**Total contributors at end of year**	18,718

The decrease in the contributors in 2006 and 2007 was mainly due to the large number of transfers from the GSF Police Scheme to the Police Superannuation Scheme.

The movement in the number of annuitants during the past five years was:

Year ended 30 June	*Total Annuitants*	*Change*	*% Change*
2003	47,779	305	0.69
2004	47,695	(84)	(0.18)
2005	47,587	(108)	(0.23)
2006	47,523	(64)	(0.13)
2007	47,237	(286)	(0.60)

The movement in number of annuitants during the year was:

Number 2006		Number 2007
47,587	Annuitants at beginning of year	47,523
1,072	New retiring allowances	1,046
725	New allowances to spouses	815
76	Allowances deferred	(208)
(1,937)	Discontinued allowances	(1,939)
47,523	**Total annuitants at end of year**	47,237

There were 6,025 deferred pensions at 30 June 2007 (included under contributors) (2006: 6,019)

The movement in total number of members during the past five years was:

Year ended 30 June	Total Contributors	Total Annuitants	Total Members	Decrease During Year
2003	25,253	47,779	73,032	(1,432)
2004	23,719	47,695	71,414	(1,618)
2005	22,241	47,587	69,828	(1,586)
2006	20,240	47,523	67,763	(2,065)
2007	18,718	47,237	65,955	(1,808)

From 1996 the number of annuitants has exceeded the number of contributors. The present ratios are:

	2006	%	2007	%
Contributors	20,240	30	18,718	28
Annuitants	47,523	70	47,237	72
	67,763	**100**	**65,955**	**100**

Granting a charge over contributions

In the year to 30 June 2007, 67 charges (2006: 99) were registered by the Fund in favour of chargeholders as security over individual contributor's contributions.

GOVERNMENT SUPERANNUATION FUND
STATEMENT OF CHANGES IN NET ASSETS

FOR THE YEAR ENDED 30 JUNE 2007

2006 $000 Actual		Note	2007 $000 Actual	2007 $000 Forecast
	Increase in assets from:			
	Investing activities			
	Investment revenue			
90,864	Interest, dividend and other income	1	88,884	126,977
368,197	Changes in net market values of investment assets	2	464,513	157,314
459,061			553,397	284,291
	Operating activities			
	Operating revenue	3		
10,245	Crown		11,255	10,403
2,187	Other employers		2,561	2,368
12,432			13,816	12,771
	Operating expenses	3		
(7,821)	Investment management and custody		(9,058)	(7,664)
(4,611)	Administration		(4,758)	(5,663)
(12,432)			(13,816)	(12,771)
459,061	Surplus before tax and membership activities		553,397	284,291
3,349	Income tax benefit/(expense)	4	(198,567)	(53,277)
462,410	Surplus after tax and before membership activities		354,830	231,014
	Membership activities			
	Contributions			
731,405	Government	5	654,836	577,972
80,093	Members		73,020	65,164
15,956	Other entities		14,529	15,636
827,454			742,385	658,772
(1,018,158)	**Benefits paid**	6	(888,197)	(782,660)
(190,704)	**Net benefits paid**		(145,812)	(123,888)
271,706	**Net increase in net assets**		209,018	107,126
3,521,408	Opening net assets available to pay benefits		3,793,114	3,726,798
3,793,114	**Net assets available to pay benefits**		4,002,132	3,833,924

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

GOVERNMENT SUPERANNUATION FUND
STATEMENT OF NET ASSETS

AS AT 30 JUNE 2007

2006 $000 Actual		Note	2007 $000 Actual	2007 $000 Forecast
	Investments			
	Fixed interest – New Zealand			
162,561	NZ Government Stock		76,597	179,530
18,022	State, Crown owned/Govt guaranteed securities		14,000	16,321
97,876	Other bonds and securities		62,921	127,304
3,046	Local authority bonds		-	3,264
958,814	**Fixed interest – International**		939,322	1,006,777
	Equities			
511,504	New Zealand		637,964	570,098
1,581,041	International		1,501,733	1,655,791
318,831	**Property**		292,756	282,022
	Others			
133	Mortgages	7	31	86
477,851	Short term investments		662,927	–
4,129,679	**Total investments**		4,188,251	3,841,193
	Current assets			
36,192	Cash at bank		22,548	10,000
166,170	Receivables and prepayments	8	253,668	77,779
4,417	Other receivables	9	4,679	4,080
25,045	Income tax receivables		-	12,549
231,824	**Total current assets**		280,895	104,408
4,361,503	**Total assets**		4,469,146	3,945,601
	Less liabilities			
528,410	Other payables	12	392,278	65,630
–	Income tax payable		30,402	–
2,284	Benefits payable		4,860	2,394
37,695	Deferred tax liability	4	39,474	43,653
568,389	**Total liabilities**		467,014	111,677
3,793,114	**Net assets available to pay benefits**		4,002,132	3,833,924

The Financial Statements were approved by the Government Superannuation Fund Authority Board on 5 September 2007.

Basil Logan

Basil Logan

Chairman
Government Superannuation Fund Authority Board

Colin Blair

Colin Blair

Chairman
Audit and Risk Review Committee
Government Superannuation Fund Authority Board

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 30 JUNE 2007

2006 $000 Actual		*2007 $000 Actual*	*2007 $000 Forecast*
	Cash flows from operating activities		
	Cash was provided from:		
790,936	Government contributions	594,063	699,422
73,027	Members' contributions	68,777	64,417
18,636	Other entities	17,845	18,047
89,080	Interest and dividends	93,717	126,524
5,787	Other	4,708	842
	Cash was disbursed to:		
(1,018,593)	Benefit payments	(885,635)	(782,003)
(26,339)	Income tax	(139,509)	(57,264)
(13,044)	Operating expenses	(14,314)	(12,646)
(80,510)	**Net cash flows from operating activities**	(260,348)	(52,265)
	Cash flows from investing activities		
	Cash was provided from:		
8,689,768	Maturities and sales of investment assets	7,401,989	6,301,382
103	Mortgage repayments	108	40
	Cash was disbursed to:		
(8,590,891)	Purchase of investment assets	(7,155,393)	(6,249,157)
98,980	**Net cash flows from investing activities**	246,704	52,265
18,470	Net increase/(decrease) in cash held	(13,644)	–
17,722	Opening cash brought forward	36,192	10,000
36,192	**Closing cash balance**	22,548	10,000

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

Reconciliation of net change in net assets to net operating cash flows

2006 $000		*2007 $000*
271,706	Net increase in net assets	209,018
	Non-cash items	
(3,350)	(Decrease)/increase in deferred tax liability	1,779
(15)	Capitalised interest	(8)
3	Mortgage management expense	2
(3,362)		1,773
	Add: Movements in working capital items	
(2,069)	(Increase)/decrease in receivables and prepayments	812
41,437	Decrease/(increase) in investment receivables	(88,309)
185	Decrease/(increase) in other receivables	(262)
(25,045)	(Increase)/decrease in tax receivable	25,045
49,816	Increase/(decrease) in Crown contributions received in advance	(71,037)
153,405	Increase/(decrease) in investment payables	(68,447)
(392)	(Decrease)/increase in other creditors	3,352
(1,293)	(Decrease)/increase in tax payable	30,402
(442)	(Decrease)/increase in benefits accrued	2,576
215,602		(165,868)
	Add: Items classified as investing activities	
(1,417)	(Increase)/decrease in accrued interest portion of bonds	2,486
(368,197)	Net gains on investments	(464,513)
(41,437)	(Decrease)/increase in investment settlement receivables	88,309
(153,405)	(Increase)/decrease in investment settlement payables	68,447
(564,456)		(305,271)
(80,510)	**Net cash out flows from operating activities**	(260,348)

The following statements are made as at 30 June 2007

2006 $000		*Note*	*2007 $000*
Nil	Contingent liabilities		Nil
11,438,000	Unfunded past service liability	11	10,309,000
Nil	Trust Money		Nil

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

JUDGES SUPERANNUATION ACCOUNT
STATEMENT OF CHANGES IN NET ASSETS

FOR THE YEAR ENDED 30 JUNE 2007

2006 *$000*		*2007* *$000*
	Income from operations*	
11,502	Government contributions	12,905
326	Members contributions	173
11,828		13,078
	Expenditure*	
	Allowances:	
8,713	Retirements	9,618
1,775	Allowances capitalised	2,028
1,340	Spouses and children	1,432
11,828		13,078
–	Net changes	–

*These figures are incorporated in the Government Superannuation Fund Statement of Changes in Net Assets.

GOVERNMENT SUPERANNUATION FUND

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

PARLIAMENTARY SUPERANNUATION ACCOUNT
STATEMENT OF CHANGES IN NET ASSETS

FOR THE YEAR ENDED 30 JUNE 2007

2006 $000		*2007 $000*
	Income from operations*	
3,576	Government contributions	3,186
241	Members contributions	244
3,817		3,430
	Expenditure*	
	Allowances:	
2,764	Retirements	2,881
471	Allowances capitalised	–
582	Spouses and children	549
3,817		3,430
–	Net changes	–

*These figures are incorporated in the Government Superannuation Fund Statement of Changes in Net Assets.

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

STATEMENT OF ACCOUNTING POLICIES

The following policies have been applied in the preparation of the financial statements:

(i) Reporting entity and statutory base

The financial statements of the Fund are prepared pursuant to section 93 of the GSF Act.

The Fund was established by section 13 of the GSF Act. It consists of various defined benefit superannuation schemes, as prescribed in the GSF Act. Pursuant to section 19H of the GSF Act, the GSF Schemes are registered under the Superannuation Schemes Act 1989.

(ii) Measurement base

The financial statements are prepared on a going concern basis. The following general accounting policies have been adopted in the preparation of these statements:

(a) assets are measured at net market values; and

(b) the reporting currency is New Zealand dollars.

(iii) Particular accounting policies

The following particular accounting policies, which significantly affect the measurement of financial performance, financial position and cash flows, have been applied:

Reporting requirements

The financial statements have been drawn up in accordance with Financial Reporting Standard FRS-32: *Financial Reporting by Superannuation Schemes*, and with the provisions of relevant legislative requirements.

Reporting period

The reporting period is the year ended 30 June 2007. Comparative figures are for the year ended 30 June 2006.

Valuation of investments

Investment assets are valued as follows:

Type	*Method*
• NZ Government Stock	Net market value
• Other bonds and debt securities	Net market value
• Local Authority bonds	Net market value
• Equities	Net market value
• Property	Net market value
• Collateralised Commodity Futures	Net market value
• Mortgages	Realisable value
• Short term investments	Net market value
• Cash and call deposits	Realisable value

Valuation of interest rate contracts

Cross currency and interest rate swaps are stated at net market value.

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

Financial instruments
The following methods have been used to estimate the fair value of each major class of financial instrument:

Financial instrument	*Method*
• Investments	Net market value
• Mortgages	Realisable value
• Short term investments	Net market value
• Cash and call deposits	Realisable value
• Receivables and prepayments	Realisable value
• Creditors	Realisable value

Off balance sheet financial instruments
In the normal course of business, and if appropriate, the investment managers, appointed by the Authority, enter into transactions involving off balance sheet financial instruments in order to manage the Fund's exposure to risk. These include foreign exchange contracts, swaps, financial options and futures. Investments, not taken up as hedging transactions, are valued at market rates prevailing at the reporting date. The resulting gains and losses are recognised in the Statement of Changes in Net Assets.

Investment income
Dividend income is recorded on the ex dividend date. Interest and other investment income are accounted for on an accrual basis. Certain investment expenses are directly charged against investment income. Gains and losses on the sale of equities are determined by using the average cost of equities sold and are recorded on the settlement date.

All realised and unrealised gains and losses at the end of the year are included in the Statement of Changes in Net Assets.

Taxation
Income tax expense is recognised on the surplus before tax and membership activities, adjusted for permanent differences between taxable and accounting income. The income tax expense, charged to the Statement of Changes in Net Assets, includes both the current year liability and the deferred tax on the movement in timing differences, after allowing for non-assessable income and non-deductible expenses.

The liability method of accounting for income taxation is applied on a comprehensive basis. The tax effect of all timing differences, between taxable and accounting income, is recognised in the Statement of Net Assets as a future tax benefit, or a deferred tax liability. The future tax benefit, or deferred tax liability, is stated at the income tax rate prevailing at balance date. The future tax benefit is not recognised until the realisation of the benefit is virtually certain.

Foreign currency transactions
Transactions in foreign currencies are translated to New Zealand currency at the exchange rates in effect at the transaction date. Assets and liabilities denominated in foreign currencies, including forward exchange contracts, are translated at the closing rates of exchange at the balance date. The resulting gains or losses are recognised in the Statement of Changes in Net Assets.

Repurchase agreements
Securities sold under agreements to repurchase are retained within the investments and accounted for accordingly. Liability accounts are used to record the obligation to repurchase.

Statement of Cash Flows

- *Basis of preparation*

The Statement of Cash Flows has been prepared using the direct approach.

- *Cash and cash equivalents*

Cash and cash equivalents consist of current accounts in banks, used in the day to day cash management of the Fund, and are unconditionally convertible to cash within two working days.

- *Operating activities*

Operating activities include all receipts of contributions and investment income, and payments of benefits and expenses.

- *Investing activities*

Investing activities relate to the acquisition, holding, and disposal of investments. Investments can include securities not falling within the definition of cash.

Consolidation
The Fund's financial statements include the Judges Superannuation Account and the Parliamentary Superannuation Account.

(iv) Changes in accounting policies
There were no significant changes in accounting policies during the year.

This statement is to be read in conjunction with the Statement of Accounting Policies and the Notes to the Financial Statements.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2007

1 Interest, dividends, and other income

2006 $000		2007 $000
13,339	NZ Government Stock	5,711
2,822	State, Crown owned/Government guaranteed securities	1,108
217	Local Authority bonds	51
4,231	Other bonds and securities	2,212
27,664	International fixed interest	38,213
3,230	Short term and call deposits, including treasury bills	2,752
28,329	Dividends (New Zealand equities)	23,412
4,189	Dividends (International listed property securities)	4,193
3,762	Dividends (International unlisted property securities)	8,295
15	Mortgages to members	8
3,066	Other sources	2,929
90,864	**Total**	88,884

2 Changes in net market values of investment assets

2006 $000		2007 $000
(3,125)	NZ Government Stock	(3,025)
(894)	State, Crown owned/Government guaranteed securities	(446)
(42)	Local Authority bonds	(8)
419	Other bonds and securities	(3,606)
(7,186)	International fixed interest (including hedging gains)	27,065
12,305	Short term investments	4,155
20,157	New Zealand equities	75,971
301,718	International equities (including hedging gains)	314,274
38,414	International listed property securities (including hedging gains)	37,075
6,431	International unlisted property securities (including hedging gains)	5,633
–	Collateralised Commodity Futures	7,425
368,197	**Total**	464,513

3 Operating revenue and expenses

In terms of section 15E (1) of the GSF Act, the administrative expenses of the Authority, including investment management and custody expenses, are reimbursed by the Fund. Both the Crown and other employers reimburse the Fund under section 95 of the GSF Act for the Authority's expenses. In the reporting period, as certified by the Government Actuary:

- the Crown contributed 81.5% of the Authority's investment management and custody expenses reimbursed by the Fund, and other employers contributed the balance of 18.5%.
- the Crown contributed 81.4% of the Authority's other operating expenses reimbursed by the Fund, and other employers contributed the balance of 18.6%.

4 Income tax

2006 $000		2007 $000
459,061	Surplus before tax and membership activities	553,397
	Plus taxation effect of permanent differences:	
(443,702)	Non-assessable/deductible investment (gains)/ losses	65,906
548	Withholding tax credits	218
12,022	Imputation credits	8,442
27,929		627,963
9,217	Income tax @ 33%	207,227
(548)	Less withholding tax credits	(218)
(12,022)	Less imputation credits	(8,442
4	Prior year adjustment	-
(3,349)	Tax (benefit)/expense	198,567
	The taxation charge is represented by:	
1	Current tax	203,352
(3,350)	Deferred tax	(4,785)
(3,349)		198,567
	Movement in deferred taxation	
(41,045)	Opening balance	(37,695)
3,354	Deferred portion of current period tax expense	4,785
-	Transfer from current tax	(6,062)
(4)	Prior year adjustment and rounding	(502)
(37,695)	Deferred tax liability	(39,474)

5 Government contributions

2006 $000		2007 $000
716,327	Public Service superannuation benefits	638,745
11,502	Judges superannuation benefits	12,905
3,576	Parliamentarians superannuation benefits	3,186
731,405	**Total**	654,836

Funding arrangements:

There is no requirement on the Crown to fully fund the GSF Schemes. The basis of funding to meet benefits is partly from contributors' contributions, as set out below, and the surplus after tax, the balance being the contributions from the Government and non-departmental employers. Reliance is placed on the provisions in the GSF Act for the Crown to ensure that sufficient funds are available, or will be available, to pay benefits as they fall due.

Member Contribution %	GSF Scheme	Employer Contribution %
	General Scheme	
6.5	Non-funding employers	6
6.5	Funding except Islands*	Between 6 and 10
6.5	Islands	6
	Special Schemes	
7.6	Armed Forces	15.4
7.5	Police	16.1
8.5	Prison Officers	Nil

*As the employer contribution rate is subject to age and gender of contributors, it is different from one employer to another.

6 Benefits paid

2006 $000		2007 $000
558,120	Pension entitlements	583,213
82,054	Allowances capitalised	74,915
89,270	Spouses and children	94,440
	Refunds:	
7,146	Cessation of employment	4,917
272,455	Transfers to other schemes	123,286
8,471	Cessation of membership	7,080
642	Death	346
1,018,158		888,197

7 Mortgages

The Housing New Zealand Corporation manages mortgages previously granted to members of the Fund.

8 Receivables and prepayments

2006 $000		2007 $000
Receivables:		
1,609	Crown contributions - operating	2,601
1,620	Members' contributions	671
445	Other entities' contributions	-
1,740	Interest and dividends	1,301
113,724	Investment settlements receivable	202,033
Prepayments:		
47,032	Benefits	47,062
166,170	**Total**	253,668

9 Other receivables

2006 $000		2007 $000
4,307	Past service contributions	4,537
110	Pension entitlements	142
4,417	**Total**	4,679

10 Actuarial valuation

Section 94 of the GSF Act requires that, at least every 3 years or at shorter intervals as directed by the Minister of Finance, the Government Actuary shall examine the financial position of the Fund. On 22 August 1999, the Minister directed an annual valuation to be carried out. The latest published valuation was made at 30 June 2006, and the report, dated 30 November 2006, was tabled in Parliament on 14 February 2007.

11 Liability for accrued benefits

The Government Actuary valued the accrued benefits of the Fund, as at 30 June 2007, to calculate the unfunded past service liability (**UPSL**) for inclusion in the Crown's Financial Statements for the year ended 30 June 2007. The Government Actuary's report is dated 10 August 2007.

The projected aggregate funding method, based on balance date membership data, was used in the valuation. This method requires the benefits payable from the Fund, relating to service up to the valuation date, to be estimated, and then discounted to the valuation date. The valuation is carried out in accordance with generally accepted accounting practice (**GAAP**), as considered appropriate by the Crown for the determination of the UPSL. In particular, it requires the liability in respect of the projected benefit payments to be discounted at appropriate after tax rates derived from Government Stock market prices, as at valuation date.

Significant assumptions, used in the valuation of accrued benefits for inclusion in the Crown Financial Statements were:

2006 %		*2007* %
	After tax discount rates	
4.4	year 1	5.00
4.2	year 2	4.83
3.8	year 3 to year 4	4.63
3.8	year 5	4.60
3.7	year 6	4.44
3.7	year 7	3.92
3.8	year 8	3.99
3.8	year 9	4.25
3.8	year 10 and thereafter	4.25
	CPI	
2.25	year 1	2.25
2.25	year 2 to year 7	2.25
2.25	year 8	2.25
2.25	year 9	2.25
2.25	year 10 and thereafter	2.25
	Annual salary increase excluding promotional effects	
3.0	year 1	3.0
3.0	year 2 to year 7	3.0
3.0	year 8	3.0
3.0	year 9	3.0
3.0	year10 and thereafter	3.0

Rates of mortality, morbidity and withdrawal are based on scheme experience, that experience being used to adjust standard published tables where available.

UPSL

2006 $000		*2007* $000
15,231,000	Total accrued benefits as at end of year	14,311,000
(3,793,000)	Less net assets available to pay benefits	(4,002,000)
11,438,000	**Total UPSL as at end of year**	10,309,000

The UPSL has decreased by $1,129 million between 30 June 2006 and 30 June 2007. The decrease was mainly due to an increase in the discount rates.

Vested benefits

Vested benefits are benefits payable to members as a whole, under the conditions of the GSF Schemes, if they ceased being members on balance date.

Under the terms of the GSF Schemes, the total liability for accrued benefits vested with members, as at 30 June 2007, is $14,320 million (30 June 2006: $15,122 million).

Purchase of additional benefits

Additional payments of $5.194 million (2006: $5.524 million), to acquire further benefits, were made during the year by members with pre entry service, or on early retirement.

12 Other payables

2006 $000		2007 $000
151	Crown receipts	140
441	Use of money interest payable	4,044
51	Unallocated contributions	53
2,510	Government Superannuation Fund Authority	2,268
84,187	Crown contributions in advance - benefits	13,150
441,070	Investment settlements payable	372,623
528,410	**Total**	392,278

13 Financial instruments

(a) *Credit risk*

In the normal course of its business the Fund incurs credit risk with the New Zealand Government, state owned enterprises, local authorities, financial institutions and other debtors.

The Fund invests in New Zealand dollar denominated fixed interest securities, equities, secured mortgages, and foreign currency denominated fixed interest and property securities and equities in accordance with the Statement of Investment Policies, Standards and Procedures (**SIPSP**).

The SIPSP contains credit and exposure policies to limit credit risk from the Fund's investments.

The Fund's maximum exposure to credit risks is the carrying values as outlined in the Statement of Net Assets.

(b) *Foreign currency risk*

The Fund is exposed to foreign currency risk by investing in foreign currency denominated equities, fixed interest and property securities.

During the year the hedge ratio for international equities was increased from 88% pre tax to 104% pre tax by foreign exchange contracts.

The benchmark index for the management of international fixed interest portfolios is 100% pretax hedged to the United States dollar. The managers of international fixed interest portfolios are permitted, under their mandates, to hedge the portfolios in the range 90 – 110% to United States dollars by way of foreign exchange contracts. The currency exposure in the international fixed interest portfolios, between United States dollars and New Zealand dollars, is 100% hedged by foreign exchange contracts.

The currency exposure in the international listed and unlisted property portfolios is 100% hedged pretax by foreign exchange contracts.

The face value of the foreign currency contracts, with respect to foreign currency exposure at the end of the year, is as follows:

2006 $000		2007 $000
1,444,980	Foreign currency contracts for international equities	1,646,254
1,035,720	Foreign currency contracts for international fixed interest securities	1,027,289
135,351	Foreign currency contracts for international listed property securities	129,703
87,774	Foreign currency contracts for international unlisted property securities	71,089
2,703,825	**Total**	2,874,335

The fair value of the foreign currency contracts is included in the carrying value of the investments in the Statement of Net Assets.

Foreign currency transactions are translated to New Zealand dollars at exchange rates in effect at the date of the transactions.

(c) *Interest rate risk*
Weighted average effective interest rates and maturity periods are:

2007 Monetary Assets	Effective Interest Rate	0-6 Months $000	6-12 Months $000	12-24 Months $000	24-60 Months $000	Over 60 Months $000	Total $000
NZ Government Stock	7.16%				66,249	10,348	76,597
State, Crown/Govt guaranteed	8.03%			8,426	5,574		14,000
Other bonds and securities	7.83%		6,005	8,568	23,307	25,041	62,921
Local authority bonds							–
International fixed interest	4.22%	20,645	40,665	90,418	262,957	524,637	939,322
Mortgages	6.06%	31					31
Cash at bank	7.96%	22,548					22,548
Short term investments	6.82%	657,375	5,552				662,927

2006 Monetary Assets	Effective Interest Rate	0-6 Months $000	6-12 Months $000	12-24 Months $000	24-60 Months $000	Over 60 Months $000	Total $000
NZ Government Stock	5.94%				58,936	103,625	162,561
State, Crown/Govt guaranteed	7.00%	5,995			9,847	2,180	18,022
Other bonds and securities	6.90%	3,331	4,446	12,335	34,749	43,015	97,876
Local authority bonds	7.32%			2,541		505	3,046
International fixed interest	3.86%	67,245	39,271	54,285	295,502	502,511	958,814
Mortgages	5.32%	133					133
Cash at bank	7.38%	36,192					36,192
Short term investments	4.16%	472,826	5,025				477,851

(d) *Interest rate exposures*

The Fund's SIPSP provides the investment managers the ability to use interest rate hedging instruments, within specified limits, to hedge interest rate exposures.

There were no interest rate hedging instruments outstanding as at 30 June 2007 (2006: Nil).

(e) *Fair values*

The carrying values of the Fund's assets and liabilities are equivalent to their fair values.

14 Related parties

In terms of sections 81W(2), 88(2) and 95(1) of the GSF Act, the Minister of Finance pays into the Fund out of public money any deficiency in benefits payable to contributors and annuitants.

The Fund has business transactions with the Crown, Government Departments, Crown Entities, and State Owned Enterprises, together with a number of other public sector entities, on an arm's length basis. These transactions are not considered related party transactions except for the following:

- The Fund has invested a significant proportion of its assets in New Zealand Government Stock. The Fund's interests are disclosed in the Statement of Net Assets.
- The Authority managed the Fund's assets and administered the GSF Schemes. For the year ended 30 June 2007, the Fund paid the Authority $13,816 million (2006: $12,432 million) for operating expenses, as detailed in the Statement of Changes in Net Assets on page 41. In turn, the Fund was reimbursed by the Crown and other employers, as set out in Note 3.

15 Actual versus forecasts

- Investment revenues are subject to the volatile nature of investment markets, this being the principal reason for the variance between the forecast and actual changes in net market values of investment assets.
- Increases in market values of investments resulted in greater investment management and custody expenses than the forecast set out in the Statement of Changes in Net Assets.
- The forecast benefit payments are actuarially estimated and cannot be projected with accuracy as actual payments are dependent on factors beyond the Authority's control, such as early retirements, redundancies, unexpected salary changes, or transfers to other superannuation schemes.

16 Adoption of New Zealand Equivalents to International Financial Reporting Standards

In December 2002 the New Zealand Accounting Standards Review Board (**ASRB**) announced that all New Zealand reporting entities will be required to comply with New Zealand equivalents to International Financial Reporting standards (**NZ IFRS**) for periods commencing on or after 1 January 2007, with the option to comply early for periods beginning on or after 1 January 2005.

The Fund will adopt NZ IFRS for the year ended 30 June 2008, with 1 July 2006 being the transition date ie, the start of the comparative period.

Transition from existing NZ GAAP to NZ IFRS will be made in accordance with NZ IFRS 1 "First–time Adoption of New Zealand Equivalents to International Financial Reporting Standards". Upon first time adoption of the NZ IFRS, comparative information for the year ended 30 June 2007 will be restated in the NZ IFRS compliant financial statements. Details of the impact that adoption of NZ IFRS has had on the Fund's financial statements will be set out in the comparative financial statements.

The Board has established a conversion project, monitored by the Board's Audit and Risk Review Committee, to achieve transition to NZ IFRS reporting. The project includes assessing the impacts of NZ IFRS to the Fund, then designing and implementing changes required to current accounting policies and procedures, as well as systems and processes, in order to successfully transition to NZ IFRS.

To date, no significant changes in accounting policies have been identified as potentially having a material impact on the NZ IFRS financial statements of the Fund. Changes will occur in:

- Disclosure, particularly in relation to financial instruments.
- Investment assets, which will be stated at fair value (without deduction of disposal costs), rather than net market value (market value less the estimated disposal cost). The effect of this change is to recognise an increase in investment assets and accordingly net assets available to pay benefits by approximately $3.017 million (2006: $2.552 million).
- Liability for accrued benefits, which will be included in the Statement of Net Assets.
- Deferred tax, which will be calculated with reference to the temporary differences between the book values of balance sheet items for accounting purpose as compared to those for tax purposes, rather than to the timing differences between the reported earnings and taxable income.
- Provision for bad debts, which can only be recognised when a loss event has been deemed to occur.
- Receivables, which are carried at amortised cost using the effective interest rate methods, less any impairment losses.

This summary should not be taken as an exhaustive list of all the differences between NZ GAAP and NZ IFRS. There is potential for further change when the Fund prepares its first set of NZ IFRS financial statements due to changes in the standards, changes in business, or changes in Management's interpretation of the standards.

The assessment of the impact of NZ IFRS is continuing. As the Fund progresses toward full adoption of NZ IFRS it will continue to provide users of the Fund's financial statements with updated information about the likely impacts of NZ IFRS on the Fund's earnings, cash flows and financial position.

Deloitte.

REPORT OF THE AUDITOR-GENERAL

TO THE READERS OF THE GOVERNMENT SUPERANNUATION FUND'S FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2007

The Auditor-General is the auditor of the Government Superannuation Fund (**the Fund**). The Auditor-General has appointed me, Michael Wilkes, using the staff and resources of Deloitte, to carry out the audit of the financial statements of the Fund, on his behalf, for the year ended 30 June 2007.

Unqualified Opinion

In our opinion the financial statements of the Fund on pages 41 to 57:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect:
  - the Fund's net assets as at 30 June 2007; and
  - the changes in net assets and cash flows for the year ended on that date.

The audit was completed on 5 September 2007, and is the date at which our opinion is expressed.

The basis of the opinion is explained below. In addition, we outline the responsibilities of the Government Superannuation Fund Authority Board and the Auditor, and explain our independence.

Basis of Opinion

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed our audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements. If we had found material misstatements that were not corrected, we would have referred to them in the opinion.

The audit involved performing procedures to test the information presented in the financial statements. We assessed the results of those procedures in forming our opinion.

Audit procedures generally include:

- determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
- verifying samples of transactions and account balances;
- performing analyses to identify anomalies in the reported data;
- reviewing significant estimates and judgements made by the Board;
- confirming year-end balances;
- determining whether accounting policies are appropriate and consistently applied; and
- determining whether all financial statement disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements.

We evaluated the overall adequacy of the presentation of information in the financial statements. We obtained all the information and explanations we required to support the opinion above.

Responsibilities of the Government Superannuation Fund Authority Board and the Auditor

The Board is responsible for preparing financial statements in accordance with generally accepted accounting practice in New Zealand. Those financial statements must fairly reflect the net assets of the Fund as at 30 June 2007. They must also fairly reflect the changes in net assets and cash flows for the year ended on that date. The Board's responsibilities arise from the Government Superannuation Fund Act 1956.

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001 and section 93A of the Government Superannuation Fund Act 1956.

Independence

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the New Zealand Institute of Chartered Accountants.

Other than the audit, we have no relationship with or interests in the Fund.

Michael Wilkes

DELOITTE

On behalf of the Auditor-General

WELLINGTON, NEW ZEALAND

DIRECTORY

Government Superannuation Fund Authority Board

Basil Logan (Chairman)
David May (Deputy Chairman)
Colin Blair
Helen Bowie
Tim McGuinness
Susie Weaver
Ralph Stockdill

Executive Office

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Scheme Administrator

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Wellington

Custodian

JP Morgan Chase Bank NA

Investment adviser

Russell Investment Group Limited

Tax adviser

PricewaterhouseCoopers

Actuary

Government Actuary

Auditor

Michael Wilkes
Deloitte
on behalf of the Auditor-General

Bankers

National Bank of New Zealand Limited

Solicitors

DLA Phillips Fox
Crown Law

All correspondence relating to the GSF Schemes should be addressed to -

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Government Superannuation Fund Scheme Administration
Level 6, New Zealand Post House
7-27 Waterloo Quay
PO Box 3614
Wellington

or

The Chief Executive
Government Superannuation Fund Authority
PO Box 3390
Wellington

Investment Managers

New Zealand fixed interest
AMP Capital Investors (New Zealand) Limited
AllianceBernstein New Zealand Limited (*to 2 October 2006*)

International fixed interest
Pacific Investment Management Company LLC
Goldman Sachs Asset Management International
Wellington Management Company LLP

New Zealand equities
AllianceBernstein New Zealand Limited
Tower Asset Management Limited

International equities
AMP Capital Investors (New Zealand) Limited
Assure Funds Management Limited (previously BNZ Investment Management Limited)

Property
AMP Capital Redding Investors Limited
LaSalle Investment Management (Securities) L.P.
RREEF America REIT II, Inc

Currency management
International Equities and Property
State Street Global Advisors, Australia, Limited

International Fixed Interest
ANZ National Bank Limited

Collateralised Commodity Futures
Commodities Swap
Goldman Sachs International

New Zealand Cash
AMP Capital Investors (New Zealand) Limited

GOVERNMENT SUPERANNUATION FUND AUTHORITY
STATEMENT OF INVESTMENT POLICIES, STANDARDS AND PROCEDURES

Introduction

The Authority was established in 2001 to manage and administer the assets of the Government Superannuation Fund (**GSF or the Fund**) and the Government Superannuation Fund Schemes (**GSF Schemes**) in accordance with the Government Superannuation Fund Act 1956 and subsequent amendments (**the GSF Act**). The Authority is an autonomous Crown entity under the Crown Entities Act 2004 (**Crown Entities Act**).

This section sets out relevant extracts from the GSF Act, with respect to investment, and the Investment Beliefs adopted by the Government Superannuation Fund Authority (**the Board**).

Further information on the Authority is available via website *www.gsfa.co.nz*

The GSF Act

The Authority manages the assets of the Fund in accordance with the requirements of the GSF Act. Extracts from sections 15J (2), 15L and 15M of the GSF Act are set out below.

Section 15J (2)

Section 15J (2) of the GSF Act requires that:

> *"The Authority must invest the Fund on a prudent, commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with –*
>
> *(a) best-practice portfolio management; and*
>
> *(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."*

Section 15L

Section 15L of the GSF Act requires that:

> *"(1) The Authority must establish, and adhere to, investment policies, standards, and procedures for the Fund that are consistent with its duty to invest the Fund on a prudent, commercial basis, in accordance with section 15J.*
>
> *(2) The Authority must review those investment policies, standards, and procedures for the Fund at least annually."*

Section 15M

Section 15M of the GSF Act requires that:

> *"A statement of investment policies, standards, and procedures must cover (but is not limited to) –*
>
> *(a) the class of investments in which the Fund is to be invested and the selection criteria for investments within those classes; and*
>
> *(b) the determination of benchmarks or standards against which the performance of the Fund as a whole, classes of investment, and individual investments will be assessed; and*
>
> *(c) standards for reporting the investment performance of the Fund; and*
>
> *(d) ethical investment, including policies, standards, or procedures for avoiding prejudice to New Zealand's reputation as a responsible member of the world community; and*
>
> *(e) the balance between risk and return in the overall Fund portfolio; and*
>
> *(f) the Fund management structure; and*
>
> *(g) the use of options, futures, and other derivative financial instruments; and*
>
> *(h) the management of credit, liquidity, operational, currency, market, and other financial risks; and*
>
> *(i) the retention, exercise or delegation of voting rights acquired through investments; and*
>
> *(j) the method of, and basis for, valuation of investments that are not regularly traded at a public exchange; and*
>
> *(k) prohibited or restricted investments or any investment constraints or limits."*

Statement of Investment Beliefs

The Authority appreciates that one of the hallmarks of successful investment organisations is the development and adoption of a clear set of investment beliefs to communicate shared values and to provide a starting point for investment actions. Accordingly the Board has adopted the following set of Investment Beliefs. It is intended that the Beliefs are continuously reviewed and formally reviewed as part of the annual statutory review of the Statement of Investment Policies, Standards and Procedures.

1. **Higher returns are associated with higher risks**
   Investors demand a return premium to compensate them for investing in risky assets.

2. **Setting the asset policy mix is the most important investment decision**
   Setting, managing and monitoring the appropriateness of the strategic asset allocation is the key investment management function. Although active management may be engaged to seek additional sources of return to the underlying asset class returns, their additional impact on the risk and return characteristics of the portfolio is secondary compared to the risks and returns of the underlying markets themselves.

3. **Diversification reduces risk**
   Total investment risk can be reduced for any given return target by investing in a diversified range of asset classes that gives exposure to different sources of return which are complementary, or not closely related and, within an asset class, by investing across a range of industries, countries and companies. Diversification reduces risk but has a proportionately lesser effect on returns. A portfolio that is well-diversified across asset classes and well-diversified within those asset classes, will deliver more consistent returns over time than a less diversified portfolio.

4. **Market timing is not a reliable source of return because of the short term unpredictability of returns**
   Asset values and returns are determined largely by expectations about fundamental factors that drive future cash flows and by the discount rates applied to those cash flows. In the short term, returns fluctuate randomly as new information is incorporated into asset prices. Returns are also affected by uncertainty, temporary influences and sentiment in the short term. These random components (sometimes referred to as 'noise') make predicting returns very difficult over short periods and hence market timing is not a reliable source of return. Over longer periods, the more stable components of return become more evident.

5. **Nevertheless, account should be taken of unusual asset price behaviour**
   Asset prices deviate significantly from normal relationships from time to time, increasing the risk of abnormal future returns, ie, asset price 'bubbles' do occur. Notwithstanding the difficulty of market timing, it is appropriate to take account of this risk in implementing major investment decisions.

6. **Control of costs is important**
   Investment returns should be considered net of all costs. Costs can be incurred in the form of fees, commissions, transaction expenses, and market impact costs. Costs can also be structural such as deviations from the strategic asset allocation, maintenance of the management structure and unduly constraining investment managers' ability to add value.

7. **Markets vary in their efficiency, and market inefficiencies offer skillful managers the opportunity to add value**
The more inefficient the market, the greater the opportunities for skilful active managers to out-perform the returns from a well diversified passively held portfolio through analysis and research, and by exploiting market inefficiencies. It is possible to identify skilful managers by thorough research. The greater expected returns from active management should be weighed against the higher costs and any tax implications involved with active management. Rewards to active management will be maximised by engaging skilful managers with diversified investment approaches over the broadest possible number of independent investment decisions.

OVERVIEW

This Statement of Investment Policies, Standards and Procedures (**SIPSP**) records the framework set by the Board for the governance and management of the investment assets held by the Fund. The Board's governance framework is designed to establish good decision-making processes, clearly define fiduciary roles and responsibilities, and to provide effective policies and procedures for management of the investment assets of the Fund.

The SIPSP contains policies and objectives relating to the investment of the assets held on by the Fund. Its contents are set out under the following headings:

Part A – Matters required under the GSF Act

Part B – Current investment structure of the Fund

PART A - MATTERS REQUIRED UNDER THE GSF ACT

(SECTION REFERENCES ARE TO SECTIONS OF THE GSF ACT)

1 ASSET CLASSES AND SELECTION CRITERIA

Required under section 15M (a) - The classes of investments in which the fund is to be invested and the selection criteria for investments within those classes.

The Fund may be invested in the following general asset classes:

- International equities
- New Zealand equities
- Property
- New Zealand fixed interest
- International fixed interest
- New Zealand cash and short term securities
- Alternative assets

In addition, the currency exposure associated with international investing will be managed.

The Fund may be invested in other asset classes or in specific sub-categories of the asset classes listed above in the future.

The selection criteria for investments within the current asset classes are:

1.1 International equities

The international equity securities that comprise the broad based passively managed international equity products that have current IRD binding rulings enabling gains to be accumulated free of taxation in New Zealand (until 1 October 2007).

1.2 New Zealand equities

The equity securities and securities convertible into equity securities of companies that are either:

- listed on the New Zealand Stock Exchange (**NZX**) and resident in New Zealand for tax purposes;
- are included in the NZX 50 Index; or
- certain convertible debt instruments and options provided the equities to which they relate satisfy the permitted investment criteria.

1.3 Property

Shares or units in companies or trusts that invest principally in real property.

1.4 New Zealand fixed interest

Debt instruments:

- Issued or guaranteed by the New Zealand Government or an agency of the New Zealand Government; or
- New Zealand dollar denominated debt instruments issued by entities that have debt ratings, as rated by a recognised international rating agency, satisfactory to the Authority.

1.5 International fixed interest

Debt instruments:

- Denominated in foreign currencies that are issued or guaranteed by foreign governments or government agencies that are satisfactory to the Authority; and
- Corporate credit and asset-backed or collateralised instruments denominated in foreign currencies that are issued or guaranteed by entities that are satisfactory to the Board.

1.6 Cash

Cash includes:

- New Zealand dollars and, as specifically provided for in the relevant investment management contracts, foreign currencies held in the portfolio for liquidity purposes, and
- fixed interest securities and short dated money market instruments with a short term debt rating, as rated by a recognised international rating agency, satisfactory to the Authority and in New Zealand dollars.

The Authority does not have a strategic allocation to cash. Small holdings of cash may be permitted in investment mandates of other asset classes for liquidity and operational purposes and held as collateral against derivative transactions.

1.7 Alternative assets

Assets which have less liquidity than listed securities or provide particular return or diversification benefits. These may include commodities, hedge fund strategies, New Zealand and international private equity and infrastructure investments.

1.8 Currency management

1.8.1 Separate mandates

Forward foreign exchange contracts relating to the currencies in which the securities that comprise the portfolio are denominated or their close proxies.

1.8.2 Pooled products

In accordance with any selected manager's currency hedging policy and practice.

1.9 Derivatives

Managers are permitted to use derivative instruments. The policies, standards and procedures with respect to derivative instruments are presented in section 6.

Any assets held in the form of derivatives must be collateralised with either cash or the underlying securities.

2 BENCHMARKS AND PERFORMANCE MEASUREMENT

Required under section 15M (b) – Determination of benchmarks or standards against which the performance of the fund as a whole, classes of investment, and individual investments will be assessed.

2.1 Determination of benchmarks

The benchmarks for the Fund as a whole and for individual asset classes are selected to be consistent with the risk and return assumptions that underpinned determination of the strategic asset allocation for the Fund.

2.2 Performance measures

2.2.1 Performance of the Fund as a whole

The performance of the Fund as a whole will be assessed by comparing the after tax return with the NZX New Zealand Government Stock Gross Index return (after tax) plus 2.5% per annum over rolling ten year periods. This performance measure will be reviewed at least annually.

2.2.2 Classes of investment

The performance of classes of investment will be assessed by comparing the actual performance of the investment managers for that asset class with the benchmark for that asset class plus any return value-added component the Board has decided is appropriate. Investment managers' performances are generally considered over rolling three year periods and managers are required to comply with agreed mandates.

Investment managers are also to be compared to other managers in the same asset class.

The Authority recognises that investment performance objectives are expected to be met over the medium term. From year to year, investment returns may not meet those medium term objectives.

Investment performance is measured:

- before the deduction of any fees due to the investment managers; and
- after transaction costs have been deducted (but before custodian costs are deducted).

3 STANDARDS FOR REPORTING THE INVESTMENT PERFORMANCE OF THE FUND

Required under section 15M (c).

3.1 Reporting by the investment manager

The investment management mandates should contain such reporting provisions to enable the Board to determine the managers' compliance with the investment contract and success in meeting the Authority investment objectives.

The periodic reports should cover:

- reviews of the portfolio managed by the particular investment manager for the Authority (**the portfolio**) including performance reporting and portfolio valuations;
- certification that the terms of the investment contract have been met including certification that the portfolio has not been leveraged;
- reconciliation of portfolio accounts with those of the custodian; and
- a statement of any voting right issues.

The Board will review the managers' investment performance quarterly and investment managers will be required to meet with the Authority on an annual basis.

3.2 Reporting by the custodian

In respect of each investment manager, the custodian is to provide the reports required by the Authority to enable monitoring and review of managers' performance.

Those reports should include:

- the overdraft position of each portfolio;
- accounting matters including portfolio valuation;
- reconciliation of portfolio values and cash flows with the investment managers;
- investment performance measurement;
- taxation matters; and
- reports of compliance with mandate specific restrictions.

4 THE BALANCE BETWEEN RISK AND RETURN

Required under section 15M (e) of the GSF Act – The balance between risk and return in the overall fund portfolio.

4.1 Investment Objective

To minimise the Crown's contribution to GSF by maximising the return on the assets of the Fund over the long term, without undue risk, and in accordance with best practice.

4.2 Investment Performance Measure

The performance of the Fund will be assessed by comparing the after tax return with the NZX New Zealand Government Stock Gross Index return (after tax) plus 2.5% per annum, measured over rolling ten year periods.

4.3 Risk Parameter

Having no more than a 1 in 10 chance in any one year of a loss after tax greater than 6% of the total Fund (after tax).

The Investment Performance Measure and the Risk Parameter will be reviewed at least annually, taking into account the investment and tax environment in which the Authority operates.

5 THE FUND MANAGEMENT STRUCTURE

Required under section 15M (f).

5.1 Policy

The following components of the Fund management structure will be out-sourced:

- advisory services – legal, tax advisory, actuarial, investment advisory and audit services;
- investment management;
- custodian / investment back office; and
- secretariat and management services.

5.2 Procedures

Selection of managers for these roles will take into account, among other criteria specific to the role:

- best-practice portfolio management;
- the skills and experience the manager brings to the role;
- the substance and viability of the manager;
- the costs that can be expected to be incurred;
- the potential for cost savings and other efficiency gains; and
- the existence of appropriate risk management structures.

Generally, unless specific circumstances require a different approach, the selection of managers will be contestable and conducted through a request for proposal and interview process.

Investment mandates shall include guidelines setting out eligible investments, performance measurements, constraints and exposure limits including country and issue exposures, use of derivatives, and reporting requirements.

Managers will be regularly reviewed against the criteria above to determine their suitability for their role.

5.3 Governance

The Authority is charged with overall governance responsibilities for the investment of the Fund, among other functions. The Board has appointed a Board Investment Committee to address specific investment issues from time to time. The Investment Committee is provided with authority from the Board in each instance to make particular decisions on those issues.

The Board itself retains the power of appointment of managers and custodians within the Fund management structure.

The current management structure for the Fund is presented in Part 2: Current investment structure of the Fund.

6 THE USE OF DERIVATIVES

Required under section 15M (g) – The use of options, futures and other derivative financial Instruments.

6.1 Introduction

Derivative financial instruments (**derivatives**) are financial contracts whose value depends on, or is derived from underlying assets, and includes futures contracts, forward currency contracts, swaps, forward interest rate contracts and options.

In relation to derivatives, "effective exposure" means the exposure to the underlying asset or liability that arises from holding the derivative. For futures and forward contracts, the effective exposure is the value of the underlying asset or liability at current market rates. For options contracts, determination of the effective exposure takes accounts of the 'delta' of the option (the sensitivity of the option value to changes in the value of the underlying asset or liability).

6.2 Policy – derivatives (excluding forward foreign exchange contracts)

Derivatives may be entered into, including futures, forwards, options and swaps (including credit default swaps) as specified in each investment management agreement.

Derivative instruments traded on recognised exchanges may be entered into.

Over-the-counter options, swaps, forward rate agreements may also be entered into or held in the portfolio subject to each counterparty having an appropriate credit rating as measured by a recognised rating agency for counterparty risk and appropriate contractual arrangements (for example, an ISDA agreement) being in place between the manager and each counterparty.

The holding of derivatives must be fully supported by cash, short term debt instruments readily convertible to cash or permitted investments (but excluding derivatives) under the relevant mandate when measured on an effective exposure basis. At all times, the value of all derivative positions measured on an effective exposure basis must not result in portfolio liabilities exceeding portfolio assets. Derivatives must not be used to leverage the portfolio.

The effective duration of any derivatives, shall be taken into account for the purposes of determining compliance with the duration limits of fixed interest portfolios. The determination of the exposure to any company, security or market shall take into account the exposure resulting from derivatives for the purposes of determining compliance with portfolio exposure limits. The amount of derivatives in a portfolio is limited by either limiting exposure to individual counter-parties or limited by specifying total derivative exposure in the portfolio.

The Authority recognises that, where it invests in pooled products offered by investment managers, it may be indirectly investing in derivatives. All investment managers are required to provide the Authority with a copy of their policies relating to derivatives securities trading risk and to manage their derivative exposures in accordance with those policies.

6.3 Procedures - derivatives (excluding forward foreign exchange contracts)

The value of derivatives, which comprise interest rate swaps, futures and options contracts, are measured on an effective exposure basis. The value of other derivatives is measured on a best practice basis. Revaluations of derivatives will be undertaken on at least a weekly basis.

6.4 Policy – forward foreign exchange contracts

Derivatives relating to foreign exchange may be used for the purposes of managing and hedging currency exposures held within the Fund and for the purposes of purchasing or selling foreign currencies required for the settlement of foreign exchange transactions. Derivatives are not to be used to leverage the Fund.

The net exposure to foreign currencies (after taking into account hedging positions) in the relevant portfolios is to be in accordance with the Authority's hedging policy.

In general and where applicable, currency exposures are to be hedged directly as opposed to proxy-currency hedging with a highly correlated third currency to reduce the primary exposure - for example using a United States dollar hedge to reduce a Canadian dollar exposure. However proxy-currency hedging is permitted where direct hedging is impractical, for example in thinly traded markets where suitable foreign exchange hedging contracts are unavailable or where the costs and administration of direct hedging small exposures are out-weighed by proxy-currency hedging.

Appropriate parameters for hedging using proxy currency will be established with the currency managers.

6.5 Procedures - forward foreign exchange contracts

Foreign exchange hedging contracts may be entered into only with counterparties that have credit ratings approved by the Board and measured by a recognised rating agency for counterparty risk and domiciled in New Zealand or in countries with which New Zealand has a double tax treaty.

Contractual arrangements (for example, an International Swap and Derivatives Association (**ISDA**) agreement) must be in place between the manager and each counterparty in a form suitable to the Authority.

Appropriate operational ranges will be established with managers around the determined hedge ratio to avoid excessive costs of continually adjusting the hedge to the precise hedge ratio.

Each fund manager and the transition manager must have risk management policies and procedures in place that address counterparty risks suitable to the Authority.

7 RISK MANAGEMENT

Required under section 15M (h) – The management of credit, liquidity, operational, currency, market, and other financial risks.

7.1 Credit risk

Credit (or counterparty risk) is the risk of default by a counterparty to a particular transaction or an issuer of a security held in the portfolio.

Credit risk is managed by requiring that managers of fixed interest investments invest in securities issued by:

- the New Zealand Government or foreign governments or entities guaranteed by the New Zealand Government or foreign governments; or
- entities with an appropriate long term debt rating as measured by a recognised rating agency.

Investment managers of fixed interest investments must ensure the maximum exposure to any single issuer other than the New Zealand or foreign governments is within specified bounds and that the total exposure to issuers other than the New Zealand Government or foreign governments is within specified guidelines that depend on the credit rating of those issuers.

Any foreign currency forward contracts entered into must be with entities that have an appropriate minimum credit rating as determined by an international credit rating agency for counterparty risk and appropriate contractual arrangements (for example, an ISDA Agreement) must be in place between the currency manager and the counterparty.

Any cash balances must be held in an interest bearing account with the custodian and any short term securities must have an appropriate short term debt rating as measured by a recognised rating agency.

7.2 Liquidity risk

Liquidity risk is the risk that a security cannot be sold when required or that the price achieved is significantly different from the quoted price.

Liquidity risk is managed by:

- requiring, except as specifically authorised by the Board, managers to only invest in securities traded on recognised exchanges;
- where investment in securities that are not traded on recognised markets are authorised by the Board, controlling exposure to those securities;
- requiring managers, within the terms of their individual contracts, to hold diversified portfolios; and
- limiting the credit rating of the fixed interest and cash investments to minimum levels.

7.3 Operational risk

Operational risk is the risk of financial loss due to mismanagement, error, fraud or unauthorised use of techniques and/or financial products.

Operational risk is managed by:

- engaging an independent global custodian to separate the investing function (undertaken by the investment managers) from the transaction settlement, recording and reporting of investment activities (as undertaken by the global custodian).

- requiring investment managers and the custodian to:
  - provide the Authority with third party covenants or assurances against these events;
  - have in place insurance arrangements to cover claims in those events;
  - have in place and regularly confirm the existence and efficiency of internal policies and controls to address those risks;
  - compliance reporting by investment managers, the custodian and the external auditors; and
  - reconcile the Fund's recorded positions regularly.

7.4 Currency risk

Currency risk is the risk that the foreign currency denominated assets will lose value due to the effect of an adverse exchange rate movement.

Currency risk is managed by:

- engaging a currency manager to manage the international equities and property currency exposure in accordance with the hedging ratio for that asset class;
- specifying the bounds within which the international fixed interest managers may take on currency exposures relative to a benchmark that is fully hedged to United States dollars; and
- engaging a currency manager to implement a passive hedge to New Zealand dollars for the international fixed interest portfolio's value in United States dollars.

The instruments that managers may use and the credit worthiness of the counterparties are detailed in the investment management contract with respective managers.

7.5 Market risk

Market risk is the risk of adverse movements in an investment market (including asset prices, volatility, changes in the yield curve or other market related variables). Market risk is managed by requiring investment managers to manage their portfolios within defined market exposure limits. Those limits include:

- New Zealand fixed interest
  - duration limits relative to the duration of the benchmark; and
  - maximum limits on non-Government investments.
- New Zealand equities
  - limits on the percentage weight of any individual company in the portfolio relative to its benchmark weight;
  - limits on investment in companies not represented in the benchmark;
  - limits on investment in any individual company not represented in the benchmark; and
  - limits on the maximum investment in any individual company.
- International equities (to 1 October 2007)
  - the investments are to be passively managed at benchmark weights.
- International fixed interest
  - duration limits relative to the duration of the benchmark;
  - maximum limits on non-Government investments; and

  - maximum limits on exposure to single entities (excluding governments).
- Property
  - maximum and minimum limits on regional exposures relative to those exposures in the benchmark;
  - limits on investments not represented in the benchmark; and
  - limits on exposures for individual investments.
- Currencies
  - limits on the extent to which currency exposures may vary from the benchmark prescribed by any investment mandate; and
  - proxy currency hedging is permitted for minor currency exposures to reduce compliance costs.

8 VALUATION OF ILLIQUID INVESTMENTS

Required under section 15M (j) – The method of, and basis for, valuation of investments that are not regularly traded at a public exchange.

Generally, the investments of the Fund are to be regularly traded on recognised exchanges.

Where investments are not regularly traded on recognised exchanges, for example unlisted pooled investments or over the counter derivatives, year end independent pricing will be obtained on material investments (either through the Authority's custodian or from another source).

For monthly valuations, the Authority will either:

- obtain an independent price for each security; or
- use the investment manager's prices, if an independent price is not widely published.

9 INVESTMENT CONSTRAINTS

Required under section 15M (k) – Prohibited or restricted investments or any investment constraints or limits.

9.1 Prohibited or restricted investments

Except as required to control risks (as set out under section 7) and in accordance with the Authority's responsible investment policy there are no specifically prohibited or restricted investments. However each investment management contract specifies those investments that constitute permitted investments and managers may not invest other than in those permitted investments.

Specific written authorisation from the Authority is required to invest outside of the prescribed permitted investments. The Board will consider such investments as they arise on application from the investment manager.

9.2 Investment constraints and limits

The Authority has developed constraints and limits in respect of each investment class to control risks (see section 7). It has also determined limits to the exposure to each investment class to ensure the investment objective of the Fund is not compromised by excessive deviation from the Fund's strategic asset allocation.

The Authority is precluded from controlling any other entity or from holding such a percentage of the voting rights of another entity that would require it to seek control of that entity. See section 15K of the GSF Act. Limits on the maximum holding that can be held in each issuer address this.

10 RESPONSIBLE INVESTMENT

Required under section 15M (d) – Ethical investment, including policies, standards, or procedures for avoiding prejudice to New Zealand's reputation as a responsible member of the world community and 15M (i) – The retention, exercise or delegation acquired through investments.

This section outlines the Authority's Policies, Standards and Procedures (**RI Policies**) for:

- ethical investment, including avoiding prejudice to New Zealand's reputation as a responsible member of the world community;
- environmental, social, and governance considerations; and
- the retention, exercise, or delegation of voting rights acquired through investments.

10.1 Responsibilities

Section 15J (2) of the GSF Act sets out the Authority's responsibilities with respect to investment of the Fund. Specifically, the GSF Act requires that:

"The Authority must invest the Fund on a prudent, commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with -

(a) best-practice portfolio management; and

(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."

In addition, the GSF Act also requires the Authority's Statement of Investment Policies, Standards and Procedures to cover ethical investment, including policies, standards, or procedures for avoiding prejudice to New Zealand's reputation as a responsible member of the world community; and the retention, exercise, or delegation of voting rights acquired through investments.

The Authority is also bound by the Crown Entities Act, Income Tax Act, the Public Finance Act and various other legislation and regulations.

The Board is accountable for, and maintains oversight of, the Authority's RI Policies. The Board has established the Responsible Investment Committee to oversee the development of the RI Policies, monitor their implementation, and make recommendations to the Board, as required.

The Authority's Management (**Management**) is responsible for implementation of any decisions the Board makes under the RI Policies. Management reports regularly to the Responsible Investment Committee and Board, and produces discussion papers and recommendations on specific issues at the Board's or the Committee's request.

The Authority's RI Policies are regularly reviewed by the Board.

10.2 Development of responsible investment

The investment community is recognising the impact of environmental, social and governance factors on investment value and performance where they are material and, in many cases, is also accommodating the non-financial concerns of investors. Best practice in this area is still evolving and it requires careful balancing against a requirement to invest prudently in the financial interests of investors.

The Authority, along with significant numbers of institutional investors globally, is a signatory to the United Nations Principles for Responsible Investment (**UN PRI**). The UN PRI aims to help integrate consideration of environmental, social and governance issues by institutional investors into investment decision-making and ownership practices. The UN PRI operates its own secretariat that assists international institutional investors collaborate in engaging with companies on RI issues.

10.3 Policies

Section 15J (2) of the GSF Act sets out the Authority's responsibilities with respect to investment of the Fund.

The Authority may take other factors into account in its investment processes, provided this does not conflict with its responsibilities under the GSF Act and can be implemented in a practicable and cost effective way. The factors the Authority may take into account are set out in section 10.4 (Responsible Investment Standards).

Where an investment is found to contravene the Authority's Responsible Investment Standards, the Board considers the best action or actions to take. Responsible investment interventions may include engagement, voting, exclusion and/or divestment.

Exclusion or divestment decisions taken under the RI Policies may be cancelled where advice is subsequently obtained by the Authority indicating that the investment again complies, or has demonstrated actions consistent with complying, with the Investment Standards.

In addition to the application of the Responsible Investment Standards to the investments held in the Fund, the Authority:

- Encourages the adoption of good corporate governance practices through engaging a proxy voting service[1] which promotes good corporate governance principles to companies and provides specific engagement activities, and by exercising voting rights across the Authority's portfolio. In general the Authority will support proposals that reflect good corporate governance practice and are in the Fund's interests. Where a voting proposal does not meet good corporate governance practice and/or is not in the Fund's interests, the Authority will oppose the proposal.
- May support initiatives to clarify the benefits of integrating responsible investment into investment processes, and to develop tools for implementation.
- Recognises investment managers that integrate responsible investment into their investment analysis and/or engage with corporate entities as part of their investment process, where it improves investment performance.
- Stays abreast of best practice in the area of responsible investment by monitoring relevant literature and research, and the steps that other funds are taking with respect to responsible investment.
- Works together with similar investors to enhance the effectiveness of its RI Policies. This may include developing or supporting collaborative initiatives, participating in networks and information platforms to share tools, pooling resources and collectively addressing relevant emerging issues.

[1] The Authority has engaged Institutional Shareholder Services Pty Limited(ISS) as its proxy voting service provider.

10.4 Standards

10.4.1 Responsible investment

Responsible investment standards have been developed for the Authority's investment in:

- fixed interest securities (other than public debt) issued by, and shares in, corporate entities (together **corporate securities**) that are held by the Authority in non-pooled investment arrangements. This definition may be updated from time to time to include other asset classes;
- fixed interest securities issued by central governments, entities guaranteed by central governments, local authorities and quasi-government organisations (together **public debt**) that are held by the Authority in non-pooled investment arrangements; and
- products which aggregate the investments of multiple investors and manage them under a common investment mandate (referred to as **pooled investment products**).

10.4.1.1 Corporate securities

In applying the RI Policies to corporate securities, the Authority will have regard to (amongst other considerations):

- information and advice obtained by the Authority that a corporate entity has, on the basis of credible evidence from publicly available sources, participated in:
  - serious infringements of relevant international standards relating to human rights, labour and employment, the environment or international security and disarmament;
- and the participation relates to a material part of, or is materially significant to, the corporate entity's business and/or is of such a nature that the Board considers that ongoing investment may give rise to a risk of prejudice to New Zealand's reputation as a responsible member of the world community; and
- information and advice obtained by the Authority that the entity is subject to economic or other sanctions that New Zealand applies.

10.4.1.2 Public debt

In applying the RI Policies to public debt, the Authority will have regard to (amongst other considerations):

- information and advice obtained by the Authority that a country is, on the basis of credible evidence from publicly available sources, widely regarded in the world community as having participated in:
  - serious infringements of relevant international standards in relation to human rights, labour, or the environment; or
  - other reprehensible conduct;
- of such a nature that the Board considers that ongoing investment in the public debt of that country may give rise to a risk of prejudice to New Zealand's reputation as a responsible member of the world community; and
- information obtained by the Authority that indicates that the country has been subject to international censure (including the imposition of sanctions) by New Zealand and the wider world community in relation to human rights, labour, the environment or other reprehensible conduct.

10.4.1.3 Pooled investment products

Investment in a pooled investment product (**product**) may be a practicable and cost effective way of achieving exposure to some investment markets. The Authority will have no influence or control over the structure of the product, the corporate securities held by the product or individual voting decisions of the product.

In applying the RI Policies to an actively managed or indexed product the Authority will assess the product itself, rather than each corporate security held by the product.

The Authority will review its assessment of a product should there be a material change in the product, including the composition and/or weighting of the underlying corporate securities held by the product.

10.4.2 Corporate governance guidelines - voting

The Fund will hold shares in a number of New Zealand and international companies. As an owner of shares, the Authority is committed to encouraging companies to adopt good corporate governance and disclosure practices.

The Institutional Shareholder Services (**ISS**) Proxy Voting Guidelines, adopted by the Authority, provide direction for the Authority in monitoring the corporate governance of companies in which it is a shareholder and in deciding how to vote. The ISS Proxy Voting Guidelines are also a means of communicating the Authority's expectations and reasons for voting to the companies in which the Authority is a shareholder, on topics such as transparency, broad alignment with shareholder interests, remuneration, business ethics and voting rights.

ISS has developed the guidelines with reference to global corporate governance principles and codes adopted by the Securities Commission, New Zealand Stock Exchange, the ASX Corporate Governance Council and other international agencies, and New Zealand investor funds. The ISS Proxy Voting Guidelines are reviewed regularly and amended as developments occur in best practice corporate governance, or when there are changes to regulatory requirements.

The Authority will generally vote as set out in the ISS Proxy Voting Guidelines, but the Authority will respond to specific issues on a company by company basis.

Where a security is held in a jurisdiction where there are specific legal or codified requirements in relation to corporate governance, that law or code will be the basis for monitoring and deciding action.

The ISS Proxy Voting Guidelines for New Zealand can be viewed on the Authority's website - *www.gsfa.govt.nz*

10.4.3 The UN Principles for Responsible Investment

The UN PRI aspirational principles provide operational guidelines for developing the Authority's responsible investment capabilities. The UN PRI provides tools to enable the Authority to benchmark their own performance in the area of responsible investment (see section 10.2).

Where consistent with our fiduciary responsibilities, we commit to the following six principles of the UN PRI:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

10.5 Procedures

The RI Policies include actions and supporting procedures on:

- exercising votes at company meetings, including votes on responsible investment resolutions;
- monitoring portfolio holdings against the Responsible Investment Standards;
- analysing key responsible investment issues or potential non-compliance of the Responsible Investment Standards, in order to assess the most appropriate shareholder response, in accordance with the requirements of the GSF Act.
- excluding or divesting of investments as appropriate;
- communicating the Authority's responsible investment expectations to its investment managers and encouraging (relevant) managers to seek appropriate disclosure on responsible investment issues, from corporate entities for which the Authority is invested in.
- Improving the Authority's expertise in, and the effectiveness of, their shareholder activities through membership of relevant organisations and evaluation of quality research.

10.5.1 Voting

General

Investment managers are delegated responsibility to exercise voting rights attached to securities held by the Fund. However, the Authority retains the ultimate right to exercise voting rights.

International Equities

Investment managers will be delegated responsibility to exercise voting rights in accordance with their judgement of what is in the best interests of the Fund. In general, this will be in accordance with the ISS Proxy Voting Guidelines.

New Zealand Equities

Investment managers will be delegated responsibility to exercise voting rights in accordance with their judgement of what is in the best interests of the Fund. In general, this will be in accordance with the ISS Proxy Voting Guidelines. A proxy voting service will research upcoming voting proposals and provide recommendations to investment managers. Investment managers must advise the Authority how they intend to vote where the issue is likely to attract widespread publicity, where the investment manager does not intend to vote in accordance with the recommendations from the proxy voting service or could create a conflict of interest for the Fund or the investment manager.

Management, under delegated authority from the Board, may direct an investment manager on how to vote if the investment manager has a different view on an issue than that recommended by the proxy voting service, or where there are conflicting views among the investment managers on the same issue.

10.5.2 Monitoring

The Authority engages specialist research agencies and external advisors[2] to supply advice to the Board to enable it to monitor securities against the Investment Standards.

For the purposes of applying the Responsible Investment Standards for Public Debt, the Authority may, in consultation with the external advisors:

- consider only the countries in which the Authority is invested or intends to invest; and
- out of those countries, establish a list of countries which the Board considers does not give rise to risk of prejudice to New Zealand's reputation as a responsible member of the world community should the Authority invest in public debt of that country.

The Board reviews the list no less than annually, and more frequently should it receive advice at any time that a more frequent review is appropriate or the list of countries changes. In this case, only the additional country or countries shall be reviewed.

10.5.3 Analysis

The Authority may undertake further analysis on key issues, or potential non-compliance of Investment Standards, in order to assess the most appropriate shareholder response, in accordance with the requirements of the GSF Act.

The Authority's analysis may include:

- the nature and size of investment by the Fund;
- the materiality of the issue or non-compliance with the Responsible Investment Standards;
- the regulatory environment, including international conventions;
- impact on long term financial performance and investment efficiency of the Fund;
- the effectiveness of shareholder actions; and
- the cost and practicalities of shareholder action.

International public and corporate entities operate in different legal, cultural, and geographical contexts. The Authority endeavours to understand individual circumstances if con-compliance of the investment standards occur and takes these issues into account when deciding the response to the non-compliance.

[2]Hilary Willberg and Michael Powles
Innovest Strategic Value Advisors Inc and Sustainable Investment Research Institute Pty Limited (SIRIS)

10.5.4 Engagement

The Authority may engage with companies in which it holds an interest in, in collaboration with other investors. It is the Authority's view that engagement activities are not effective unless coordinated with groups of large investors with similar views. In most cases engagement will involve encouraging companies to address significant contraventions of Responsible Investment Standards, and/or to improve their business practices.

10.5.5 Exclusion and divestment

The Authority may decide to exclude investment in, or divest from, certain securities. Any exclusion or divestment decisions made in accordance with this policy must be taken by the Board.

The Authority informs its investment managers of any decisions to exclude, or divest, securities from the Fund's portfolios. The security is then placed on an exclusion list which is monitored by the Authority and its custodian.

10.5.6 Communication and disclosure

The Authority communicates its responsible investment expectations to investment managers and requires each investment manager to disclose how (and why) responsible investment factors are integrated into their investment processes.

10.6 Transparency and reporting

The Authority will publish its RI Policies and communicate regularly on its activities.

PART B: CURRENT INVESTMENT STRUCTURE OF THE FUND

11 ASSET ALLOCATION

The Fund and asset class features are summarised in the following table.

Table 1: Strategic Benchmark Allocations and Asset Class Rebalancing Ranges

	Weight*	**Rebalancing Range**
International equities	52%	49% to 56%
New Zealand equities	13%	10% to 16%
Property	7.5%	4% to 11%
Total growth assets	**72.5%**	**69% to 76%**[3]
International fixed interest	20.5%	18% to 22%
New Zealand fixed interest	4%	**2% to 6%**
Total fixed interest	**24.5%**	**24% to 30%**[3]
Collateralised commodity futures	**3%**	2% to 4%
International equities pre-tax hedge ratio (max)	120%	110% to 130%
Property hedge ratio to NZ dollars	150%	145% to 155%
International fixed interest hedge ratio to US dollars	100%	70% to 130%
International fixed interest hedge ratio US to NZ dollars	100%	100%

*The weight is the Strategic Asset Allocation effective 1 October 2007.

11.1 Asset allocation and rebalancing

- Asset allocation is to be managed passively that is, no attempt will be made to add value by deliberately and actively over-weighting particular asset classes at the expense of others. However, developments in tactical asset allocation or strategic tilting will be actively monitored with respect to their applicability to the Fund.
- Each month the Fund's actual asset allocation will be checked against the rebalancing ranges. Asset allocations will be allowed to fluctuate within their permitted rebalancing ranges and taking known cash flows for the next month into account, transactions will be undertaken to ensure compliance with those rebalancing ranges.
- The permitted ranges relative to the strategic benchmark allocations within which the actual allocation may vary before rebalancing is required are:
  - subject to total growth assets (equities plus property assets) being between 69% and 76% of total Fund assets:
    i. international equities between 49% and 56% of total Fund assets;
    ii. New Zealand equities between 10% and 16% of total Fund assets; and
    iii. property between 4% and 11% of total Fund assets.

[3]The rebalancing ranges for individual asset classes are subject to the total growth assets and total fixed interest assets rebalancing ranges.

- subject to total income assets (fixed interest assets) being between 24% and 30% of total Fund assets:
    i. international fixed interest being between 18% and 22% of total Fund assets; and
    ii. New Zealand fixed interest being between 2% and 6% of total Fund assets.
- collateralised commodity futures between 2% and 4% of total Fund assets

• where an asset class is outside of its rebalancing range, it is rebalanced to the point half-way between the strategic asset allocation for that asset class and the breached rebalancing range.

11.2 Implementation

Implementation strategies for significant asset allocation changes or the addition of new asset classes may include a staged entry or exit programmes to achieve investing and disinvesting goals.

11.3 Performance measurement

Asset Class Benchmarks and Return Performance Targets are set out in Table 2.

Table 2: Asset Class Benchmarks and Return Performance Targets

Asset Class	Benchmark	Return Value Added Target
International equities	Modified 'grey list' MSCI Index[4]	Nil
New Zealand equities	Russell/J B Were Gross Tradable Index	3.0% per annum
Listed property – segregated portfolio	UBS Warburg Global Real Estate Total Return Investors Only Index expressed in United States dollars	2.5% per annum
Listed property – pooled portfolio	UBS Warburg Global Real Estate Total Return Investors Only Index 100% hedged to New Zealand dollars	Nil
International fixed interest	Lehman Brothers Global Aggregate Index 100% hedged to United States dollars but excluding New Zealand Government securities	1.0% per annum
New Zealand fixed interest	NZX New Zealand Government Stock Gross Index	0.6% per annum
Commodity futures	Goldman Sachs Commodity Index expressed in United States dollars	Nil
Commodity futures collateral	New Zealand 90-Day Bank Bill Index	Nil
Currency – international equities	Currency weights of modified 'grey list' MSCI Index[4]	Nil
Currency – property – segregated portfolio	Currency weights of underlying segregated property portfolio	Nil
Currency – international fixed interest	100% hedged to New Zealand dollars according to a pre-determined pricing formula	Nil

[4]The hedge ratio is being progressively implemented to be 120% hedged, before tax, on 30 June 2008.

12 RISK CONTROL

To control risk the following constraints are applied to the Fund's investments.

12.1 International equities

- The investments are passively managed at benchmark weights;
- The tracking error of the passive product to its benchmark will be monitored.

12.2 New Zealand equities

- The maximum investment (including the effect of any derivatives) in any individual company must not exceed 5% of the issued capital of that company;
- The investment in any individual company must not vary from its benchmark weight by more than the following limits (subject to a minimum of zero):
- The greater of plus or minus:
  - 5% of its benchmark weight; and
  - half its benchmark weight,

  provided that:
  - no more than 20% of the portfolio may be invested in companies not in the benchmark; and
  - no more than 5% of the portfolio may be invested in any single company not in the benchmark.
- Underwriting or sub-underwriting of share issues is permitted up to a maximum of 5% of the net asset value of the portfolio;
- The use of derivatives must not exceed 20% of the net asset value of the portfolio measured on an effective exposure basis;
- Up to 5% of the net asset value of the portfolio may be held in cash and short term securities that meet the criteria for cash and short term securities below.
- The tracking error of the portfolio relative to the benchmark is expected to be below 5%.

12.3 Listed property – segregated portfolio

- Permitted investments are shares or units in companies or trusts that invest principally in real property and are traded on recognised stock exchanges and cash.
- A minimum of 95% of the portfolio must be invested in non-cash permitted investments.
- Regional (North America, Europe and Asia / Pacific) exposures must be within 15% of the respective regional exposures in the benchmark.
- No more than 15% of the portfolio may be invested in non-benchmark investments.
- The tracking error of the portfolio measured over rolling three year periods is expected not to exceed 6.0%.

12.4 Listed property – pooled products

The risk minimisation parameters are those of the product and as such are only indirectly under the control of the Authority. Those parameters include:

- Limits on regional exposures relative to the exposures of the benchmark;
- A minimum number of stocks to be held in respect of each region;
- Maximum limits on the exposure to non-benchmark stocks and to single stocks.

12.5 Unlisted property

The risk minimisation parameters are those of the product and as such are only indirectly under the control of the Authority. Those parameters include:

- Limits on exposures to property types;
- Limits on exposures to geographical or metropolitan areas;
- Limits on the use of leverage.

12.6 International fixed interest

- Permitted investments are debt securities that are:
  - denominated in the currencies represented in the benchmark; and
  - either are included in the benchmark or have a long term credit rating of at least AA- as rated by the Standard & Poor's.
- The average market value-weighted quality of the portfolio must be no lower than A+.
- A minimum of 30% of the international fixed interest portfolio must be allocated to domestic government issuance.
- The maximum exposure to any non-Government single entity is 5% of the net asset value of the portfolio.
- Maximum exposure to a single counterparty is 5% of the net asset value of the portfolio.
- The following duration limits apply:
  - The duration of the portfolio must be within 2.5 years of the duration of the benchmark at all times.
  - The duration of the dollar bloc portion of the portfolio must be within 2 years of the benchmark duration of that portion.
  - The duration of the Euro bloc portion of the portfolio must be within 2 years of the benchmark duration of that portion.
  - The duration of the Japanese portion of the portfolio must be within 2 years of the benchmark duration of that portion.
- The tracking error of the portfolio measured over rolling three year periods is expected not to exceed 2.5%.

12.7 New Zealand fixed interest

- Permitted investments are New Zealand fixed interest securities denominated in New Zealand dollars and issued by:
  - the New Zealand Government or agency of the New Zealand Government;
  - New Zealand Entities guaranteed by the New Zealand Government; or
  - entities with a long term (in excess of 365 days) debt rating of not less than A3 as rated by Moody's Investor Service or A- as rated by Standard & Poor's;
- The maximum exposure to any single issuer other than the New Zealand Government or agency of the New Zealand Government or entities guaranteed by the New Zealand Government is:
  - 5% of the net asset value of the portfolio for issuers with a Standard and Poors long term rating of AA- or better; and
  - 4% for issuers with a Standard and Poors long term rating of A+, A or A-.
- The duration of the portfolio must be within plus or minus 1.5 years of the duration of the benchmark;

- Up to 50% the New Zealand fixed interest portfolio may be allocated to non-sovereign issues;
- Managers of the New Zealand fixed interest portfolio are permitted to enter into derivatives providing that:
  - the face value of all interest rate swaps does not exceed 50% of the net asset value of the portfolio; and
  - the face value of all futures, options, forward rate agreements, repurchase agreements and other derivatives, excluding interest rate swaps, does not exceed 50% of the net asset value of the portfolio.

12.8 Cash and short term fixed interest (including collateral cash)

- The maturity of the investments is not to exceed 365 days.
- Any short term securities must have a short term (not exceeding 365 days) debt rating of not less than Prime -1 as rated by Moody's Investor Services or A1 as rated by Standard & Poor's.
- Any cash balances must be held in an interest bearing account with the custodian.

12.9 Collateralised commodity futures

- Appropriate contractual arrangements (for example, an ISDA agreement) must be in place between the currency manager and the counterparty.
- The swap counterparty to have a credit rating of at least A-.

12.10 Foreign currency management

International equities

- The currency exposure will be managed passively by a specialist currency manager.
- The currency hedge ratio for international equities is to be a maximum of 80% hedged on an after tax basis (approximately 120% hedged before tax). The increase in the hedge ratio is being progressively implemented to be 120% hedged, before tax, on 30 June 2008.
- The hedge ratio will be permitted to vary between +10% and –10% around the pre-tax hedge ratio before being required to be re-balanced to be within that range.
- The hedge will be implemented by taking currency hedging position only in currencies represented in the international equities benchmark index.
- The currency exposure will be managed passively by a specialist currency manager.
- Only forward contracts relating to currencies of countries represented in the underlying international equity portfolio are permitted (those countries are: Australia, Canada, Germany, Japan, United States and United Kingdom).
- At all times the currency exposure of any country in the currency management portfolio plus the currency exposure of that country in the Authority's international equity portfolio must be within 10 percentage points of the currency exposure of that country in the currency benchmark but may not be less than 0%.
- Any foreign exchange forward contracts entered into must be with entities that have a short term credit rating of A1 or higher as determined by Standard & Poor's (or as an alternative rating agency is used a rating of equivalent standing)

and either domiciled in New Zealand or domiciled in a country with which New Zealand has a double taxation agreement.

- Appropriate contractual arrangements (for example, an ISDA must be in place between the currency manager and the counterparty.
- Currencies are passively managed within bounds around benchmark weights (as shown in Table 2 above).
- The effect of the currency management portfolio is to result in the tracking error of the currency component of the Authority's international equity portfolio relative to the currency benchmark to be within 0.20%.
- No single counterparty may hold derivatives that expose that counterparty to more than 25% of the currency management portfolio.

International fixed interest

The performance of the international fixed interest managers is measured relative to the benchmark 100% hedged to United States dollars. Managers are permitted to deviate from the 100% hedged position within the following constraints:

- Exposure to authorised currencies must remain within 10% of their exposure in the benchmark.
- Overall currency exposures must be managed to between 70% and 130% on the net asset value of the portfolio in United States dollar terms.
- The cumulative currency exposure of the portfolio must not exceed 30% of the net asset value of the portfolio.
- An ISDA Agreement must be in place between the managers and any counterparty.

The New Zealand dollar / United States dollar currency exposure of the portfolio is 100% hedged to New Zealand dollars and passively managed according to an agreed pricing formula by a contracted currency manager.

Property

- The currency hedge ratio for international property is to be 100% after tax (approximately 150% hedged before tax).
- Forward contracts relating to currencies of countries represented in the benchmark portfolio and their close proxies where the currency exposure is less than 1% of the total exposure of the portfolio are permitted.
- At all times the currency exposure (allowing for any hedging by proxy currencies) of any country must be within 10 percentage points of the currency exposure of that country in the benchmark but may not be less than 0%.
- The overall New Zealand dollar currency exposure of the currency management portfolio plus New Zealand dollar currency exposure of the Authority's property portfolio shall remain in the range 140% to 160%.
- Any forward contracts entered into must be with entities that have a short term credit rating of A1 or higher as determined by Standard & Poor's (or as an alternative rating agency is used a rating of equivalent standing).
- Appropriate contractual arrangements (for example, an ISDA Agreement) must be in place between the currency manager and the counterparty and the counterparty must be either domiciled in New Zealand or domiciled in a country with which New Zealand has a double taxation agreement.

- The effect of the currency management portfolio is to result in the tracking error of the currency component of the Authority's property portfolio relative to the currency benchmark to be within 0.30%.
- No single counterparty may hold derivatives that expose that counterparty to more than 25% of the currency management portfolio.
- The value of all derivative securities when measured on a market equivalent basis, held in the currency management portfolio open at any one time must not exceed 100% of the net asset value of the currency management portfolio.

13 MANAGEMENT STRUCTURE

The Authority has adopted the following investment management structure for the Fund:

13.1 A global custodian to provide the appropriate separation of functions between the investing function (undertaken by the investment managers) and the transaction settlement, recording and reporting of investment activities (undertaken by the global custodian).

13.2 All the assets of the Fund, apart from cash holding required for operational liquidity purposes, are held under custody unless specifically authorised otherwise by the Board.

13.3 Cash required for operational liquidity purposes is managed by the Authority's Management.

13.4 Contracted investment managers:

- Two international equities managers' products to mitigate manager and product risk.
- Two New Zealand equities managers with complementary styles to mitigate manager and style risk.
- Three property managers with complementary styles to mitigate manager and style risk.
- Three international fixed interest managers with complementary styles to mitigate manager and style risk.
- One New Zealand fixed interest manager.
- Two specialist currency managers to manage the currency hedging exposure associated with the international fixed interest, equities and property.
- One commodity futures swap counterparty.
- One New Zealand manager for the cash collateral related to the commodities futures investment.

Table 3 Investment Managers and Custodian

Asset Class	Investment Managers
International equities	AMP Capital Investors New Zealand Limited Assure Funds Management Limited
New Zealand equities	AllianceBernstein New Zealand Limited TOWER Asset Management Limited
Property	AMP Capital Investors New Zealand Limited LaSalle Investment Management (Securities) LP RREEF America REIT II Inc
International fixed interest	Goldman Sachs Asset Management International Pacific Investment Management Company LLC Wellington Management Company LLP
New Zealand fixed interest	AMP Capital Investors New Zealand Limited
Commodity futures counterparty	Goldman Sachs International
Commodity futures cash collateral	AMP Capital Investors New Zealand Limited
Currency	ANZ National Bank Limited State Street Global Advisors Australia Limited
Custodian	J P Morgan Chase Bank

13.5 Joint Venture with Board of Trustees of the National Provident Fund. The Authority, in a joint venture with the Board of Trustees of the National Provident Fund, has established Annuitas Management Limited to provide management services to the Board. The prime function of Annuitas is to provide staff who act in management roles on behalf of the Authority. Management is responsible for:

- The economical management of the activities and planning for the Authority.
- The identification and implementation of appropriate strategies for the Authority to meet its obligations under the GSF Act and its objectives from time to time.
- Administration and board secretarial.
- Financial and accounting.
- Management of external advisers.
- Management of contracted services including investment management services.
- Contract compliance monitoring.
- Liaison with Crown agencies.
- Reporting to the Board.